

AMID A GLOOMY ASSESSMENT AND GOOD NEWS FOR FOREIGN DIRECT INVESTMENT

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Abstract

Attention to the issue of Foreign Direct Investment (FDI) has been phenomenal by many governments. Kosovo is not left behind by it. Economic development in developing countries such as Kosovo is largely dependent on foreign direct investment. In the midst of a grim assessment of failed attempts by low income, many countries attract and use foreign direct investment. This study tries to gather the good news. Access to land is of crucial importance for combating poverty and promoting local development. Land offers people a place to live and it is important for their identity, provides access to land and natural resources, as such, provides income, food and employment, it can also provide access to credit in the form of collateral. Secure access to land is seen as a prerequisite for achieving the Millennium Development Goals (MDGs). Many studies have shown that foreign investment affect economic growth. Moreover, economic freedom provides an important contribution to growth than civil and political freedom. Foreign direct investment in manufacturing, agribusiness and services is a "good thing" as long as foreign firms do not pollute the environment or badly treated workers.

Key Words: Foreign Direct Investment, Economic Development, Good News for Investment, Access to Land, Externalities.

INTRODUCTION

Kosovo is a country that desperately needs foreign investment to get a new development burst in all organizational and consolidation aspects of the state. To achieve this, the government should take care to improve the image of Kosovo, promoting Kosovo as a stable country, representing to investors the potential of the country. In recent years Kosovo has significantly intensified cooperation with countries in the region, particularly with Central Europea Free Trade Agreement (CEFTA). As a result, private sector development and investment promotion and their security, brought to Kosovo technological progress and capital accumulation. This prompted the World Bank, in its report "Doing Business 2013" declare Kosovo the most dynamic reformer in Central and South-Eastern Europe, and the protection of investors marked the largest increase in the world (76 positions higher). Privatization of state enterprises, a process which was not carried out effectively and efficiently has not prevented consolidation of serious

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investors to the most important sectors of the economy. More serious access in recent years has led the privatization continue with more significant rates. By offering such policies, Kosovo can encourage attracting of foreign investment, increase employment, etc. It is of interest to work on political stability, infrastructure, environment and other factors of major importance to promote Kosovo within and outside its borders. Regional cooperation, macroeconomic stability based on good governance and adequate institutional and human capacities are necessary for a regional and global integration. FDI over the last decade were high, as a powerful means in attracting capital and carrying out the technology transfer, influencing a positive impact on the economic growth. It is clear that a country like Kosovo benefits substantially from FDI in this early stage of development. Many evaluations have been done and it is proven that FDI have a positive impact on the economic growth, considering FDI as exogenous, as regards the situation in Kosovo, we can not say that FDI are independent from economic and political developments. Investments become even more important if they are oriented to agriculture and manufacturing. The reason is that access to land creates possibility to distinct areas with a low development in Kosovo, ignored by many governmental projects, have employment opportunities and social integration. Establishment of new businesses in rural areas, access to credit through collateral is one more chance to start a new job. Civil liberty within Kosovo society is the largest in the region. Having in mind that Kosovo passed a war, this free movement of all nationalities and access to economic life is an important factor which makes Kosovo a stable country to invest.

FDI AND GROWTH FACTOR STABILIZING THE ECONOMY OF KOSOVO

Beforehand we must be acquainted that FDI constitute a much broader class of cross-border activities. A broad definition of FDI is given by the [Organisation for Economic Co-operation and Development](#) (OECD):¹ *"Foreign Direct Investment by OECD (2007), reflect the intention of providing a stable interest of a resident entity in one economy (direct investor) in a resident entity of another economy (direct investment enterprise). Lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the enterprise management."* Romer (1993) emphasized the significant idea about the existence of "the gaps" between the developed and developing economies. FDI increase and economic growth tend to accompany each other. Developing economies reached a higher economic growth than the developed ones in 2010, which are expected to expand between 3.5 to 5 % per year. He argued that (See Brems, 1970); FDI is an important tool for the transfer of such knowledge from developed countries to developing countries. The domestic market, absorbing foreign investors makes it easier for local firms to take new technology and invent new kinds of goods. Developing economies which aspire to increase FDI and economic growth can learn from economic miracles such as trade liberalization, simple and fair tax system, dialogue between the public and private sector, infrastructure development and investment promotion. Any place designated for investment should provide security to investors. Good investment climate stimulates economic growth, higher income and less poverty. Many of the region countries

