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POLICY BRIEF

Foreign Direct Investments and Exports: Kosovo and the Western Balkans



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Foreign Direct Investments and Exports: Kosovo and the Western Balkans

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Abbreviations

CEFTA – Central European Free Trade Agreement

EUR – Euro

FDI – Foreign Direct Investments

GDP – Gross Domestic Product

KAP – Aluminum Plant Podgorica

KIESA – Kosovo Investment and Enterprise Support Agency

IOM – International Organization for Migration

SAA – Stabilization and Association Agreement

SEZ – Special Economic Zones

TAP – Transatlantic Project

UNDP – United Nations Development Programme

USD – US Dollars

WB – Western Balkans

Introduction

There is plenty of empirical work that intends to examine the determinants of sustained growth in developing economies over the recent years. Among a great array of political, legal, and social aspects, it is commonly admitted that Foreign Direct Investments (FDI) and exports constitute two important factors that contribute to the economic growth of developing economies.

The positive effects of FDI net inflows occur in many ways. Provided that in developing economies the saving rates are relatively low, FDI helps in increasing investments, leading, among other things, to the creation of new jobs and generation of tax revenues. In addition, FDI provides access to advanced technology that has a positive role in enhancing total factor productivity and factor incomes. With the investments of foreign firms in the recipient economy, modern technology and know-how is spread through various formal and informal linkages and exchanges, thus helping labors to improve their productivity.¹ Moreover, international competitiveness resulting from FDI net inflows allows the host economy to increase exports and improve the balance of payments, and, in many instances, relieving international finance constraints to economic growth.² Finally, FDI, through all its direct and indirect contributions, can serve as a major driver of enterprise restructuring as well as overall economic restructuring.³

Export-led growth, too, has multiple positive effects in the country's output. Export markets enable sustained growth, because they do not involve any constraints on the demand size, implying that there is almost a limitless demand.⁴ Export growth enhances factor productivity as a consequence of gains acquired from increasing returns to scale.⁵ In addition, exports can help in improving efficiency and grooming of entrepreneurs. Interaction with foreign

markets, enabled by exports, contributes to the importation of advanced technologies and production know-how, thereby promoting cross-border knowledge spillovers.⁶ Moreover, export growth alleviates foreign exchange obstacles, which results in the import of technology/capital-intensive intermediate inputs.⁵ It is worth noting, too, that export growth can create positive externalities on the non-export sectors of the country,⁷ through providing incentives for technological advancements, human capacity development, and more efficient management.⁸ This is largely attributable to the direct access of exporting firms to foreign knowledge. In general, developing countries with a greater proportion of exports in the economy outperformed the countries with less exports due to the aforementioned positive effects.

Furthermore, there is also a strand of literature that suggests that exports and FDI may have a bidirectional positive relationship, which then translates into economic growth.⁹ On the one hand, a greater volume of FDI net inflows increases the recipient country's export capacities; whereas, on the other hand, access to larger markets attracts more FDI net inflows. In short, promoting the increase of FDI and exports is essential to achieving sustained economic growth.

Generally, the Western Balkans (WB) has not performed very well in these two aspects. Kosovo, in particular, has been lagging behind, occupying the bottom places in all FDI and export indicators. That said, this policy paper intends to shed light on the patterns of FDI and exports in Kosovo specifically and in the WB in general.

The rest of this policy brief is organized as follows. *Section 2* provides a general overview of FDI in Kosovo, focusing on the latest trends, broken down by source country and sectors. *Section 3* gives a general overview of exports in Kosovo, concentrating also on the latest trends based on

main destinations and sectors. *Sections 4 and 5* compares the performance of all WB countries with respect to FDI and exports, respectively. *Section 6* concludes and draws recommendations dedicated specifically for Kosovo.

Overview of FDI in Kosovo

In 2016, FDI in Kosovo marked a decrease of around 30 percent compared to the previous year, from 308.8 million EUR to 215.9 million EUR. Capital and fund of investment in shares, which comprise the bulk of FDI, recorded a decrease of approximately 26 percent, from 243.7 million EUR to 179.0 million EUR. In addition, debt instruments plummeted by 54 percent, from 80.7 million EUR in 2015 to 36.9 million EUR in 2016. The decrease has been present in almost all sectors. A more notable decrease was recorded in the real estate sector and financial service sector, around 39 percent and 70 percent, respectively, compared to the previous year.¹⁰ This could suggest that the market for these two sectors is getting saturated.

FDI Trends by Source Country

Table 1 depicts FDI trends in a wider time context (including the past five years), focusing on the top source countries based on the value of investments. Kosovo has managed to attract close to 1.2 billion EUR of FDI in the last five years. For this period, Turkey tops the list of source countries with 274 million EUR (23 percent of total FDI), followed by Switzerland with 258.4 million EUR (22 percent), and Germany with 171.6 million EUR (14 percent). The high volume of FDI from Turkey is in part attributable to the privatizations and investments in privatized assets that have occurred during this period, particularly privatization of electricity distribution and supply, as well as investments in the new terminal in the airport. On the other hand, Switzerland and Germany have always been a great source

of FDI due to the concentration of the Kosovo diaspora in these two countries.

