

**ROCHESTER INSTITUTE OF TECHNOLOGY  
IN PARTNERSHIP WITH  
AMERICAN UNIVERSITY IN KOSOVO**

**MASTER OF SCIENCE DEGREE IN  
PROFESSIONAL STUDIES  
PUBLIC ADMINISTRATION PROGRAM**

**CAPSTONE PROJECT:**

**INVESTMENT, ECONOMIC GROWTH AND  
KOSOVO'S JUDICIAL SECTOR**

**KUSHTRIM BAJRAMI**



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My deepest gratitude is for my family for their understanding and support. I would like to dedicate this achievement to the memory of my mother, Shefkete Bajrami (1959-2007), who is a constant source of inspiration.

## **LIST OF ABBREVIATIONS**

ADR - Alternative dispute resolution

CBK - Central Bank of Kosovo

CEECs countries – Central and Eastern European Countries

FDI – Foreign Direct Investments

GDP – Gross Domestic Product

IPAK – Investment Promotion Agency of Kosovo

KJC - Kosovo Judicial Council

KPC - Kosovo Prosecutorial Council

OECD – Organization for Economic Cooperation and Development

OSC - One Stop Centre

PTK - Post and Telecommunication of Kosovo

POE's - Publicly Owned Enterprises

SEE countries – South Eastern European Countries

UNCTAD – The United Nations Conference on Trade and  
Development

VAT – Value added tax

## **EXECUTIVE SUMMARY**

The inflow of FDI is vital for supporting successful transition of Kosovo's economy. The FDI will enhance the economic development, improve trade balance, reduce unemployment and support the development of the private sector. These represent the basis for a sustainable economic development of Kosovo.

Although local courts recognize foreign arbitral awards, enforcement is often weak and disputes can take a lengthy time to resolve. While the basic legislation of a market-oriented economy is in place, determining property ownership remains a significant challenge. These legal uncertainties, in addition to poor implementation of laws and contract enforcement, and an underdeveloped judiciary, hinder foreign investment and economic growth.

A huge number of administrative and bureaucratic barriers remain as a serious challenge for Kosovo's business investment environment. There is a lack of fully functional authority that could serve as a one single point authority for foreign investors. This would provide information and assistance in the process of investment.

This capstone project explored the determinants, motives and barriers (advantages and disadvantages) for foreign investment in Kosovo. Special reference was given in assessing the judiciary system in Kosovo as an important determinant for FDI attraction.

A survey was conducted with foreign companies operating in Kosovo in order to get their perception about what issues they considered as key determinants and barriers to investing in Kosovo. Interviews were also conducted with the judiciary stakeholders to get their inputs on the impact of the judiciary efficiency on Kosovo.

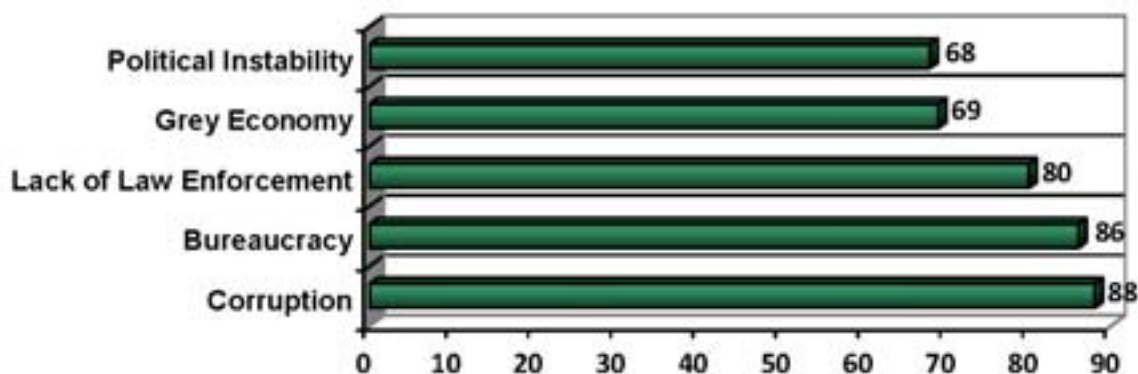


Figure 1. The top five FDI barriers according to the 50 companies interviewed

According to the survey results there are five big barriers that hinder FDI in Kosovo: (1) corruption, (2) state bureaucracy, (3) lack of law and contract enforcement, (4) competition from the grey economy and (5) political stability. Legal uncertainties, in addition to weak law implementation, poor contract enforcement, and underdeveloped judicial capacity to efficiently and effectively resolve complex litigation hinder economic growth and investment.

