FOREIGN DIRECT INVESTMENTS IN KOSOVO

Albana Fona

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FOREIGN DIRECT INVESTMENTS IN KOSOVO
Bachelor’s degree

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November, 2018

Prishtina
FOREIGN DIRECT INVESTMENTS IN KOSOVO

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November, 2018

This paper has been compiled and submitted to meet the partial requirements for the Bachelor Degree
ACKNOWLEDGEMENT

This journey would not have been possible without the support of my family, professors and mentors, and friends. To my family, thank you for encouraging me in all of my pursuits and inspiring me to follow my dreams. I am especially grateful to my parents, who supported me emotionally and financially.

I want to express my sincere gratitude to my advisor Prof. Hasan Metin for the continuous support, for his patience, motivation, and immense knowledge. His guidance helped me in all the time of research and writing of this thesis. I could not have imagined having a better advisor and mentor.

Albana Fona
November, 2018
Prishtina
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LEXICON OF TERMS

FDI – Foreign Direct Investment
OLI – Ownership, Location and Internalization
SOEs – Socially-Owned Enterprises
1. INTRODUCTION

The main purpose of this study is to identify and analyse the factors that determine what makes Kosovo attractive to FDI, why have the investments dropped through the years and how Kosovo can increase its competitive position in attracting FDI. The globalization of the world economy has created enormous opportunities to attract foreign direct investment (FDI).

FDI helps to solve several problems because it provides valuable capital to stimulate economic growth and development.

Kosovo needs to increase its inward foreign direct investment (FDI) in order to achieve economic growth.

Friendly political environment increases the attractiveness of the host country for FDI. The findings of the literature review demonstrated that Kosovo’s advantages in attracting FDI are; its exchange rate stability, labour costs and infrastructure. The neighbouring countries, are all members of the Central European Free Trade Agreement (CEFTA) and they all provide openness to trade, so I would not consider it as an advantage or a determinant that can play a significant role on the decisions of foreign direct investors to invest on our country.

GDP, GDP per capita, inflation rate are found to be a disadvantages when it comes to attracting FDI in Kosovo, as they are the lowest in the region. In developing countries various actors such as public money should be used to improve infrastructure, reduce corruption and educate people are very important factors that improve the image of the country, and also providing a range of services for potential investors need to be taken into consideration when it comes to creating an attractive environment for FDI.
2. LITERATURE REVIEW

In accordance with the nature of the research questions, two theoretical fields will be thoroughly elaborated. The complexity of the issue requires a thorough analysis of the theories and determinants of FDI. The underlying reason for this approach is to constructively provide theoretical basis for the following arguments. The rest of this chapter is organized as follows: Section 2.1 reviews a more general literature on FDI. Section 2.2 discusses the theories of FDI with special focus on Dunning’s eclectic paradigm and locational determinants which are elaborated in the Sub-section 2.3 - 2.7.

2.1 What is FDI?

According to Moosa (2002, p. 261), “foreign direct investment (FDI) is the process whereby residents of one country (the source country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (the host country)”.

The impact of FDI on growth may also positively affect poverty levels in the host country by increasing employment opportunities and wages. (Klein, M., C. Aaron and B. Hadjimichael, 2001)

The International Monetary Fund’s (IMF, 1977, p.136) Balance of Payments Manual defines FDI as “an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor while the investor’s purpose is to have an effective voice in the management of the enterprise”. For an interest and control to exist, IMF (1993) defines the ownership level of a direct investment as 10% of the voting shares. Razin et al. (1999) argue that the concept of ‘long-term interest and control’ portrays the most important distinguishing feature of FDI from portfolio investment. This argument has also been elaborated by Lall and Streeten (1977) by which they relate control with an informational advantage and a degree of discretionary decision-making power or influence by the direct investor in management policy and strategy of the enterprise.
The early attempts to explain why foreign direct investment exists emerged in the 1960s, just as flows of FDI began to increase in volume. Jones and Wren (2006) argue that before 1960s, FDI was modelled as a part of neoclassical capital theory. But according to Dunning (1981), FDI is more than just the transfer of capital due to the simultaneous transfer of technology, organizational and management skills. At the same time, host countries hope to gain access to this technology and skills that they do not yet possess (Blomstrom and Kokko, 1998). Case studies have shown that foreign subsidiaries might introduce new know-how, stimulate competition, and transfer production techniques and management skills (Blomstrom and Kokko, 1998). Moreover, Dunning (1981) points out that the resources are transferred within the firm rather than between two independent parties in the marketplace, as is the case with capital. According to Jones and Wren (2006), these factors give rise to the following key theories on FDI: Hymer’s (1960) market imperfections theory; Vernon’s (1966) product life-cycle theory; Buckley and Casson’s (1976) internalization theory; Horst’s (1972) locational determinants; Dunning’s (1977) eclectic theory; and Graham’s (1978) strategic behaviour of firms. While different theories on FDI present a much broader set of FDI determinants including firm-specific, strategic and transaction-related factors, the consideration of all of these factors/theories would be relevant for highly disaggregated studies using firm-level data. Since the focus of this study is on locational determinants, these will be the main focus of this literature review, after brief overviews of the eclectic OLI paradigm next.