Table 1: FDI net inflows by source country (in million EUR)

	2012	2013	2014	2015	2016	TOTAL	% of Total FDI
FDI net inflows (million €)	229.1	280.2	151.2	308.8	215.9	1,185.20	-
Turkey	65.6	88.6	20	55.4	44.4	274	23%
Switzerland	43.8	41.7	38.2	72.9	61.8	258.4	22%
Germany	49.5	21.7	29.4	45.3	25.7	171.6	14%
Albania	4.7	19.3	20.4	40.1	28.6	113.1	10%
The US	10.8	12.7	14.7	25	22.6	85.8	7%
Austria	0.38	10.7	30.26	33.51	9.95	84.8	7%
Bulgaria	8.1	5.56	14.53	1.56	0.43	30.2	3%
The UK	14.31	10.66	-39.45	26.63	13.63	25.8	2%
Italy	4.38	8.73	3.31	5.67	1.91	24	2%
Norway	2.86	4.7	5.95	2.88	3.44	19.8	2%

Source: Central Bank of Kosovo 2017

FDI Trends by Sectors

The sectorial distribution is of a paramount importance when it comes to assessing the long-term effects of FDI, particularly its effects to export growth. Table 2 reveals the sectorial distribution of FDI in Kosovo across the past five years.

For the last five years, real estate turns out to be the leading sector for most FDI net inflows with a total amount of 751.1 million EUR, accounting for around 63 percent. The high volume of FDI in the real estate sector is mainly attributable to the Kosovo diaspora, who in order to maintain some sort of an attachment with their country of origin, invest large amounts of money in building new houses and buying

apartments. These properties are usually used during the summer or winter holidays when they come to visit their relatives, but remain idle most of the time during the year. According to a study conducted by IOM and UNDP (2013), around 60 percent of the Kosovo diaspora investments are channeled towards this sector.¹¹ Generally, these types of investments, because of a relatively lower multiplying effect, do not produce significant benefits to the economy.

The following two sectors, which constitute a considerable share in total FDI during this period, are the financial sector and construction sector with 152 million EUR (13 percent) and 103 million EUR (9 percent), respectively. The demand for financial services by individuals, businesses, and the public sector stimulated foreign banks to invest in Kosovo. Around 90 percent of the assets in the financial sector in Kosovo are owned by foreign banks.¹² The construction sector, on the other hand, is one of the key contributing sectors to FDI. Huge investments in highways that have taken place over the recent years comprise a large share of FDI in this sector.

The electricity and water supply sector; the transportation, storage, and communication sector; and the wholesale and retail sector, comprise a smaller share, 79.7 million EUR (7 percent), 58.8 million EUR (5 percent) and 57.1 million EUR (5 percent), respectively. The electricity and water supply sector has experienced a decreasing trend over the years and generally does not attract large FDI net inflows. The largest amounts of FDI net inflows in this sector corresponds to the period when electricity distribution and supply was privatized. FDI in transportation, storage, and communication has also recorded a decreasing trend, partially due to the outflow of dividends in the telecommunications sub-sector. Finally, FDI in the wholesale and retail sector, albeit smaller in total, has been steady over the years. This sector indeed is by far the largest

contributor to private sector as per cumulative turnover and number of employees (around 3.9 billion EUR and 45 employees, respectively). Note that the sum of FDI per sector is greater than the total FDI value, due to the fact that sectors with overall negative values (such as the mining sector) are not taken into account in the Table below.

Table 2: FDI by sectorial distribution (in million EUR)

Column1	2012	2013	2014	2015	2016	TOTAL	% of Total FDI
Total FDI (million €)	229	280	151	309	216	1,185.20	-
Real estate, renting and business activities	116	136	142	190	168	751.1	63%
Financial Intermediaries	22.4	4.4	41.9	64.3	19	152	13%
Construction	31.1	17.3	-20	46.3	28.2	103	9%
Electricity, gas and water supply	2.2	48.8	13.4	11.9	3.4	79.7	7%
Transport, storage and communication	32.4	51	-9.1	-6.1	-9.4	58.8	5%
Wholesale, retail trade, repair of motor vehicles	9.3	14.6	8.4	12	12.8	57.1	5%
Manufacturing	27.4	11.5	-34	20.7	5.3	31	3%

Source: Central Bank of Kosovo 2017

Overview of Exports in Kosovo

Kosovo is characterized by very low exports. In 2016, exports of goods marked a slight decrease of about 5 percent compared to the previous year, from 325.3 million EUR to 309.7 million EUR. This decrease is mainly driven by the decrease of exports in base metals, which constitute the largest share of exports in Kosovo.¹³ The decrease of base metal exports occurred as a result of lower production (due to lower demand) of nickel and the fall of metal prices in the international markets during 2016. Two other sectors that played a role in the overall decrease were textile, and

machineries/electricity appliances.

Export Trends by Destination

CEFTA and EU members have been the main destinations of Kosovo exports (of goods) over the last five years. For these years exports to CEFTA members amounted to 599.9 million EUR or 39 percent of the total. Slightly less have been the exports to EU members, amounting to 502.3 million EUR or 33 percent of the total. The two main reasons explaining the domination of these destinations consist of geographical proximity and trade agreements (free trade agreement with CEFTA countries; the Autonomous Trade Preference and now the Stabilization Association Agreement with the EU). Of the top 10 export destinations for the past five years, Italy turns out to be the first destination with 220.7 million EUR (14 percent), albeit with a sharp decrease since 2012 from 71.4 million EUR to just 5.7 million EUR in 2016. Following is Albania with 210.3 million EUR (14 percent). A notable increase throughout the years has been recorded in exports to Serbia, from 15 million EUR in 2012 to 41.3 million EUR in 2016. This country has now become the second destination in terms of Kosovo exports. This is a result of the new agreements reached between these two countries, which helped in alleviating non-tariff barriers in particular. For more detailed information, please see Table 3.