¹ Benchmark of FDI", 1999, p. 7

without large energy reserves or raw material, but with reforms in institutions and good climate for businesses have become a good example in attracting of the investors. Investors worry about political unrest, freezing of assets or legislative changes that could reduce planned earnings, so in order to minimize risk the investor may prefer another country with lower profits. According to United Nations Conference on Trade and Development (UNCTAD), developing countries attracted 42 % of FDI global luxury, and in 2004 their increasing level of FDI was higher than that of the developed countries. Empirically, there is no strong evidence on positive impact of FDI on economic growth in transition countries. But there are cases that indicate that different economic or political stability, Garibaldi et al. (2002) in different countries in transition, has not produced the same results. Garibaldi et al. (2002), shows that the low risk of exchange rates is beneficial for foreign investment. Kosovo with Euro Currency does not risk the investiture that brings their capital to start the business. FDI favorable policy, tax support, Lucas (1993), transparency of the legal system, protection of the property rights, repatriation of profits, a low level of corruption and price liberalization, foster the foreign investors reinvest their profits in expansion of production or trade capacities. The adequate privatization method to attract FDI in transition countries, Lansbury et al. (1996, 1996) emphasizes the importance of privatization extension and elimination of barriers that are present in Kosovo. Delays of many assets in privatization have caused in Kosovo loss of millions as well as the wishes unrealized to thousands of people who want a job. It should be noted that institutional stability is a prerequisite for macroeconomic stability. Trade agreements with neighboring countries, the signaling effect for EU membership reflects a successful process of transition that Kosovo is going through. Good infrastructure and subsidies make a country with comparative advantages because the transport costs additional business services are reduced.

FDI FLOWS

A consensus from academics stresses that there is a positive link between FDI and growth in those countries where they have achieved at least a sufficient level of education, technology and infrastructure. Therefore, FDI is considered as an important catalyst for transition economies (Blomstrom M, Kokko A, 2003). Due to poor relations with the European Union (EU), Kosovo remains less developed and has the smallest FDI inflow in comparison with the countries of Eastern and Central Europe. Opening the doors for multinational corporations by developing countries, made FDI grow and be a factor that promotes economic growth. In total revenues worldwide this percentage increased from 1 percent in 1980 to 5 percent in 2000 and then dropped to 1.4 percent in 2003. But in 2010, there was again a slight decrease. Global Foreign Investments have lost momentum in 2012, although the prospects for 2013 and 2014 are optimistic. In terms of FDI inflows, Albania was ranked the second in the SEE countries in 2010 with 739 million euro, after Serbia.

Table 1: FDI inflows: World, South East Europe (SEE), Republic of Albania, Republic of Kosovo, 2005-2011 (million euros net)²

Expecting economies	2005	2006	2007	2008	2009	2010	2011
World	782 673	1 164 682	1 534 682	1 208 931	802 041	936 640	1 085 242*
SEE	3 870	7 885	9 384	8 663	5 446	3 109	4 745*
Albania	213	259	481	663	717	793	742
R. Kosovo	107.6	294.8	440.7	366.5	287.4	365.8	393.9

Source: World Bank, 2012.