The eclectic (or Ownership, Location and Internalization, OLI) paradigm has been for over two decades a dominant analytical framework for empirical investigation of FDI determinants and foreign activities of multinational enterprises (Dunning, 2000). Dunning (2000) argues that a firm will engage in international production if there are Ownership referring to competitive advantage, Location and Internalization advantages in doing so. The three variables are interdependent and necessary rather than sufficient. The greater the competitive advantage of the investing firm, relative to those of other firms the more they are likely to engage in, or increase their foreign production (Dunning, 2000). Dunning (1993) also argues that, companies import ownership advantages allowing them to reach
success when competing with local companies, which is crucial considering that local companies have advanced information over local markets, preferences of local consumers and practices being applied by local businesses. Two types of ownership advantage are usually differentiated by international business theory: proprietary knowledge and superior business strategy (Casson 1990). These ownership advantages may include the size of the firm, the level or quality of management, access to factor inputs, access to product markets and technological capabilities. Location specific variables refer to the advantages of one potential FDI host country compared to the others. They may include input prices, transportation costs, communication costs and government incentives, as discussed in more detail in the next subsection. The third variable provides a framework for evaluating alternative ways in which firms may organize the creation and exploitation of their core competencies, given the locational attractions of different countries or regions (Dunning, 2000). Reasons for internalization include the avoidance of transaction costs, the protection of the good, avoidance of tariffs and the ability to capture economies of scale from production, marketing and finance.

2.2.1 Types of FDI

In the continued effort to extend and update the earlier taxonomy used by Jack Berhman (1972), Dunning and Lundan (2008) distinguish between four types of FDI: natural resource seeking, market seeking, efficiency seeking and strategic asset or capability seeking. It is, however, worth noting since early 2000s most of the larger MNEs have pursued multiple objectives, and most engage in FDI that combines the characteristics of two or more of the above categories (Dunning and Lundan, 2008). Natural resource seeking FDI refers to enterprises prompted to invest in foreign markets to acquire specific resources with higher quality at lower real costs compared to their domestic market (Dunning and Lundan, 2008). Basically, there are three main types of resource seekers: the first type seeks for different physical resources; the second type seeks for abundant cheap and well-motivated unskilled and semi-skilled labour while the third type seeks for technological
capability, expertise on management or marketing as well as organizational skills. Resource seeking FDI have very little autonomy, implying greater influence by headquarters and limited value-adding processes and activities cause benefits to host countries that is questioned by scholars (Driffield 2001). Market seeking FDI refers to enterprises that invest in a specific country to supply with goods or services to their market or the neighbouring countries (Dunning and Lundan, 2008). This type of investment may be undertaken to sustain the existing markets as well as to exploit or promote new markets. Efficiency seeking FDI refers to experienced, large and diversified MNEs producing fairly standardized products and engaging in internationally accepted production processes (Dunning and Lundan, 2008). Strategic asset or capability seeking is the fourth group of MNEs which refers to the ones that engage in FDI, generally by acquiring the assets of foreign corporations, so they can promote their long-term strategic objectives – particularly that of sustaining or advancing their global competitiveness (Dunning and Lundan, 2008).

2.2.2 Locational determinants of FDI

Location is important when a company gains from its presence in a given market by benefiting from its favourable conditions (Dunning and Lundan, 2008). So theoretically, the FDI location is determined by relative the relative (expected) profitability of competing locations. Coughlin et al. (1991) argue that foreign firms will choose to invest in a specific location if an only if by doing so will maximize their profit. As to what determines this (expected) profitability, different locational factors have been hypothesized and analysed by researchers and each potential host location is characterized by a set of those factors. The review of theoretical arguments and empirical evidence provided in this section will seek to identify the factors that are expected to affect FDI inflows into Kosovo and its neighbouring countries, which will subsequently be used to design and conduct the empirical analysis for this thesis.
2.2.3 Market size and growth potential

When making a locational decision, the market size and growth potential associated to a specific location needs to be carefully considered. The decision of whether to serve distant customers by export or by investing directly in a specific foreign country is not related only to the size of that market but it also depends on the market size of the neighbouring countries (Head and Mayer, 2004). The size of the domestic market in conjunction with the growth prospects play an important role when foreign investors decide to relocate production, or to engage in export-bound production in the host country (Bhasin et al., 1994). Numerous empirical studies have found that market size and growth appear to be among the most significant determinants of FDI. The size of the market in conjunction with the growth prospects of the host country market are considered as important ‘pull’ factors and in theory they are expected to be positively related to the level of FDI flows (Dunning, 1993). Large (and growing) markets are conductive to higher (or increasing) demand for products and services provided by foreign investors, and it allows the attainment of the economies of scale (Caves, 1971). The size of the market is typically measured by the absolute level of GDP and the GDP per capita is used to measure the purchasing power of population (Johnson, 2006).

2.2.4 Labour costs and productivity

Theoretically, the importance of the cheap labour in attracting FDI is agreed upon by the supporters of the dependency hypothesis as well as those of the modernization hypothesis, although with numerous implications (Charkrabarti, 2001). So, it may be expected that low labour costs, measured by wage per worker, have a significant positive effect on attracting FDI since this leads to lower production costs (Dunning and Lundan, 2008). Empirically, however, no unanimity even among some of the empirical studies that specifically elaborated the role of the labour cost in attracting FDI: thus, results range from high labour costs discouraging FDI flows to no substantial effect or even positively related. ODI (1997), for instance, has found that low labour costs are statistically significant, particularly for the FDI in labour-intensive industries and for export-oriented subsidiaries. Human capital is found
to be a relevant determinant for FDI in skilled labour-intensive sectors where the level of education improves productivity and facilitates technological innovation and adaptation (Brooks et al., 2010). Therefore, a significant positive relation is expected to exist among the two. Similarly, a positive relation among productivity and FDI was also found by (Asiedu, 2006; Cleeve, 2008), while Schneider and Frey (1985) came up with inconclusive effects.