The process of legal reform requires substantial reforms in terms of improving the legal infrastructure that would impact the business investment climate and attract FDI. Therefore, this capstone project offers some specific recommendations for government institutions on how to improve the investment climate in Kosovo and attract the foreign direct investments such as:



1. Reform of Judiciary processes / courts - The establishment of a Fast Tracking Mechanism for dealing with the disputes of investors. This mechanism will improve the independent judicial system by giving priority to business contacts with foreign investors.
2. Establishment of Information Hub for Investors that will guide to investing in Kosovo and will serve as a single point of contact for guidance on laws, policies, incentives, investment climate and trends, investment opportunities, costs of setting up a business, process for finding land and sector specific information.
3. Establishment of One Stop Center (OSC) for starting a business, to register business in two easy steps and receive certificate in 24 hours at the Kosovo One Stop Center. This center will avoid the bureaucratic procedures and assist foreign investors by avoidance of administrative and informal barriers and improvement of the administrative environment that would reflect on the reduction of business purchase cost.

## CHAPTER 1

### GLOBAL ECONOMY AND THE JUDICIAL SECTOR

#### 1.1. Global investment trends

Over the past 20 years, the flow of FDI has increased dramatically in the Central and Eastern European countries. The inflow of FDI is considered to have an important role in speeding economic growth, enhancing economic development, positively effecting employment, productivity and balance of payments, especially in transition economies such as is Kosovo.

FDI inflows increased across all major economic groupings in 2011. Despite turmoil in the global economy, global FDI inflows rose by 17 per cent in 2011, to US\$1.5 trillion, surpassing their pre-crisis average, based on UNCTAD estimates.<sup>1</sup>

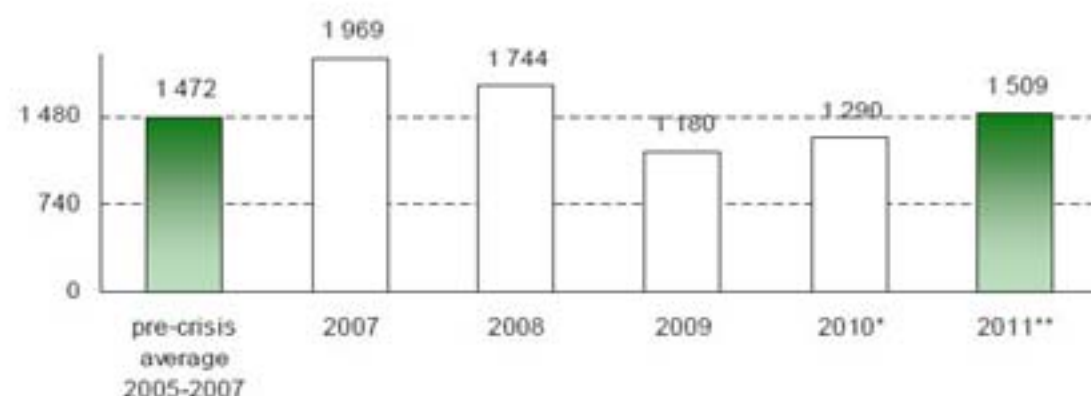


Figure 1.1 Global FDI flows, average 2005–2007 and 2007–2011 (Billions of dollars), Source: UNCTAD.

<sup>1</sup> UNCTAD, World Investment Report 2012. Towards a new generation of investment policies.

In 2011, FDI flows rose in all three sectors of production (primary, manufacturing and services), and the rise was widespread across all major economic activities.<sup>2</sup>

The impact of the crisis in developing countries was reflected also in the Southeast European economies.<sup>3</sup> After a decade of constant growth, the economic performance of countries in the region was impacted negatively from the economic crises that started to appear at the end of year 2008 and beginning of 2009. In 2009, the majority of these countries had a decline in GDP that resulted with an average decline of 2.6 % in the entire region. Excluded are Kosovo and Albania that showed a positive increase on GDP growth rate (3.8% and 2.5 % accordingly), but these percentages of growth are less than previous years percentages (Figure 1.2).