Table 3: Kosovo's exports by destination country in the last five years

Exports (in million €)	2012	2013	2014	2015	2016	Total	% of Total Exp.
Total	276	294	325	325	310	1530	-
CEFTA	100	105	127	124	144	600	39%
EU 28	110	118	98	106	70	502	33%
Italy	71.4	74.4	49.7	19.6	5.7	221	14%
Albania	40.2	43.8	44	40.3	42.1	210	14%

Macedonia	26.4	26.1	36	33.4	38.6	160	10%
India	22.9	29	27.4	47	9.4	136	9%
Serbia	15	14.5	27.3	32.3	41.3	130	9%
Montenegro	16.8	17.3	16.1	12.1	13.9	76.2	5%
Germany	15	11	11.3	11.7	13.8	62.9	4%
Switzerland	15.1	7.2	10	11.7	16.8	60.8	4%
Turkey	11.4	7.4	10.4	9.2	7.6	46	3%
Austria	4.4	6.3	6.4	12.3	6.7	36.2	2%

Source: Kosovo Agency of Statistics 2017

Export Trends by Sector

Table 4 shows the exports of Kosovo goods according to sector over the last five years. These sectors indeed comprise about 96 percent of all exports (of goods) for this period, on average. For all these years, base metals lead by far with an overall amount of 726 million EUR or 45 percent. Kosovo has a long tradition of metal processing. The largest exports of metal products occur from formerly socially-owned enterprises, which are now privatized and separated into smaller enterprises with a modern style of production. Of all metal base products that are exported, processed ferronickel dominates, followed by iron, and steel products. Mineral products are the second most exported products with 235 million EUR or 15 percent. Trepça, the large industrial complex, is responsible for most of exports. The share of other sectors is in single digits. It is noteworthy to mention that steep increases have been noted in plastics and rubber and chemical products; the exports of these products in 2016 (almost) doubled compared to 2012. For more detailed information about other sectors, please see Table below.

Table 4: Kosovo's export of goods by sectors in the last five years

Export by Sectors (in million EUR)	2012	2013	2014	2015	2016	Total	% of Total Exp.
Total	276	294	325	325	310	1530	-
Base metal and articles of base metal	146	144	167	158	111	726	47%
Mineral products	36.5	48.4	44.7	41.6	63.9	235	15%
Prepared foodstuffs beverages and tobacco	16.1	19.3	20.5	25.4	27.6	109	7%
Plastics, rubber and articles thereof	14	18.2	16.3	23.5	28.9	101	7%
Vegetable products	14.4	15.4	18.5	15.5	16.8	80.7	5%
Machinery, appliances and electric materials	16.7	12.6	13.4	12.3	9.2	64.2	4%
Textiles and textile articles	11.4	12.8	14.7	12	8.8	59.6	4%
Leather and their articles	10.4	11.7	11.4	10.8	11.2	55.4	4%
Miscellaneous manufactured articles	2.5	2.6	3.6	4.6	9.8	23.1	2%
Product of chemical industries	2.5	1.7	2.6	2.9	4.7	14.4	1%

Source: Kosovo Agency of Statistics 2017

Export of Services

As far as exports of services are concerned, Kosovo has performed relatively better. According to the MTI, exports of services in 2016 amounted to 1.038 billion EUR, accounting for around 77 percent of total exports (both goods and services) of that year. There has been an increase of around 17 percent compared to 2015 (887 million EUR).

The main sectors participating in the exports of services include: travel (tourism) with 809 million EUR, followed by business and professional services with 63 million EUR; ICT with 48.5 million EUR; construction services with 13 million

EUR; and Government services with 35.5 million EUR.¹⁴

FDI in the Western Balkans¹

The Volume of FDI Net Inflows in the Western Balkans

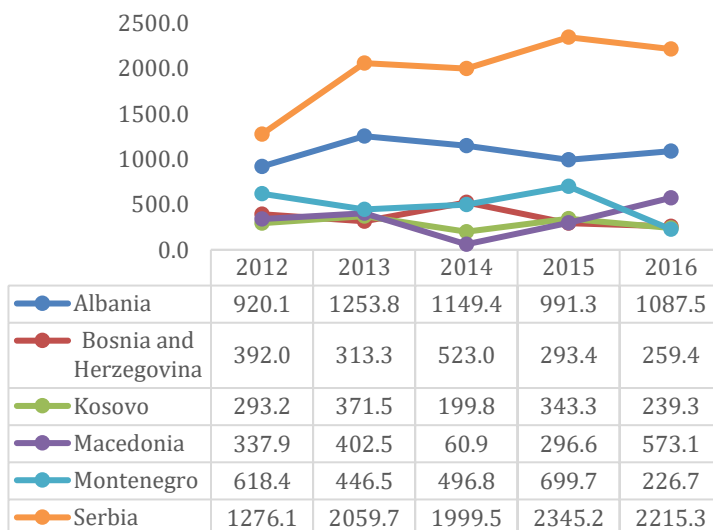
Over the last five years, the total volume of FDI net inflows in the six WB countries amounted to 22.6 billion USD (around 15 percent of FDI in Central Europe and the Baltics), reaching its peak in 2015 with 4.9 billion USD. The distribution of FDI net inflows among WB countries was uneven (see Figure 1). Serbia has by far attracted the largest amount of FDI net inflows over these years, reaching its maximum in the last two years (2.3 billion USD in 2015 and 2.2 billion USD in 2016).¹⁵ The relatively larger size of the economy along with its population size (around 7 million) may partly explain the substantially higher amounts of FDI net inflows in this country. The EU prospects, favorable incentives, industrial zones, and similar are also some other factors that have played a role in the domination of Serbia.