2.2.5 Infrastructure

Good infrastructure increases the investment productivity and therefore attracts foreign direct investment. The availability of adequate and quality physical infrastructure has been argued to be a crucial determinant for the inflow of foreign investments as it will minimize the cost of doing business by increasing effective working hours thus leading to operational efficiency (Yin et al., 2014). A reliable infrastructure such as transportation, information and communication are vital for the movement of goods and services to the end users.

2.2.6 Openness to trade

In the literature, the openness to trade is often measured by the share of a country’s total trade (imports + exports) to the country’s GDP. The lower the degree of restrictions imposed by the host location on international trade, the greater the degree of openness and thus the lower the cost of doing business in the respective location (Yin et al., 2014). In a study conducted for 38 developing countries by Demirhan and Masca (2008) it was found that the degree of openness to trade was among the most important determinants for FDI inflow. However, this factor is not found to be relevant to all different types of FDI. The market seeking FDI will not be attracted to the trade openness as some restrictions would be of benefit to them, while the multinational firms engaged into export-oriented investments will prefer to operate in more open economies. Thus, the impact of trade openness according to a range of surveys suggests a widespread perception that it encourages more foreign investment.
2.2.7 Macroeconomic policy

Host country’s level of taxes, the inflation rate and the exchange rate are among the most frequent elements that are being investigated under macroeconomic policy. Having a joint currency is another important factor to be considered by investors prior to entering a new foreign market. The empirical research remains fairly inconclusive with regard to the sensitivity of FDI towards the host country level of taxes. Some studies have found a significant negative effect that the level of taxes have on FDI (e.g. Cassou, 1997), while Jackson and Markowski (1995), for instance, find that the level of taxes does not have a significant effect on FDI. The level of inflation is used as an ancillary variable to measure the overall economic instability, which is expected to increase the cost of capital for the foreign investor and consequently affect the potential profitability, so acting as an FDI deterrent. In the same manner, the level of the exchange rate is expected to affect FDI as far as it affects the firm’s cash flow, profitability and the attractiveness of domestic assets to foreign investors (De Mello, 1997). If the domestic currency is weak compared to that of the foreign investor it will allow the foreign firm to set-up cheaper production in that country, but it will reduce the value of expected profits (Jones and Wren, 2006).

2.3 Determinants of FDI in Kosovo

Conventionally, it is argued that, among the most important determinants which attract foreign investors to invest in Kosovo are: young and motivated work force, low labor costs, market openness and access without customs duty to the EU markets, institutional approach, infrastructure, macroeconomic policy (KIESA, 2016).
2.3.1 Legal framework on FDI in Kosovo

The Legal framework is rebuilt from 1999 in accordance with EU legislation. The Law on Foreign Investment, December 2013 (Law no. 04/2013) ensures equal treatment of local and foreign investors:

- Non-discriminatory treatment
- Constant protection and security
- Compensation in case of nationalization and expropriation, including payment of interest
- Compensation in case of violation of applicable law and international law attributable to Kosovo
- Freely transferable and otherwise unrestricted use of income
- Protection against retroactive application of laws
- Legal or non-legal actions

Bilateral agreements are concluded with a numerous country in regard to investment protection, as with: USA (OPIC), Austria, Turkey, Albania, Switzerland, Belgium, Luxemburg, United Arab Emirates and Macedonia.

Agreements provides:

- Investment protection and security
- Free Funds Transfer
- Free Profit and Dividends Repatriation
- Protection against retroactive application of laws
- Protection from expropriation
- Establishment of a company

Registering a business in Kosovo is both simple and free-of-charge. All businesses and trade names are listed with the Registry of Business Organization and Trade Names and the basic information regarding registered companies can be transparently and freely accessed via the internet.
The business registration is done with the Ministry of Trade and Industry’s Business Registration Agency (www.arbk.org). KBRA operates based on an electronic database, as a simple, faster process for the free registration of new businesses. (Kosovo Investment and Enterprise Support Agency, 2018)

2.3.2 Kosovo’s Economy

After the war, we found the Kosovo economy in a miserable state. During the conquering decade, during the war, Serbia had exploited, stolen, destroyed many factories and had not allowed economic development and investment. With the help of international friends Kosovo after the war begins the economic recovery, opens factories, investments, and establishes the Kosovo Trust Agency (KTA), which conducts tenders for the privatization of the social economic successors in Kosovo.

Kosovo’s economy has a big trade imbalance, because it is very dependent on imports and it has a low export base, so foreign investments can be used as a tool to stimulate production and to decrease Kosovo dependence on imports. Also, foreign investments could also be utilized as an important tool to soften the unemployment rate.

2.3.2 Unemployment

The unemployment rate of up to 30 percent (Kosovo Statistics Agency, 2017) is considered to be alarming for a country like Kosovo, which is considered to have potential for economic development.

Kosovo within years, according to field experts, has failed to create a more developed economy, due to the low level of foreign investment, inadequate fiscal policies and the high level of corruption.
According to these data unemployment is more pronounced in females by 36.6 percent, compared with males, 28.8 percent. (Kosovo Statistics Agency, 2017)

While, the most pronounced unemployment rate is in the age group 15-24 and over 50 percent.

Pushing out of unemployment, many Kosovo citizens, mostly young, had migrated illegally to Western Europe during November 2014 through June 2015.

two-thirds of the population in Kosovo are working age populations. The working age population includes 15-64 age ages.

Within the working age population, the participation rate in the workforce is 43.5%.