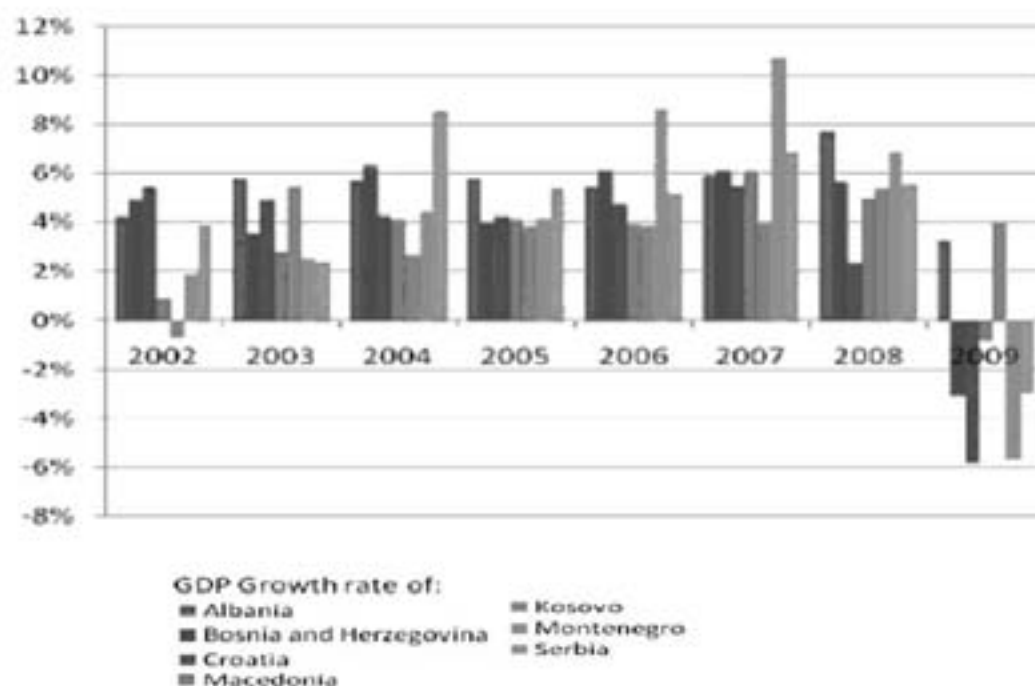


Figure 1.2 GDP growth rate in some of the SEE countries, 2002-2009.  
Source: International Monetary Fund<sup>4</sup>

<sup>2</sup> UNCTAD, World Investment Report 2012. Towards a new generation of investment policies.

<sup>3</sup> Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia, Montenegro and Serbia.

<sup>4</sup> International Monetary Fund, World Economic Outlook Database, October 2010

## **1.2. Trends on judicial sector**

All countries need a judicial system that is effective, independent, upholds the law, protects the rights of all of its citizens, and prosecutes powerful and ordinary individuals equally. A judicial system with these characteristics contributes to economic development, stability, and human rights by providing options to protect commercial interests, enforce obligations, and settle disputes.

Most developing countries have liberalized their economies over the last decades and amended the relevant foreign investment laws with the objective of improving the legal and regulatory environment that governs FDI. However, many of the sound policies and legal reforms "on paper" fail to translate into practical improvements "on the ground" and the inflows of FDI remain low or decreasing in a large number of countries.

The nature of FDI is changing, and the role of commercial law reform is now a more significant factor for FDI than before in many developing and emerging country markets. Many FDI arrangements are evolving from bilateral (whether private, government, or international organization) investment to multitiered market arrangements involving international credit markets, venture capital, private equity and hedge funds, and a variety of securitization mechanisms.

In this context, alternative methods for resolving disputes are becoming an increasingly popular substitute for litigation.

Traditionally, alternative dispute resolution (ADR) has been used in labor negotiations and other contract disputes. However the use of ADR has recently expanded to such areas of the law as commercial disputes.