Albania comes second, attracting relatively constant amounts of FDI net inflows over the years (around 1 billion USD, on average). This is in part attributable to the energy projects that have taken place over the recent years, particularly the TAP project.¹⁶ Other WB countries – Macedonia, Montenegro, Kosovo, and Bosnia and Herzegovina – have managed to attract lower amounts of FDI net inflows throughout this period. It is worth noting that among these countries, inward FDI in Macedonia has recorded a sharp increasing trend, whereas in Montenegro it was the opposite. In the former, the volume of FDI net inflows in 2016 has increased by about 70 percent compared

¹ In order to avoid any eventual conversion error, all the values in the WB cross-country analysis are kept in the original form – in USD, as provided by the World Bank.

to 2012; whereas in the latter, the recorded decrease was around 63 percent. The positive trend in Macedonia may be explained by the flourishing industrial parks that provided for very attractive incentives for international investors.¹⁷ On the other hand, the negative trend in Montenegro is mainly due to an outflow of telecom dividends.¹⁸

Figure 1: FDI net inflows in the WB countries over the last five years (in million USD)



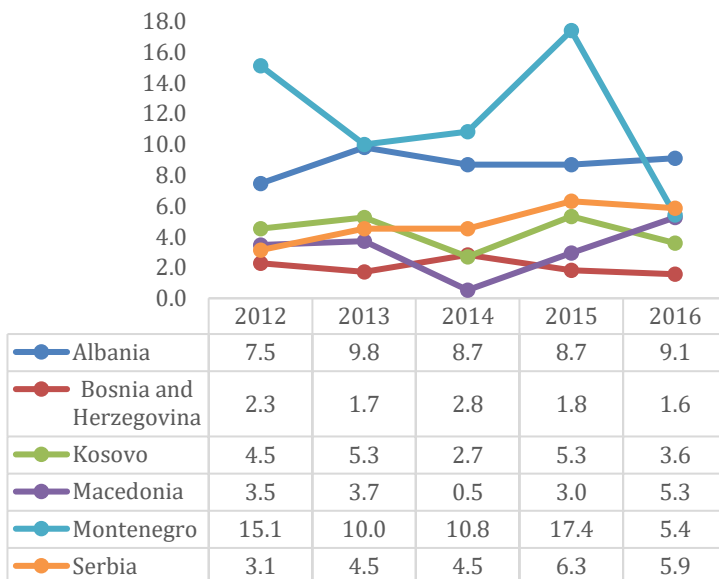
Source: World Bank 2017

FDI Net Flows in Relation to GDP and Population

In order for FDI net inflows to become more comparable across the WB countries (to control for size differences), this paper, through Figure 1 and Figure 2, sheds light on FDI-to-GDP and FDI per capita indicators for the last five years. In both these indicators, Montenegro (except in 2016) tops the list of WB countries. This may be, to some extent, misleading though given the small population size (just 0.6

million)¹⁹ and comparatively lower GDP (4.2 billion USD).²⁰ Notwithstanding this, it is worth noting Montenegro has developed a business-focused economic system attractive for FDI inflows.

Figure 2: Share of FDI in the GDP of the WB countries over the last five years (in percent)

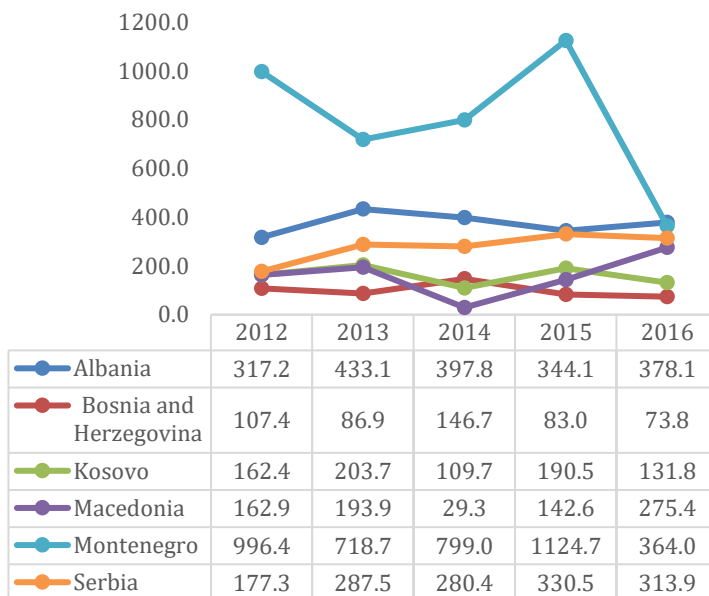


Source: World Bank 2017²¹

Albania ranks second with regard to FDI-to-GDP and FDI per capita, with an average of 8.8 percent and 374.1 USD, respectively. As indicated previously, this good performance of Albania is primarily driven by the large energy projects, particularly Trans Adriatic Pipeline and the Devoll hydropower project.¹⁸ Recent structural reforms (notably in the energy and financial sector), strengthening of the judiciary system, and the recognition by the EU as an official candidate country in 2014, may be some of the factors that have had an impact on FDI net inflows.