The employment rate by gender is the highest for males (48.1%), while females employment rate is 12.5%. Women are employed mainly in the sectors of education, health care and trade, with 47.9% of them, while men are mainly employed in the sectors of construction, manufacturing and trade, with 47.0%. (Kosovo Statistics Agency, 2017)

clEconomic sectors, which lead on employment are: trade with 14.9%; construction with 13.8%; output by 13.3%; and education by 9.2%. (Kosovo Statistics Agency, 2017)

2.3.3 Infrastructure

The road network consisting of 630 km of main roads has been largely rebuilt over the last few years, adding some completely new roads. By building an auto-route linking Albania and Serbia directly through Kosovo, it is becoming an important port in the corridor linking the Adriatic Sea to Western Europe.

In 2013 Bechtel and its joint-venture partner Enka completed Kosovo's Route 7 Motorway which cost more than 1 million euros. The 102-kilometer dual-carriage highway extends from Morinë, at the southwest border with Albania, to the north of Kosovo’s capital, Pristina. Route 7 serves as the centerpiece of the country’s national transport system, helping to promote trade and economic development in Kosovo and throughout the region as the trade route contributes to the economic integration of the countries of southeastern Europe, Western Europe, and beyond.
The project contributed greatly to the region's economic development. Bechtel-Enka and its team worked to procure goods with local content, hire local subcontractors, and directly employ the people of Kosovo. The project hired a workforce that included 70 percent local Kosovars. Further, some 80 local contractors and hundreds of local suppliers worked on the project. Over the course of construction, more than 10,000 Kosovars received training that provided them new skills that they can use in future jobs. (Motorway, 2018)

2.3.4 Railways

The rail network in Kosovo has a combined length of 330km. It covers the entire territory, connecting the two regions, the south-north and the east-west. On the south as well as in the north, the railway line offers access to the international rail network. The ongoing rehabilitation and modernization of the rail system in Kosovo provides a solid basis for meeting the growing demand for logistics services. The construction of a new line connecting Pristina with the port of Durres in Albania is under development.

2.3.5 Air transport

Apart from the road and rail network, Kosovo has a modern international airport. With more than one million passengers per year, Pristina International Airport is among the most frequented airports in the region, offering several international airliners and flights to the most important European centers. In 2010 the airport went under concession as a result of the Agreement between the Government of Kosovo and the Private Public Partnership, the Turkish-French consortium "Limak and Airports de Lyon”. (Ministry of Foreign Affairs - Republic of Kosovo, 2018) Turkish-French consortium Limak and Aeroports de Lyon officially took over the
responsibilities of Pristina International Airport. Public Private Partnership is projected to manage and operate Pristina International Airport 'Adem Jashari' for the next 20 years to modernize and extend the terminal to 27 thousand square meters worth over 100 million euros in investments from Limak and Aerats de Lyon. Limak Kosova under the consortium agreement built the completely new Terminal of Pristina International Airport 'Adem Jashari', doubling it from 27,000 square meters as was agreed on 42,000 square meters, using the latest technology in the market. (Ministry of Foreign Affairs - Republic of Kosovo, 2018)

Pristina International Airport was awarded with the Limak Airpot de Lyon concession for a 20-year period, in return for € 100 million in investments to modernize and expand the Airport, helping to become a key hub in the near future. (Ministry of Foreign Affairs - Republic of Kosovo, 2018)

2.3.6 FDI in Kosovo

The global financial crisis during the period 2008-2010, together with the end of the largest waves of privatization as it is known that the privatization of public enterprises usually brings the largest amounts of FDI significantly contributed in FDI decline in Kosovo at the respective period (Riinvest, 2014).

Capital and investment fund, which accounts for about 91.9 percent of total FDI, amounted to euro 264.5 million, which is 44.9 percent more than in the previous year. FDIs in the form of debt instruments marked the value of euro 23.2 million, or 37.9 percent less than in the previous year. FDI growth was mainly evidenced by the financial services sector, real estate and the construction sector, while the trade and industry sector declined. Investments in 2018 are expected to mark a real increase of 10.1 percent, based on projections for significant public investment growth of 25.8 percent, but also private investments of 5 percent.

According to the CBK (2018) , a significant contribution to the growth of private investment
is expected to continue to have banking lending, which is characterized by faster growth rates and lower interest rates. Also, changes in tax policy over the past years are expected to boost private investment.

Foreign direct investment benefits the global economy, as well as investors and recipients. Capital goes to the businesses with the best growth prospects, anywhere in the world. Investors seek the best return with the least risk.

Table 1: Monthly statistics of FDI-s in Kosovo

<table>
<thead>
<tr>
<th>FDI inflow in Kosovo, January-December 2017</th>
<th>Value in mil. Euro</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>19.6</td>
</tr>
<tr>
<td>February</td>
<td>22.1</td>
</tr>
<tr>
<td>March</td>
<td>23.4</td>
</tr>
<tr>
<td>April</td>
<td>31.7</td>
</tr>
<tr>
<td>May</td>
<td>18.3</td>
</tr>
<tr>
<td>June</td>
<td>33.4</td>
</tr>
<tr>
<td>July</td>
<td>32.5</td>
</tr>
<tr>
<td>August</td>
<td>33.3</td>
</tr>
<tr>
<td>September</td>
<td>-0.3</td>
</tr>
<tr>
<td>October</td>
<td>27.0</td>
</tr>
<tr>
<td>November</td>
<td>27.3</td>
</tr>
<tr>
<td>December</td>
<td>19.4</td>
</tr>
<tr>
<td>Total:</td>
<td>287.7</td>
</tr>
</tbody>
</table>

Source: CBK
Table 2. FDI according to economic activity

<table>
<thead>
<tr>
<th>Year 2017</th>
<th>Value in mil. Euro</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real estate, Rent and other activities</td>
<td>187.2</td>
</tr>
<tr>
<td>Financial Services</td>
<td>50.3</td>
</tr>
<tr>
<td>Construction</td>
<td>44.7</td>
</tr>
<tr>
<td>Trading Services</td>
<td>9.8</td>
</tr>
<tr>
<td>Motels and restaurants</td>
<td>0.6</td>
</tr>
</tbody>
</table>

2.3.6 Determinants of FDI in Kosovo

Conventionally, it is argued that, among the most important determinants which attract foreign investors to invest in Kosovo are: young and motivated work force, low labour costs, market openness and access without customs duty to the EU markets, institutional approach, infrastructure, macroeconomic policy (KIESA, 2016).