Trials are costly and time consuming, thus, it has become important for the disputing parties to explore, understand and utilize alternative methods to resolve their disputes. In this concern the use of ADR to resolve disputes outside the legal system has been growing in significance and popularity.

ADR includes dispute resolution processes and techniques that act as a means for disagreeing parties to come to an agreement short of litigation. It is a collective term for the ways that parties can settle disputes, with (or without) the help of a third party. Despite historic resistance to ADR by many popular parties and their advocates, ADR has gained widespread acceptance among both the general public and the legal profession in recent years. In fact, some courts now require some parties to resort to ADR of some type, usually mediation, before permitting the parties' cases to be tried.

There are advantages and disadvantages, to using ADR. Advantages include the fact that it usually takes far less time to reach a final resolution than if the matter were to go to trial. Usually (but not always), it costs significantly less money, as well. Furthermore, in the case of arbitration the parties have far more flexibility in choosing what rules will be applied to their dispute.

The parties can also have their dispute arbitrated or mediated by a person who is an expert in the relevant field.

There are disadvantages, as well. Generally, arbitrators can only resolve disputes that involve money. They cannot issue orders requiring one party to do something, or refrain from doing something. They cannot change title to property, either. Also, there is very limited opportunity for judicial review of an arbitrator's decision. While a large arbitration service could, if it so chose, have some kind of process for internal appeals, the decision is usually final and binding, and can only be reviewed by a court in limited cases.

As in most societies in transition and those grappling with the after-effects of conflict, the judiciary system in Kosovo has been under tremendous pressure. It faces a host of complex and serious challenges including ineffective courts, enormous backlogs, complex property disputes, a legacy of strong executive influence, allegations of corruption and nepotism, poor infrastructure, to name only the most prominent challenges. Foreign investors first take into consideration the impact of such factors and then make a final decision.

Modern and democratic society increasingly emphasizes the systematic malfunction where corruption is involved. The regulatory environment that investors face can be too bureaucratized. According to foreign investors, an obstacle to investing in Kosovo is not the very regulation of enterprise registration that is in accordance with European practice, but



"slow, complicated and inflexible public administration which acts according to discretionary and not professional principles".

Some procedures are unnecessarily complicated and difficult. Commercial courts have too many cases, which prolong the process of registration. Officials ask for bribes in order to accelerate some procedures. This is typical of procedures for issuing building permits. The length of court cases is considered one of the key problems in the process of realizing rule of law. Its existence is a signal to potential investors that solving a legal dispute in their business cooperation will take quite some time, i.e. they would not get legal protection in due time.

Although local courts recognize foreign arbitral awards, enforcement is often weak and disputes can take long time to resolve. While the basic legislation of a market-oriented economy is in place, determining property ownership remains a significant challenge. These legal uncertainties, in addition to poor implementation of laws and contract enforcement, and an underdeveloped judiciary capacity to efficiently and effectively resolve complex litigation hinder economic growth and foreign investment.

## CHAPTER 2

### OVERVIEW OF THE KOSOVO'S JUDICIAL SECTOR

The Constitution of the Republic of Kosovo adopted in 2008 proclaims Kosovo as a representative, democratic parliamentary republic. Governance is based on the principles of separation of powers and checks and balances.<sup>5</sup> The following comments refer to both consideration of the law and the objectives of reform.

The executive power is exercised by the Government of Kosovo with the President as the head of state. One of the powers of the President is to appoint and dismiss all judges, including the President of the Supreme Court, upon the recommendation of the Kosovo Judicial Council. Upon the recommendation of the Kosovo Prosecutorial Council, the President also appoints and dismisses prosecutors.

The Kosovo Assembly exercises the legislative power and is comprised of 120 members. Of the 120 seats, 20 are reserved for representatives of ethnic minorities, including 10 seats reserved for Kosovo's ethnic Serbs. Among other functions, the Assembly is empowered to pass laws; amend the Constitution; ratify international treaties; elect and dismiss the President of Kosovo; elect members of the Kosovo Judicial Council and the Kosovo Prosecutorial Council; and nominates Constitutional Court judges.