FDI of transition economies in South-East Europe (SEE) recovered strongly in 2011. Access of these countries to the EU affected competitive cost, natural resources and growing local consumer markets. Economic growth has been the result of public investment, privatization, donor aid and remittances especially until 2004. The year 2005 scored a significant increase of 600 million euro (107.6 FDI/492.4 remittances), while in 2006, investments as a share of (Gross Domestic Product) GDP increased to 28.3%, which is one of the highest in the region, 618 million euro (294.8 FDI/323.20 remittances). FDI in Kosovo in 2007 were concluded with 440 million euro of investments, recording a small decrease in 2008 and 2009. Kosovo has had a positive but not sufficient trend of FDI in recent years. 2010 resulted with 365 million euro, following 2011 with a small increase, 365.8 million euro, whereas the second quarter of 2012 attracted about 90.3 million FDI. Foreign investors are present in Kosovo, searching for resources, skilled free and motivated labor force, a possibility to bring technology and experts in different fields. Foreign investors are also present in seeking of strategic assets in order to benefit a significant asset that improves their competitive position in the market. Kosovo's economy, through privatizing strategic sectors, inevitably loses some of its economic independence as those sectors are controlled by foreign companies, so only the public-private partnership (which is present in Kosovo) would be the best way.³

Table 2. FDI in Kosovo – according to countries (net), in million euros, years 2007-Q2/2012).

Year	Total	AT	DE	SI	GB	CH	TR	NL	AL	LU	RS	Other
2007	440.7	35.4	48.1	56.2	116.2	9.7	5.4	41.2	3.4	13.1	0	112.0
2008	366.5	51.3	44	44.3	36.6	31.1	23.8	22.5	21.9	6	5.5	78.5
2009	287.4	15.5	75.2	50.8	6.2	22.7	14.5	25.1	23.3	8.3	0.6	55.2

²Data taken from the World Bank, Central Bank of Kosovo, the Bank of Albania, in time series (historical data) in the years 2005- 2012.

³ PhD(c): Kida Nakije, 2012: The First Scientific Conference “Impact of FDI on Economic Development, Activation Challenge of Industry and Clean Environment in Kosovo” European University of Tirana, Albania.

2010	365.8	21.1	91.5	34.0	38.9	35.1	4.9	14.5	20.3	0.4	0.4	104.7
2011	393.9	19.6	66.6	16.2	80.1	30.9	34.7	14.2	11.2	0.5	0.4	117.8
Total	1854.3	142.9	325.4	201.5	278	129.5	83.3	117.5	80.1	28.3	6.9	468.2

Source: Central Bank of Kosovo

States with inflows larger than Kosovo are: Austria, Germany, Slovenia, Great Britain, Switzerland, Turkey, Norway, Albania, Luxembourg, whereas RS-Serbia has a non-significant participation. Germany, Great Britain and Slovenia are dominant countries.

A SURVEY TO INDICATORS IN SUCCESSFUL ATTRACTING OF FDI IN KOSOVO

Kosovo of the recent years based on economic indicators has had positive growth trends despite the international financial crisis. Investments are becoming an important factor of this growth, especially the financial sector. Positive performance and stable monetary policy, based on Euro, has made Kosovo an attractive location for investors. Not being a member of the EU presents an obstacle to Kosovo's path towards a faster economic development. The fact that Kosovo is a member of the Multilateral Investment Guarantee Agency (MIGA), the legal framework improvement means that the foreign investor as well as the local one has the capital guaranteed, even profit repatriation if there is any interest. Taxes are among the lowest in Europe. VAT rate of 16 %, Corporate Income Tax of 10 %, Individual Income Tax rate of 4, 8 and 10 %, are very attractive for doing business and at the same time for capital accumulation. Free Trade Agreement of Europe necessarily creates possibilities to Kosovo products to infiltrate even outside Europe.⁴ In 2012, Kosovo has made significant progress in the World Bank Report of Doing Business. Kosovo has improved the indicator of starting a business for 44 places compared to the last year. Indicator for building permits improved for 33 positions, while major improvements were made to the protection of investors that Kosovo has progressed for 76 positions. Access to electricity has improved for 6 positions, taxpaying for 4, cross-border trade has improved for 9 positions, while the implementation of contracts for 1 position.⁵ Having considered the favorable business climate, stable macroeconomic environment and excellent opportunities in various sectors of business, Kosovo is becoming more and more an attractive country for doing business. Albania is an example which shows that even countries with low income can attract investment and have positive performance that surpasses even the countries such as Bulgaria, Poland and Macedonia. Transition is also known as a passage which brings positive growth rates thanks to the open economy and inflation control. There are countries which, even with a high level of GDP per capita, result with not such a good performance of investments as those of Eastern European countries. The positive effect of FDI in transition countries was also highlighted by Bevan and Estrin (2000), strengthening even more the conviction that joining the EU(European union) of these countries makes the growth even more positive. Some authors as Balasubramanyam, Bevan and Estrin (2000), Barrell and Holland

⁴ Investor Guide, Investing in Kosovo, May 2011.