2.4 Labour cost and productivity

According to the Ministry of Trade and Industry, Kosovo offers workforce at a cost much lower than elsewhere in Europe. From the feedback that the respective Ministry receives from the current Foreign Investors it is specifically the quality of labour and productivity at work recognized as one of the most important advantages that Kosovo offers for them. Likewise, from a survey conducted by IFC (2014) Investors’ Perceptions of Kosovo’s
Business Environment, it was found that one of the top determinants for attracting FDI in Kosovo is the low labour cost and high productivity.

2.4.1 Market size and growth

Market size, as a factor in determining FDI in Kosovo, from different studies previously conducted, appears not to be very important (Spahiu, 2010). This is because Kosovo market is the smallest one in the region. If this relates to the theory which suggests that large (and growing) markets are conductive to higher (or increasing) demand for products and services provided by foreign investors, and it allows the attainment of the economies of scale (Caves, 1971), it can be noted that there have been some positive movements with regards to the increase in demand for the investors’ products and/or services. However, it is not as big as to allow economies of scale to occur.

2.4.2 Access to other markets and openness of the economy

Kosovo currently enjoys free trade within the Central European Free Trade Agreement – CEFTA, enabling its producers including here foreign investors (as they are treated equally by Law on Investment) to access the regional market of 25 million customers without any customs duty (Ministry of Trade and Industry, 2017). Moreover, Kosovo has free and unlimited access to the entire European Union market with over 500 million customers. In addition, similar agreements exist with the U.S., Japan and Norway and Turkey (Ministry of Trade and Industry, 2017). Considering all these benefits from investing in the market of Kosovo, a conclusion can be drawn that the openness of the Kosovo economy is an important factor in inducing companies to invest and is expected to have a positive relation to FDI.
2.4.3 Exchange rate instability

An important factor of the macroeconomic policy related to FDI inflow is the exchange rate. In general, exchange rates have an impact on a company’s cash flow and profitability, and their fluctuation introduces risk to the foreign investor. That is why exchange rate plays an important role in the attractiveness of host country assets to foreign investors. Immediately after the war, in 1999 Kosovar authorities adopted the Deutche Mark (DM) as the official currency of the country. With the enforcement of Euro as a single currency in the EU, Kosovo switched to Euro as well. This has been considered as a smart move since the adoption of Euro as a national currency carries numerous advantages. In this regard, Kosovo does not cope with exchange rate and currency volatility problems as do other regional countries. Thus, currency and exchange rate stability are expected to be an important determinant with a positive relationship to investing in Kosovo.

2.4.4 Governance and institutions

The World Bank “Doing Business Report” for 2014 ranks Kosovo 86 out of 189 economies which was an improvement for 10 places in a year. Perceived and actual corruption in the Government have taken their toll in attracting FDI and slowed the general economic development of the country (US Department of State, 2014). On the other hand, Kosovo has worked hard on strengthening its basic legal framework and institutional structures, with a view to reinforcing the necessary foundations for a functioning market economy. Kosovo's effective laws do not discriminate against foreign investors. According to the Law on Foreign Investments of Kosovo, foreign investors have the same rights and obligations as the residents of Kosovo and are treated equally (KIESA, 2016). Besides corruption and rule of law, there are other institutional factors such as privatization process, the physical infrastructure and economic and political instability which are crucial when it comes to attracting FDI.
2.4.5 Privatization in Kosovo

Structural and institutional deficiencies which are usually considered as serious impediments of privatization in post-socialist countries were also prevalent in Kosovo, whose economy operated on non-existent capital markets and insufficient savings (GLPS and BIRN, 2016). In Kosovo as well as in the neighbouring countries there are two types of property ownership: public and social. The public ownership refers to the state ownership whereas the social ownership belongs to society as a whole. In the last decade the socially-owned property was generally privatized by the Agency of Privatization. Around 600 socially-owned enterprises (SOEs), are privatized by the Agency of Privatization in Kosovo and the total amount of revenues collected through this process reached at over euro 600 million (Privatization Agency of Kosovo, 2016). According to the Privatization Agency of Kosovo (2015), the privatization and liquidation process of SOEs shall continue as the Agency has not yet sold around 1500 assets of SOEs, and there are 29,373 court cases pending in different court instances. So far, the Privatization process has attracted some foreign investment, and relevant institutions envisage that this process will continue to play an important role with regard to FDI in the future as well. A comparison with the neighbouring countries will be provided under Section 4.5 when the variable analysis is conducted.