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<sup>5</sup> Constitution of the Republic of Kosovo, art. 4(1) (adopted Apr. 9, 2008, effective Jun. 15, 2008)





Figure 2.1 Three branches of power in Kosovo

Judiciary is the third branch of the government and must be independent and impartial from other branches of the government. The current court structure is comprised of several levels of courts: minor offenses courts, municipal courts, district courts, a commercial court, the Supreme Court. The Constitutional Court that was created in 2008 and began operating in 2009, is a separate court that deals only with constitutional matters.

The Kosovo Judicial Council (KJC) performs judicial administrative functions to ensure independence and impartiality of the judiciary, while the Kosovo Prosecutorial Council (KPC) serves as the governing body and ensures the prosecutors independence and well-functioning.

The laws applicable in Kosovo are laws approved by the Kosovo Assembly, certain United Nations Mission Interim regulations that the Kosovo government continues to recognize subject to changes

and amendments by the Assembly of Kosovo, and laws that were in force in Kosovo on March 22, 1989. This was the last day on which Kosovo held autonomous status within the SFRY. These laws may be applied only if they address a situation not covered by a prior law and are nondiscriminatory.

The current structure of courts will undergo an entire change as per the new Law on Courts taking effect on January 1, 2013. The new structure will be comprised of three tiers of courts: basic courts, the Court of Appeal, and the Supreme Court. The basic courts will serve as first instance courts for all matters, including cases previously heard by the minor offenses courts and the first instance crimes previously within the jurisdiction of the district courts. The Court of Appeals, will serve as the second instance and will hear all appeals of basic court decisions, and decide jurisdictional conflicts between basic courts. The Supreme Court will be the final judicial authority in Kosovo, with appellate jurisdiction over Court of Appeals decisions, as well as cases that present important and unique issues of the law.

The Constitutional Court of Kosovo is the final authority for the interpretation of the Constitution and the compliance of laws with the Constitution. The Court is not part of the regular court structure set by the Law on Courts.

## **2.1. The law on foreign investment**

In 2006 Kosovo adopted a Law on Foreign Investment that gave foreign investors an equal treatment to local investors and protect them from expropriation, nationalization and retroactive application

of laws. The main objective of this law was to guarantee investment security and assure domestic and international investors the protections offered against any changes in the legal framework taking place after their investment was made.

The principal purpose of the law is to promote and encourage foreign investment in Kosovo by providing foreign investors with a set of fundamental and enforceable legal rights and guarantees that will ensure foreign investors that they and their investments will be protected and treated with fairness and respect in strict accordance with the rule of law and widely accepted international standards and practice.

By promoting and encouraging foreign investment in Kosovo, the present law aims to advance the overall economic development of Kosovo, especially the development of a robust, diversified and competitive private sector. In this way the present law aims to:

- Ensure Kosovo's full integration into the regional, European and world economies by encouraging the transfer of capital, modern technology, know-how, financial and intellectual services, management skills and information to Kosovo.
- Improve and diversify Kosovo's ability to obtain and provide goods, services and capital from and to outside markets; and
- Increase the predictability, stability and transparency of Kosovo's legal framework and its consistency with both European and international standards.

The Foreign Investment Law defines "foreign investment organization" any Kosovo business organization or other type of organization lawfully established in Kosovo if:

- at least twenty-five percent (25%) of its capital has been contributed, directly or indirectly, by a foreign investor; or it is controlled by one or more foreign investors on the basis of (a) a written contract, (b) rights to exercise a majority of the organization's voting shares or similar ownership rights, or (c) rights to appoint the majority of its board of directors or other principal supervisory organ.

## **2.2. Judiciary efficiency as a determinant of investment climate**

A competent, independent and impartial judiciary is absolutely fundamental to the rule of law in Kosovo. Economic stability, security, etc in Kosovo depend upon the proper administration of justice which in turn depends on the ability of the judiciary to render its decisions unaffected by improper influence.