⁵ Ministry of Trade and Industry, MTI_Report_Progres_2012_December_103727.pdf, p. 3.

(2000), Carstensen and Toubal (2003), Pournarakis and Varsakelis (2004) state that investors prefer larger markets, whereas according to Campos and Kinoshita (2003), market is not important for FDI.

AMID A GLOOMY ASSESSMENT OR A GOOD NEWS, FDI INCREASE REVENUES IN KOSOVO

Promotion and strengthening of the legal framework and business climate passes through the state. The state may create a suitable environment to allow investors energies and creativities to contribute to the creation of new jobs. This represents the main segment to eradicate poverty. There are at least three types of actions; the central government can take to contribute in this direction:

- Improving the environment for doing business,
- Investment protection,
- Creation of a financial mechanism that facilitates business cost (grants, loans, loan guarantees and soft loans).

In case of a fragile investment climate because of taxes, fees, fines, corruption and the necessity for additional services (lawyers, accountants, consultants, etc.), investing transaction costs increase and the investor can search elsewhere, despite costs labor, transportation and energy in Kosovo are competitive.

Investor is worried about political unrest, freezing of assets or legislative changes that could reduce planned earnings. The first decade after the war, in Kosovo was characterized by activities related mainly to the formation of its statehood. A commitment to political stability and integration into international institutions has almost taken the place for a dynamic economic development. Regarding the investment climate, Kosovo is not behind in relation to Eastern European countries or the region countries, but it has failed to infiltrate its products considerably in terms of exports, which makes it always have a negative balance of exports. The legal framework in Kosovo is being adapted to become much more favorable for investors. Protection through the Law for foreign investments No.02/L-33 is a guarantee for foreign enterprises to be treated similar to the local ones. It is of great interest application of the Law No.03/L-090 for public-private partnerships and concessions up to 40 years, which enables the investors exploit strategic sectors such as energy, mining, transportation, etc. But since 2005 the clear objective of leadership structures and favorable legal framework in Kosovo has made Kosovo have good news for FDI after the gloomy post-war period until 2004. Starting from scratch and achieving to integrate and compete with the countries with accelerated economic development has been a challenge but also an impressive success. Kosovo has successful investors such as:

- Ferronikeli (Ferronickel), investment in heavy industry which contributes to 50 % of overall exports from Kosovo to Italy, Germany, Spain, India, China and Korea.

- Klllokot, water factory which has managed to invest 4 million Euros and which is present in Albania, Macedonia and Switzerland.
- Stone Castle Vineyards, the wine factory in Rahovec (Orahovac) is among the biggest in the region that exports to Germany, England, Austria, Belgium, Switzerland, etc.
- Theranda Hotel in Prizren, which is good example of privatization.
- Trofta (Trout), hotel but also fish production company, has made the Istog region be among the tourist places to extinguish pleasure of serving fish and freshness of nature.
- M&Sillosi (M&Silo), the flour production company among the major ones in Kosovo is a success story of privatization.
- Birra Peja (Peja Beer), as a factory of nearly 50 years tradition, with 612 employees and a production of over 900 thousand liters of beer of the best quality in the region.

This shows that there are privatization successes in Kosovo but there are still black holes.⁶ Factories which worked for decades and were successful in Europe and outside it, now have remained assets with no value. In any form these enterprises were activated, privatization, concession or subsidy by the state, it would be welcomed.

WHAT KOSOVO MUST PROVIDE TO FOREIGN INVESTORS

Kosovo, as the transition countries use foreign investments to increase income and welfare of families. At the time when globalization has involved every pore of life, economic growth and creation of new jobs in Kosovo depends on two main factors:

- Foreign Direct Investment (FDI) and
- Development of Small and Medium Enterprises (SMEs).