2.4.6 Import and Export

Kosovo imports a wide range of goods as local production is still in an initial stage for most products. After the international intervention in 1999, Kosovo experienced rapid growth of imports, while on the other hand, it was not followed by the growth of exports and the domestic production sector, which represent the main indicator of the economy. The import level development stagnated in 2003 was marginally lower than in 2002 to encounter again huge development inside 2005-2006. Business imports amid 2006 in examination with 2005 expanded by 5.1%. As indicated by MTI's investigation, the
development of imports from 2005 to 2006 is the aftereffect of higher costs than quantity. The volume of diesel and oil subsidiaries has diminished amid 2006, since 2005. Different products that have added to the development of imports have been cigarettes, flour and development material. The volume and structure of Kosovo's fare in the previous four years delineates every one of the issues inside the current financial approaches that Kosovo organizations are confronting and particularly the rising areas producer. With the crumple of the social division amid the 1990s, because of the savage measures connected and the late progress of the economy and the change of responsibility for possessed undertakings, the extreme drop in send out and the loss of remote markets became exposed. This made exchange trades to be acknowledged basically through import, given the fall of key fare parts. In the post-1999 period, the economy of Kosovo, looked with the outcomes of the war and the decimation of the financial structure, has accomplished a low level of fare contrasted with the volume of imports, always reflected in a high level of reliance on imports. Kosovo is primarily acknowledged in nations from which it is likewise foreign most. As is outstanding, in 2000 the most appealing markets for Kosovar exporters were the nations in the area. Kosovo's fares have a prejudicial treatment notwithstanding amid the travel in Serbia Montenegro, accused of unique expenses (3% and 5% individually). At the fringe crossing point, for Kosovo merchandise a travel assess is paid which makes these items more successive and causes genuine market unsettling influences and intensity of Kosovo makers.

The export of goods in December 2017 was worth € 29.4 million, while the import was 297.3 million €, is an increase of (20.2%) for export and (9.5%) for import by comparison with the same period of 2016. According to the data of main export groups: (42.8%) of exports are metals base and articles thereof, (12.3%) prepared meals, beverages and tobacco, (9.4%) plastics, rubber and articles thereof, (9.0%) mineral products, (5.9%) vegetable products, (4.7%) textile and textile articles etc. According to the data of the main groups for import: (15.3%) of imports constitute mineral products, (14.2%) machinery, mechanical and electrical equipment, (13.3%) foodstuffs prepared, beverages and tobacco, (13.0%) means of transport, (8.7%) base metals and articles of (4.8%) plastics, rubber and articles thereof,
(4.7%), vegetable products, (4.0%) textile and textile articles, etc. (Ask.rks-gov.net, 2017)

<table>
<thead>
<tr>
<th>Sektionet sipas KSTJ</th>
<th>Dhjet - 2016</th>
<th>%</th>
<th>Dhjet - 2017</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Vlera</td>
<td></td>
<td>Vlera</td>
<td></td>
</tr>
<tr>
<td><strong>Eksporet (FCB)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gjithsej</td>
<td>24,519</td>
<td>100.0</td>
<td>29,481</td>
<td>100.0</td>
</tr>
<tr>
<td>Ushqime dhe kafshë të gjallë</td>
<td>2,725</td>
<td>11.1</td>
<td>2,767</td>
<td>9.4</td>
</tr>
<tr>
<td>Pije dhe duhan</td>
<td>1,495</td>
<td>6.1</td>
<td>2,451</td>
<td>8.3</td>
</tr>
<tr>
<td>Materale të papërpusuara</td>
<td>6,638</td>
<td>27.1</td>
<td>6,056</td>
<td>20.5</td>
</tr>
<tr>
<td>Lëndë djeqëse</td>
<td>1,082</td>
<td>4.4</td>
<td>96</td>
<td>0.3</td>
</tr>
<tr>
<td>Yndyma bimore dhe shtazore</td>
<td></td>
<td></td>
<td>43</td>
<td>0.1</td>
</tr>
<tr>
<td>Produkte kimike</td>
<td>1,206</td>
<td>4.9</td>
<td>1,034</td>
<td>3.5</td>
</tr>
<tr>
<td>Malirë të përpunuara</td>
<td>7,721</td>
<td>31.5</td>
<td>12,274</td>
<td>41.6</td>
</tr>
<tr>
<td>Makineri e pajisje transport</td>
<td>883</td>
<td>3.6</td>
<td>1,132</td>
<td>3.8</td>
</tr>
<tr>
<td>Malirë të tjerë të përpunuara</td>
<td>2,768</td>
<td>11.3</td>
<td>3,626</td>
<td>12.3</td>
</tr>
<tr>
<td>Malirë të pa klasifikuara diku tjetër</td>
<td>1</td>
<td>0.0</td>
<td>2</td>
<td>0.0</td>
</tr>
</tbody>
</table>

| Gjithsej                      | 271,473      | 100.0 | 297,316      | 100.0 |
|                               |              |       |              |       |
| **Importet (CIF)**            |              |       |              |       |
| Ushqime dhe kafshë të gjallë | 47,152       | 17.4  | 50,885       | 17.1  |
| Pije dhe duhan               | 12,547       | 4.6   | 12,554       | 4.2   |
| Materale të papërpusuara     | 4,706        | 1.7   | 4,916        | 1.7   |
| Lëndë djeqëse                | 33,849       | 12.5  | 42,840       | 14.4  |
| Yndyma bimore dhe shtazore  | 2,616        | 1.0   | 2,261        | 0.8   |
| Produkte kimike              | 25,825       | 9.5   | 27,160       | 9.1   |
| Malirë të përpunuara         | 45,355       | 16.7  | 49,612       | 16.7  |
| Makineri e pajisje transport | 67,068       | 24.7  | 79,877       | 26.9  |
| Malirë të tjerë të përpunuara| 32,112       | 11.8  | 26,090       | 9.1   |
| Malirë të pa klasifikuara diku tjetër | 244 | 0.1 | 200 | 0.1 |

Figure 1. Export and import in 2017

2.4.7 Franchising

There are no legal requirements for franchising; partners can agree internally on the form of such partnership. With improved legal and physical infrastructure, the Kosovo market is open for certain franchising opportunities, especially in the hotel, restaurant, and hospitality industries. Kosovo opened its first U.S. food franchise in 2016 to much fanfare and
significant demand remains for other U.S. brands. Current U.S. franchisees and licensees include: Century 21, Coca-Cola, Enterprise, Hertz Rent-a-Car, KFC, Nike (distribution license for Kosovo), Office One Superstore, and RC Cola (bottling license in Kosovo, distribution rights for Serbia, Macedonia, Albania, and Montenegro).