In comparison with the first indicator (total FDI net inflows), these two indicators somewhat dim the success of Serbia with regard to FDI. Regardless of this, Serbia is still among the top three WB countries (average FDI-to-GDP ratio at 4.9 percent; average FDI per capita at 277.9 USD). Most importantly, it recorded a positive trend over the years in both indicators. That is in part because Serbia intensified its efforts to pursue more FDI, particularly in the manufacturing sector. The investment of Fiat-Chrysler in a car manufacturing plant in 2012 is an example that there is a great tendency of foreigners to invest in this sector. It is worth noting that Serbia has the largest network of active Special Economic Zones (SEZs) – 14 in total, which considerably contribute to the growth of the manufacturing sector. Indeed, active enterprises in the SEZs in Serbia have generated more than 22,000 jobs, contributed to 15 percent of all exports, and accounted for around 80 percent of total manufacturing FDI over the past five years.

In addition to the broad range of general fiscal incentives, Serbia, under certain conditions, offers substantial labor-related incentives in the form of employment subsidies and exemptions from labor taxes and pension contributions, particularly for enterprises accommodated in the SEZs.¹⁷ These incentives along with preferential trade agreements (EU, Russia and Turkey), EU prospects, large domestic market, geographical proximity, streamlined procedures and similar have had an impact on attracting FDI in this country.

Figure 3: FDI per capita in the WB countries over the last five years (in USD)

Source: Author's calculations based on World Bank (2017) FDI

Macedonia comes in next with an average FDI-to-GDP of 3.2 percent, achieving its maximum in 2016 (5.3 percent). The average FDI per capita has been 160.8 USD, reaching its peak in 2016 (275.4 million EUR). Macedonia also has a wide network of functional SEZs and provides for the widest range of tax- and non-tax incentives to investors, including, but not limited to: encouraging subsidies, labor-related incentives, favorable lending conditions, state guarantees, and tax incentives. These incentives played a positive role in attracting new manufacturing investments in particular. The EU prospects, trade agreements, and streamlined tax and custom procedures – to name a few – have had an impact on FDI, too. Political tensions that were present during the recent years, on the other hand, deterred potential

investors. Without these, the averages of these indicators might have been higher.¹⁸

Kosovo is among the WB countries occupying the bottom places. Over the past five years, the average FDI-to-GDP has been 4.3 percent, whereas FDI per capita 159.6 USD. The peak during this period was achieved in 2013, as per Figure 2 and Figure 3. This is mostly associated with the investments in the new terminal in the airport by the consortium Limak-Aeroport de Lyon. The fall of FDI net inflows in 2014 and 2016, albeit not very significant, may be linked to the delays in creating the government and the recent turmoil in the parliament because of demarcation with Montenegro; the decline in 2016 is a result of a decrease of the diaspora demand for direct investments. In principal, political instability can seriously discourage foreign investors to invest their capital in the host country. With respect to the composition of FDI, as it was indicated, the real estate sector and financial service sector comprise the largest share of net FDI. Unlike in other top WB countries, net FDI in the manufacturing sector is very low in Kosovo.

Albeit there have been some significant improvements in streamlining the procedures (ease of starting a business, registering a property, and similar),²² Kosovo, besides other things, is lagging behind other WB countries with regards to investment incentive regimes. Low taxes are not sufficient given that other WB countries, particularly Serbia and Macedonia, have been very aggressive in offering various incentive packages, including financial. The Law on Strategic Investments²³ adopted recently in Kosovo is a progress for the very fact that it differentiates strategic investors from small investors, however, it provides no financial or fiscal incentives. The small market size (limited access to export countries due to non-tariff barriers), inherited bad image, inefficient judiciary system, among

others, can be some aspects that hamper the growth of FDI in the country.

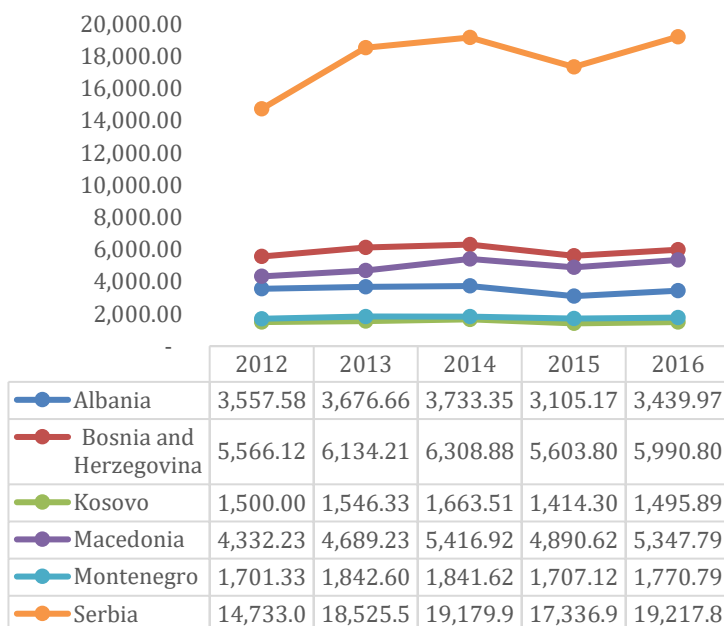
Bosnia and Herzegovina is ranked at the bottom of the WB countries with respect to FDI in the last five years (FDI-to-GDP–2 percent and FDI per capita–99.6 USD, on average). From 2014, net FDI almost halved. Complicated labor and pension laws, the lack of a single economic space, and inadequate judicial and regulatory protections, and competitive packages for investors by its neighbors have deterred potential investors.²⁴