The judicial system remains weak and inefficient. In a 2012 report from Freedom House the judicial framework and independence was ranked 5.75 (scale: 1=best/7=worst). Court decisions are generally perceived as based on outside interferences rather than the facts and law. The outside influences include threats and pressures from different groups of interest, other branches of the government, family, and friendship ties. Attempts to fight corruption, such as formation of the Anti-Corruption Agency, have proved ineffective in combating corruption in courts. A

newly established National Council against Corruption, led by the President of Kosovo, is expected to create a swift and regular inter-institutional collaboration, coordinate various tasks, and deliver periodic updates on the results of the fight against corruption. However, the council is a new body with no executive power, and therefore, its work results are yet to be seen in the future.

The duration of judicial proceedings and the poor management of cases have been presented as core problems and have an impact in the permanent burden of backlog cases with courts. An antiquated, manual case management mechanism should be replaced with the development of an electronic case information system that would maintain trial records, file submissions, track distribution, stages of procedures and record of final decisions. This improvement would have a considerable effect in reducing case processing delays, impacting the non-discriminatory review of cases and serving the transparency of courts and judges. Coordination and communication mechanisms among different instances and development of modern information systems between courts and parties should be enhanced and implemented within the provision of the procedural law.

Arbitral awards made by an arbitral tribunal inside and outside of Kosovo are recognized and declared enforceable by the Kosovo courts under the Law on Arbitration (law no. 02/L-75, promulgated by UNMIK Regulation no. 2008/30). This law establishes a set of rules that apply to arbitration agreements, arbitration proceedings, jurisdiction of arbitral tribunals and the recognition and

enforcement of arbitral awards. Arbitration is also expressly recognized under the Law on Foreign Investment.

The World Bank's "Doing Business 2011" report ranks Kosovo in the category of "ease of starting a business", at 168 out of total of 183 economies. Kosovo ranks very poorly when compared to neighboring countries (World Bank, 2011).