The opening of different franchising brands would improve the image of the country a lot, it generally opens ways for other companies to invest and develop economic ties with the country.

2.5 Joint Ventures

The Foreign Investment Law (Kosovo Assembly Law 04/L-220) allows foreign investors to wholly own businesses in all sectors of the economy, with the exception of the manufacturing or distribution of military products, where equity is limited to 49 percent. Foreign investors in all other areas are subject to the same licensing requirements as local investors. Licensing is done by the economic regulator in the respective sector. Foreign investors may be required to file a statement with local authorities identifying principal stakeholders and types of investment. No other filing requirements in excess of those required for similar domestic businesses are required for foreign investors.

Figure 2. Enterprises registered in Kosovo after legal form
Table 3: Comparison of neighboring countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>GDP (billion US$)</th>
<th>GDP per capita (US $)</th>
<th>Labour costs (Average wage) (Euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kosovo</td>
<td>2017</td>
<td>7.13</td>
<td>4068.21</td>
<td>374</td>
</tr>
<tr>
<td>Serbia</td>
<td>2017</td>
<td>39.5</td>
<td>5544.4</td>
<td>424</td>
</tr>
<tr>
<td>Macedonia</td>
<td>2017</td>
<td>11.1</td>
<td>5350.4</td>
<td>384</td>
</tr>
<tr>
<td>Albania</td>
<td>2017</td>
<td>12.9</td>
<td>4,470.5</td>
<td>395</td>
</tr>
<tr>
<td>Montenegro</td>
<td>2017</td>
<td>4.77</td>
<td>7.812.95</td>
<td>512</td>
</tr>
</tbody>
</table>

The comparison between the regional countries in regards to market size signifies clearly the position of Serbia as an ultimate leader when it comes to its GDP, while GDP per capita is the highest in Montenegro, followed by Serbia, Macedonia, Albania and Kosovo. With regards to the labour cost the highest average wage is in Montenegro while the rest are very close to each other.

Another important FDI determinant is the privatization process of a country which goes through an economic transition as is the case with the countries analysed in this study. The privatization process in Kosovo did not attract a satisfactory number of foreign investors.
and as a consequence of this process the unemployment rate instead of decreasing it just got worse. Similarly, Montenegro despite of being a destination that attracted a great inflow of foreign investment, it certainly was not all a merit of the privatization process as it was considered to have had a slow implementation and a choice of certain privatization models which significantly limited a bigger inflow of the FDI. If compared to the case of Kosovo and Montenegro, the privatization process in Serbia attracted a greater number of foreign investors. With regards to decreasing unemployment rate, the situation was similar to Kosovo, which means that it did not have an obvious effect. Also, Macedonia managed to attract a considerable number of FDI through privatization process. The process there was considered as “step by step” rather than “mass privatization” as in the case of Kosovo which enabled them to profit from the time and manage better with their employees too. Albania on the other hand, through the years of privatization has managed to receive about 28% out of the total FDI, while almost the entire service sector has been invested by foreign investors through the privatization process.

With regards to identifying the factors that determine Kosovo’s competitiveness in attracting FDI, it can be concluded that exchange rate stability, labour costs and infrastructure are the strongest factors. On the other hand, openness to trade is also known to be an important determinant but this does not make Kosovo more attractive than its neighbouring countries as they are all members of the CEFTA agreement and all have access to the other markets.
3. DECLARING THE PROBLEM

The main purpose of this study is to identify and analyse the factors that determine what makes Kosovo attractive to FDI, and how Kosovo can increase its competitive position in attracting FDI.

From this figure it can be noted that the FDI received in Kosovo during 2012 and 2014 marked a considerable decline or almost half less than in the previous years. Furthermore it is seen that FDI since 2007 have dropped in a considerable amount.

From the declaration of independence, FDI to Kosovo are always on a declining trend.
Kosovo seems to have failed in serious offers, has failed to offer potential investors ahead of time, to offer concrete, long-term and capital projects.

This comes as a result of an unfavorable and unattractive environment, a high scale of corruption, lack of transparency, bureaucracy, informality, fiscal evasion, lack of rule of law, market uncertainty, failure of the institutions and leaders to create good conditions and opportunities for FDI.

None of the investors who remain in Kosovo are focused on production activity. These businesses mainly offer service or trade activity, which does not help so much for a sustainable economic development of the country.

On the other hand Macedonian legislation in comparison to Kosovo, treats foreign and domestic companies on equal footing, and consistently offers numerous incentives, such as tax breaks and subsidies, to attract FDI.
4. METHODOLOGY

Research methods used in this thesis are classified as quantitative and qualitative. The quantitative methods study a phenomenon by analyzing the data through statistical methods. The tools that are used to measure the data analysis and test hypothesis are questionnaires and surveys. The objective of the researcher, in this case, is to measure the responses and analyze them to make conclusions (Yilmaz, 2013). On the other hand, the qualitative method is any type of research that does not have to do with any means of quantification (Rhode, 2012). The qualitative methods study a phenomenon by understating different perspectives of people, where data is collected through different qualitative methods such as interviews and case studies (Denzin and Lincoln, 2005). The objective of the researcher, in this case, is to collect the data and turn them into themes (Creswell, 2003).