Exports in the Western Balkans

The Volume of Exports in the Western Balkans

Figure 4 depicts the value of exports of goods and services in the WB countries in the last five years. The total value for this period amounted to 177.2 billion USD (4 percent of the total exports of Central Europe and the Baltics). Again, similar to FDI, particularly because of its size (population and economy), Serbia outperforms by far other WB countries with respect to exports of goods and services in this period, accounting for around 50 percent of the total; followed by Bosnia with 17 percent, Macedonia with 14 percent, and Albania with 10 percent. Montenegro and Kosovo exported less vis-a-vis other WB countries, making up only 5 percent and 4 percent of the total, respectively. Note that in Montenegro, too, the population and economic size matter. In order to somehow offset the population and economic size, the next section, as in the case of FDI, will compare in detail the WB countries through two export indicators, notably exports-to-GDP and exports per capita.

Figure 4: Volume of exports in the WB countries in the last five years (in million USD)



Source: World Bank 2017²⁵

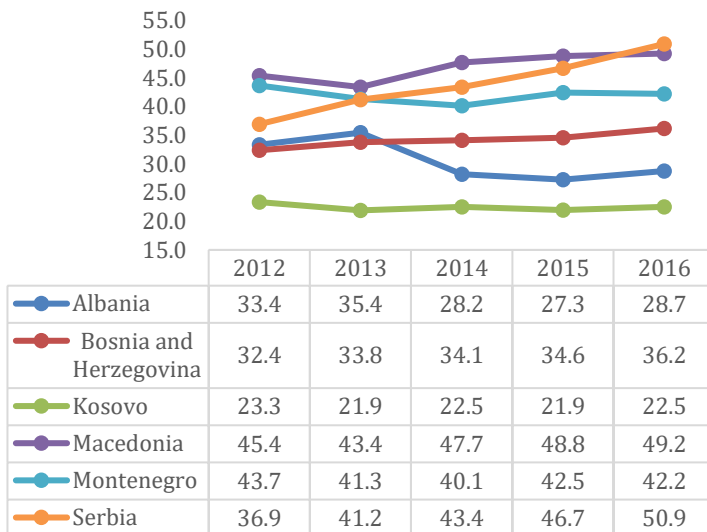
Exports in Relation to GDP and Population

Figure 5 and Figure 6 depict the export indicators (export per capita and export-to-GDP), based on which the WB countries will be compared, making also references to the total value of exports. All these indicators will provide a more complete picture of exports.

Macedonia, Serbia, and Montenegro have been the most integrated WB countries for the past five years, with exports of goods and services comprising around 47 percent, 44 percent, and 42 percent of GDP, respectively. The same countries lead with respect to exports per capita, with a

change of places between Macedonia and Montenegro. On average, the exports per capita in Montenegro amounted to 2,851.3 USD, in Serbia 2,497.7 USD, and in Macedonia 2,375.4 USD.

Figure 5: Share of Exports in the GDP of the WB countries over the last five years (in percent)

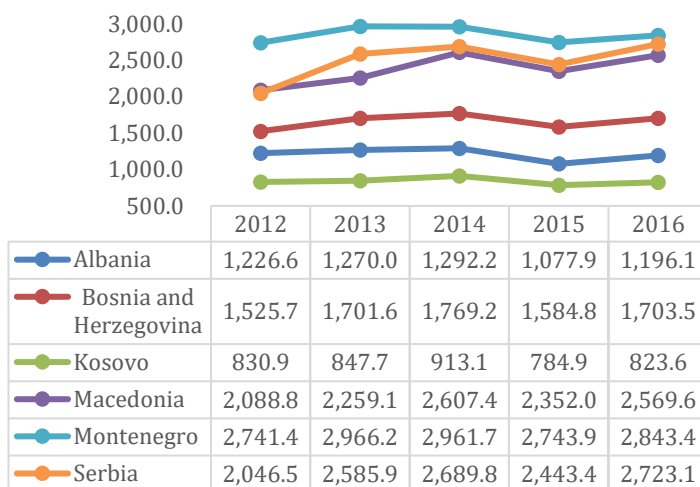


Source: World Bank 2017²⁶

Over the last years, owing to private-sector-oriented reforms, notably simplified tax procedures, public administration and SOE reforms, improved cadaster, streamlined construction permits, fiscal consolidation, and financial incentives (subsidies for strategic investors), Serbia has experienced a strong broad-based export growth, particularly spurred by recent FDI net inflows in manufacturing (automotive industry, in particular). FIAT has been the largest individual exporter with 1.5 billion USD,²⁷ comprising around 8 percent of current total exports. Export of services, dominated by tourism and

transport, played a role in the country exports, making up over 25 percent of total exports. The EU has been the biggest export destination for Serbia, accounting for over 60 percent of exports, followed by CEFTA (around 10 percent, on average) and Russia (less than 8 percent, on average).²⁸

Figure 6: Exports per capita in the WB countries over the last five years (in USD)



Source: Author's calculations based on the World Bank (2017) data

Macedonia was also characterized by a steady growth of exports in general. This, among other things, was driven by the attraction of FDI in the manufacturing sector as a result of favorable incentive policies. Exports of goods comprise the lion's share with around 90 percent of total exports. The potential for additional exports was hampered by informality – which in turn had an affected in the competitiveness of the private enterprises. The main export destination has been the EU, comprising from 60-70 percent of total exports over the last years.^{Error! Bookmark not defined.}

It is worth mentioning that during these years both Serbia and Macedonia have raised the proportion of high- and medium-skill products, as well as technology-intensive ones by participating in European value chains. This helped these countries to expand the share of exports to the EU. A notable tendency over the recent years in both countries is the creation of enterprises and skilled workers that are providing communication, information, and computer services for export markets, albeit these remain at a low level.