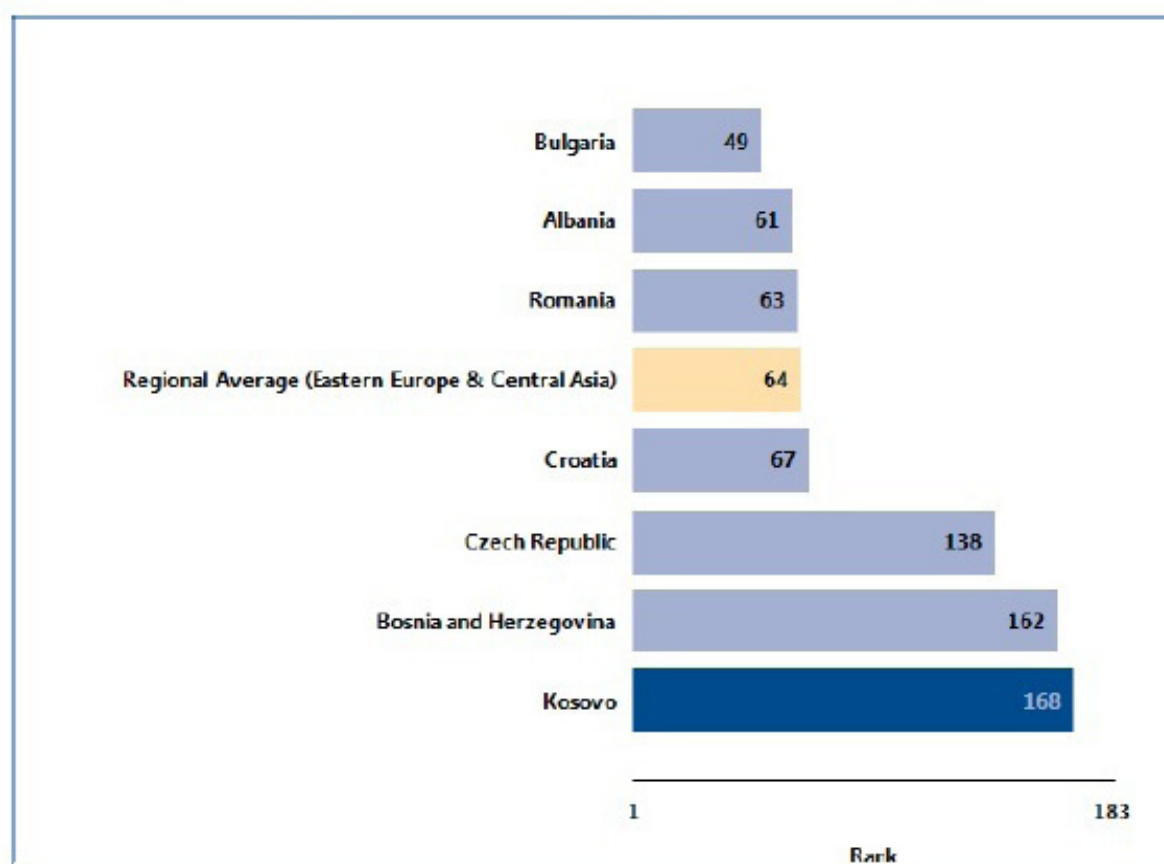


Figure 2.2 Kosovo – Ease of starting a business.  
Source: Doing Business database



Globally, Kosovo stands at 73 in the ranking of 183 economies on the ease of registering property.

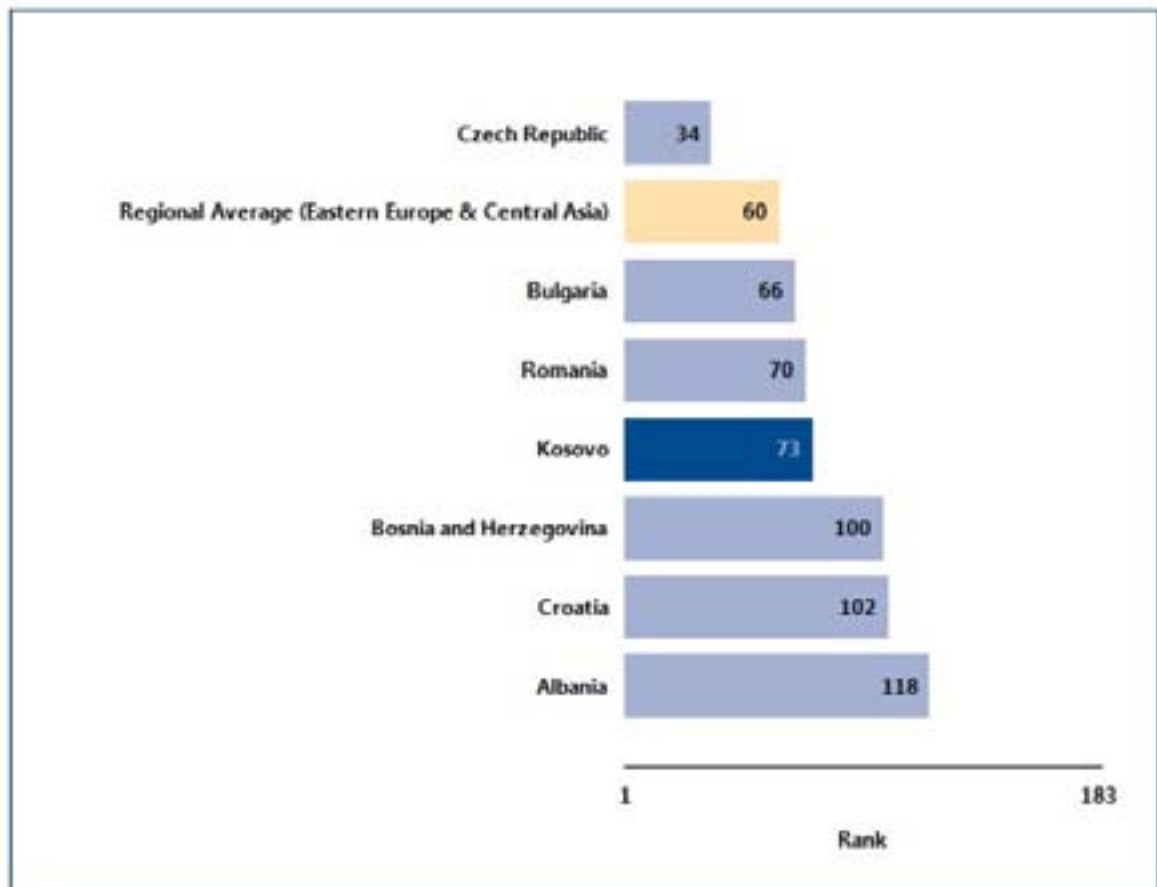


Figure 2.3 Kosovo – Ease of registering property.  
Source: Doing Business database

Globally, Kosovo stands at 46 in the ranking of 183 economies on the ease of paying taxes.