In order to be able and answer the specific questions of this research, this study will rely on an analysis of secondary data. The information for analysis will be collected from the Central Bank of Kosovo, Ministry of Trade and Industry, Ministry of Finance, KIESA (Kosovo Investment and Enterprise Support Agency), Central Bank of Kosovo

4.1 Methods for data collection

There are different methods for data collection used while conducting a research. As Gill and Johnson (2002) stated, data could be gathered in different ways, different settings and from different sources. In general, there are two methods of data collection: primary and secondary data. The primary data refers to the data that the researcher collects through interviews, questionnaires or focus groups. Its main advantage is that it has been collected from the researcher for the purpose of the study in particular (Saunders et al., 2009). The secondary data are information collected by others rather than the researcher (Bryman and Bell, 2011).
According to Saunders et al. (2009), secondary data collection consists of three main subgroups: documentary data, survey-based data, and multiple sources.

For this research paper, secondary data is used as there were sufficient books, journals, reports, and academic papers published. Another reason for choosing this approach, besides it being attainable in terms of time and financial cost, is that these sources provide sufficient objective indicators for the purposes of this thesis which are comparable across countries.
5. PRESENTING AND ANALYSING THE RESULTS

After collecting the data, the researcher evaluates if the quality and characteristics of the data will meet the objectives of this study. Data provides reliable and valid information to answer the research questions (O’Connor and Gibson, 2009). Moreover, data analysis is considered to describe facts, develop explanations, test hypothesis and provide interpretations and conclusions (Levine, 2002). Furthermore, the qualitative data analysis examines the significant and symbolic content of a research (Neuman, 2011). Moreover, the process of data analysis for this thesis was carried out based on the following steps:

Step 1: Organizing and displaying the data

According to O’Connor and Gibson (2009), the analysis process starts with “getting to know” the data. After collecting and understanding data, the researcher has a general feeling of how the results will look like. In this step, the researcher has started to collect the secondary data.

Step 2: Making connections to the research questions

The second step involves describing and evaluating the data to answer the two major research questions: (1) what are the factors that make Kosovo attractive as an FDI destination? (2) how does Kosovo compare to the other countries in the region in terms of the factors that are expected to affect FDI? Making connection to the research questions helped the researcher to reach objectives of the study.

Step 3: Data categorization and reporting the analysis According to Miles and Huberman (1994), data categorization arranges, focuses and organizes the data in order for the researcher to provide better conclusions of the findings. The data categorization was organized in line with the structure and its importance. In this study, the researcher reports the analysis in a narrative form and in an index.
6. DISCUSSIONS AND CONCLUSIONS

This study entailed the review of a large array of theoretical materials and information, in seeking to identify the factors that determine Kosovo’s competitiveness in attracting FDI as compared to the neighbouring countries. There are various academic works that have contributed in building FDI theory and modelling to answer key questions related to the determinants of FDI. In accordance with the aim of this study, a greater emphasis has been placed on the OLI paradigm, especially on the locational determinants.

Initially, the data on the relevant factors for Kosovo has been reviewed to be followed by quantitative data revision and a development of a ranking index for Kosovo and its neighbouring countries: Serbia, Macedonia, Albania and Montenegro for 2017. The findings suggest that low labour cost, exchange rate stability and infrastructure are the main advantages for Kosovo. On the other hand, openness to trade can be an additional determinant that can have an impact on the decisions of foreign investors to invest in Kosovo, but this is not considered as an advantage if compared to the neighbouring countries since they also provide it, and they are all members of the Central European Free Trade Agreement (CEFTA). GDP and GDP per capita which are used to measure the size of the market, respectively the purchasing power of population in Kosovo are found to be a disadvantage as they are the lowest in the region. Market attractiveness and economic instability which are measured by GDP growth and inflation rate are also considered as disadvantages when it comes to attracting FDI in Kosovo.

6.1 Recommendations

This research presents an urgency to develop and implement effective policies by the national authorities in tackling the raised issues of concern in the findings and analysis of the study. Below, you can find some policy implications which were identified throughout the study.
6.1.2 Policy implications

Based on the findings in this research, the following activities should result in policies to stimulate and improve Kosovo’s competitiveness in attracting FDI:

- Further improvements for more investor-friendly application of VAT
- Promote a privatization program to potential investors
- Reduce the level of corruption and offer more transparency and security to foreign investors
- Accomplish a legal framework by approving and implementing laws and regulations. For instance, the rule of Law on the Execution of the contracts, something on which foreign investors place great importance as they want to know their rights and whether their business will be protected by the host country.

6.1.3 Reflection on learning

While reflecting on the experience of writing a thesis, I came to the realization that I truly enjoyed this process, at least most of it. Though it was difficult at times to motivate myself to do the work, on the whole I enjoyed the research and writing and found that the work was much manageable than I thought it would be. The planning part was one of the most difficult as I tried to match my ideas for what I wanted to write about with a relevant topic and information that actually existed.

I enjoyed doing my own research and conducting interviews since I feel like with this research I was able to make a contribution to the field and produce something new. I can now look back and realize that this experience has helped me as a student, I now feel much more confident in my writing abilities and research skills.
7. REFERENCES


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