Montenegro, unlike most of WB countries (except Kosovo), bases most of its exports on services, with over 80 percent during the past five years.²⁹ Montenegro Riviera attracts many tourists, making this sector the largest contributor of country's exports. Russia and Serbia are the two major consumers of tourism in Montenegro. The share of exports of goods, particularly non-ferrous metals (aluminum), has been shrinking over the recent years. This is mainly due to the fact that the largest aluminum production company, namely KAP, went bankrupt, as well as due to the falling prices of non-ferrous metals. This decrease was offset by the increases recorded in the service sector.²⁹

The enterprises in Montenegro incur the high costs to import, which also translates into barriers to export. Precisely, for a Montenegrin enterprise, it takes 33 hrs. and 406 USD, on average, to import its goods.²⁹ Bottlenecks in the business environment, including: resolving insolvency, enforcement of contracts, and construction permits – to name a few, constitute some factors that have prevented Montenegro to increase its export base, export of goods in particular.

Bosnia and Herzegovina and Albania are the following two WB countries as per the two export indicators. In the former, the share of exports to GDP has been around 34

percent and export-to-GDP about 1,657 USD, on average; whereas in the latter, 31 percent and 1,212.5 USD. Bosnia and Herzegovina's exports of both goods and services also benefited from the rising external demand.

In general, as per the two indicators, Bosnia and Herzegovina has experienced a positive trend of exports. Exports of goods (driven by food, wood, chemical products, and mechanical appliances) constitute the largest share, with more than 95 percent, on average. The main export destinations for export of goods are the EU (over 70 percent), and CEFTA (over 10 percent).^{Error! Bookmark not defined.} Both export of goods and services have benefited from the rising external demand and the growing participation in EU value chains.

Albania experienced some fluctuations in exports over the recent years. Low prices of crude oil and textiles, which comprise the main exports of Albania, have had an effect in reducing the export earnings. Strong services (mainly tourism), on the other hand, helped to counter balance the decrease in exports of goods. It noteworthy to mention that Albania has made some progress in fiscal consolidation and some other structural reforms, which, to some extent, facilitated exports.¹⁸ Despite all the efforts, nonetheless, a large share of Albanian enterprises, around 87 percent have still remained local.^{Error! Bookmark not defined.} As per export destinations, similar to Serbia, Macedonia, and Bosnia and Herzegovina, the EU is the main destination, followed by CEFTA countries.

Kosovo occupies the bottom place among all WB countries with respect to exports. FDI, instead of being a great source of export growth, is oriented towards the service sector, mostly real estate and financial sector; these sectors by their very nature cannot have a direct role in rising exports. The low industrial base and therefore the low share of exports of goods prevent the integration of Kosovo enterprises into

business networks and global value chains.

Kosovo exporters are confronted with barriers of different natures. A typical illustration is the fact that a Kosovo firm needs to wait 43 hours for border compliance and another 38 hours for documentary compliance. The average in other five WB countries is 7 hours and 3.8 hours. Apart from that, a Kosovo enterprise has to pay 264 USD to export, compared to an average of 72 USD in the other five WB countries. **Error! Bookmark not defined.** In addition to these, limited access to finance, outdated technology, limited access to export market information, absence of quality and management standards, constitute some other reasons that affect the competitiveness of Kosovo enterprises and as such their ability to export.

Taking the WB as a whole, it is evident that CEFTA agreement and SAA agreements (and previous trade agreements with the EU) facilitated the exports among WB and to the EU. However, there are still curtail actions to be taken to reduce the non-tariff barriers which are very present. It should be pointed out that these agreements do not cover market access for trade in services, in this way posing a barrier for service companies.

Generally, the slower global economy may complicate the efforts to increase export. On the other hand, it may also create opportunities for WB countries, because international firms that have markets, technology, and capital will be willing to relocate in order to improve their competitiveness.

Conclusion and Recommendations

This policy brief sought to examine the patterns of FDI and exports in Kosovo in particular and in the Western Balkans in general, as well as to draw recommendations for Kosovo.

Kosovo is generally characterized by relatively low FDI net inflows. Political instability, uncompetitive incentive regime, small local market size and unfavorable business climate could be some of the reasons for this (lack of) performance. Turkey, Switzerland, and Germany are the top source countries with respect to FDI over the last years. The dominance of Turkey is mainly linked with the privatization of the electricity distribution and supply and investments in the new airport terminal. The other two countries have traditionally been on top with respect to FDI given the concentration of the Kosovo diaspora. Real estate sector and financial services, on the other hand, constitute the two sectors that have absorbed most of FDI flows over the last years. However, both of them marked a decrease in 2016, which may be indicating that the market is getting saturated.