FDI is the main source of funding for Kosovo because it increases the fixed capital formation and helps the balance of payments. FDI has the potential to generate employment, increase productivity, transfer skills and new technology, increase exports, and contribute to long-term economic development of Kosovo. Meanwhile, SMEs are considered the catalyst of employment, and creation the commercial areas in rural underdeveloped areas. The proximity of Kosovo to the states with medium income shows that it is not a guarantee for economic development. What steps has Kosovo made?

Kosovo has transformed the business environment; corporate taxes are the lowest in Europe, providing services to business registration one-stop-shop, competitive cost thanks to the young and skilled labor force willing to work for lower wages. It provided preferences to businesses but

⁶ In the city of Gjakova, there are 34 former social enterprises that are partially privatized, and the rest have remained as ruins or are given under concession to non-serious investors “who have money but no concrete projects to invest” or at least to be restructured. In these enterprises before 90s were employed about 16,000 employees, making Gjakova region attracting place to live and work. Their products penetrated Europe and further.

not to the necessary extent as Kosovo laws are constantly being changed which adversely affects the ability of investors to anticipate the profits. What must Kosovo improve, to serve the investors more?

- Infrastructure including an international airport with good access to a large number of destinations to Europe and other continents,
- A good base of universities and institutes,
- Partnership between government and unions,
- Interest to attract the best companies,
- Creation of free zones,
- Low taxes and fees,

APPROACH TO INVESTMENT ON LAND INCREASES EMPLOYMENT

It is estimated that the human footprint has affected 83 % of the global land surface (Sanderson et al 2002) and has degraded about 60 % of ecosystem services in the last 50 years. Bad practices at the beginning of this century have come to an end. Investment in the agribusiness sector should increase, and the legal prohibitions should take place to arable land turned to construction industry, as a frequent practice in Kosovo. Investments should take place in land but first the destination areas of agricultural land must be clarified, clarity of land ownership, access to soft loans, preferential conditions for farmers through subsidies, tax exemptions and customs. Acemoglu and Johnson (2005) find a positive correlation between property rights institutions, economic growth, investment and financial development. Hernando de Soto (1989, 2000), identifies the channels through which the uncertain property rights stifle the economic development. Access to land is of crucial importance for combating poverty and promoting local development. Land offers people a place to live, but without the participation of rural areas in the implementation of programs, the progress is unlikely to be made in increasing access of the poor to productive resources. Small farmers are the key to their economic development. Land provides access to natural resources and as such it provides income, food and employment. Contacts with foreign individuals and businesses can have a positive effect if they lead to new ideas and development plans. Reforms improve institutions; create prosperity, the view which supports the recent empirical research on growth and the Economic Freedom Index.⁷ Friedman (1962) believes that democracy and economic freedom are mutually reinforcing. He argues that these two aspects of liberal institutions are conducive to economic progress.

⁷ Robert J. Barro, Ph.D.

CONCLUSIONS

The purpose of this paper was to investigate the most important determinants of FDI in transition countries of Europe, especially in Kosovo. Given that FDI is a powerful tool for capital accumulation and transfer of technology, they are playing a strong role in industrialization and economic growth in transition countries. The main ways in which developing countries can facilitate investment from international markets is political risk insurance, avoidance of double taxation, investment promotion by agencies in the host country, transparency and restrictions on bribe payment or other corrupt practices. Secure property rights to provide access to loans with collateral. Property rights also provide the necessary entry incentives that a country has, as they had a strong positive effect on foreign investment activities. In addition to this, market factors and political and economic conditions have played an important role. Countries with high economic and political stability, sustainable monetary and fiscal policy, with continuous privatization efforts, are much more attractive to foreign investors than countries which still suffer from economic and political instability. In other words, there is a strong interdependence between FDI and transition success. FDI is recommended to be set on the top of the policy agenda, as well as creating of a business climate which strongly facilitates foreign investment if they want to stimulate the economic growth through FDI.

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