Of all WB countries, Serbia seems to be the country with the most sustainable FDI net inflows. The EU prospects, investments in SEZs, substantial labor-related incentives, financial subsidies, large domestic market, geographical proximity, streamlined procedures, are some of the factors that played a role in attracting FDI in this country. Albania, with the recent fiscal and structural reforms; and Macedonia, with a range of tax- and non-tax incentives, have marked some progress lately in this regard.

With respect to export indicators, Kosovo is lagging behind other WB countries. Border compliance issues, limited access to finance, outdated technology, limited access to export market information, absence of quality and management standards, inadequate investments of diaspora

– to name a few, may be some reasons that hinder Kosovo’s exports. Unlike most of the Western Balkans (except Montenegro), trade in services make the lion’s share of total exports. With respects to export of goods, metals account for the largest shares. Goods are mostly sold to CEFTA countries and the EU.

From the WB perspective, Macedonia, Serbia, and Montenegro have been the top exporters over the recent years. The main drivers of exports in Serbia and Macedonia have been FDI net inflows in manufacturing sector, particularly automotive industry; whereas in Montenegro investments in tourism.

In order for Kosovo to at least converge with the average of the WB countries with respect to FDI and exports, the following recommendations should be taken into consideration.

FDI-related recommendations

- Strengthening the incentive regime – The Government of Kosovo should develop a competitive incentive package for potential international investors, envisaging the provision of financial support (labor-related subsidies) to those investors who are interested in investing in sectors in which Kosovo has comparative advantage.
- Designing incentives for attracting investors in the manufacturing sector – The Government of Kosovo should design an attractive investment package for the manufacturing sector, particularly for subsidiaries of large international automotive manufacturers. This, among other things, would contribute to the improvement of the structural composition of exports towards higher added value products. Automotive

industry has been one of the key drivers of FDI net inflows in Central Europe during the transition period.

- Improving the business climate – The Government of Kosovo should intensify its efforts in creating a favorable business climate, by strengthening the rule of law (enforcement of contracts), fighting corruption and informality, streamlining tax procedures, and applying land consolidation reforms.
- Stimulating the Kosovo diaspora to invest in export-oriented sectors – The Government of Kosovo could initiate the establishment of effective businesses-related associations in the countries where most of the Kosovo diaspora is concentrated, namely Switzerland and Germany. These would, among other things, help potential diaspora investors by creating opportunities for merging and increasing the investment capital and by providing more information on the sectors with export growth potential.
- Maintaining political stability – Provided that political stability is one of the key determinants in attracting FDI, Members of Parliament should avoid destructive and anti-institutional behaviors that negatively affect the image of Kosovo in the international arena. The better the news about Kosovo in the international newspaper headlines, the greater the likelihood to at least grab the interest of foreign investors.

Export-related recommendations

- Providing more information on regional and world export markets – KIESA and other stakeholders (e.g. business associations) should help potential Kosovo exporters by providing updated information on export markets, trends, competition, and similar. The information provided would help potential exporters to

develop relevant strategies and plans for their businesses.

- Intensifying the efforts for the implementation of the SAA – The Government of Kosovo should intensify its efforts in implementing the obligations deriving from the SAA. The implementation of standards and requirements provided by the SAA would increase the country's capacity to export and in general would facilitate product exchanges. This is a key factor for attracting more FDI.
- Supporting the participation in European value chains – KIESA should facilitate the participation of exporters in European value chains through sending various groups of companies in trade fairs. The eventual collaboration with international companies would help in the creation of export channels.
- Considering the creation of clusters – The Government of Kosovo should support the establishment of clusters for competitive sectors in Kosovo by bringing together and facilitating the interaction between relevant education institutions, research centers, and export-oriented enterprises. If needed, it could support cluster-to-cluster collaboration and internalization of these clusters. These clusters would foster knowledge sharing, promote entrepreneurship, research and innovation, and exchange of good practices.
- Ensuring that trade agreements are fully implemented – The Government of Kosovo should ensure that exports to CEFTA members and other countries, with which Kosovo has trade agreements, are not prohibited by intentionally imposed non-tariff barriers. In cases of violations of such agreements, which most of the time occur in CEFTA, the Government of Kosovo should react by either undertaking reciprocity measures or by other

mechanisms that lead to immediate removal of these barriers.

- Reaching agreements for trade in services – Agreements for trade in services should be reached with CEFTA members and the EU to overcome the trading barriers of service companies.
- Promoting product certification – The Government of Kosovo should intensify the support to Kosovo firms when it comes to product certification in compliance with EU and international standards. This is a prerequisite for Kosovo firms to have access to developed international markets.
- Strengthening competition policies – The Government of Kosovo should develop policies that foster competition. Development and enforcement of competition policies would have an impact on mitigating vested interests and facilitating the opening of markets to trade. Greater fair competition helps potential exporters to increase their productivity, efficiency, and innovation and their ability to export as a result.

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The Democracy for Development (D4D) Institute was established in April 2010 by a group of analysts who were increasingly worried that the state-building exercise had neglected democracy. D4D's mission is to influence the development of public policy in order to accelerate socio-economic development, improve governance, and strengthen democratic culture in Kosovo.

D4D's vision is to promote an active and educated citizenry that both fully participates in the public space and utilises the public arena of representation and decision-making to deliberate and build consensus over smart, efficient, and sustainable resource allocation as well as equitable development.

For more information about D4D's activities please visit our website: www.d4d-ks.org.