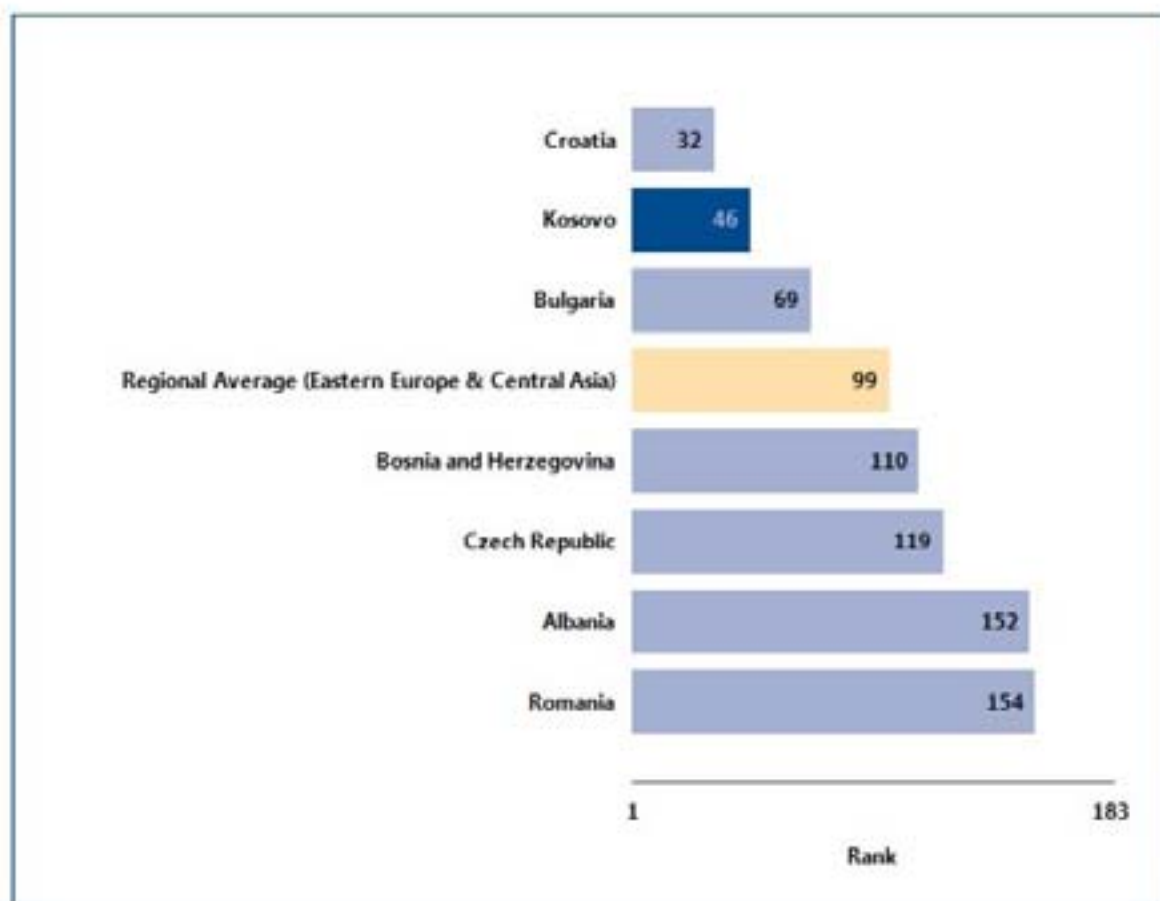


Figure 2.4 Kosovo – Ease of paying taxes. Source: Doing Business database



Economies with the strongest protections of investors have well-functioning courts and up-to-date procedural rules that give investors the means to prove their case and obtain a judgment within a reasonable time. Globally, Kosovo stands at 174 in the ranking of 183 economies on the strength of investor protection index.

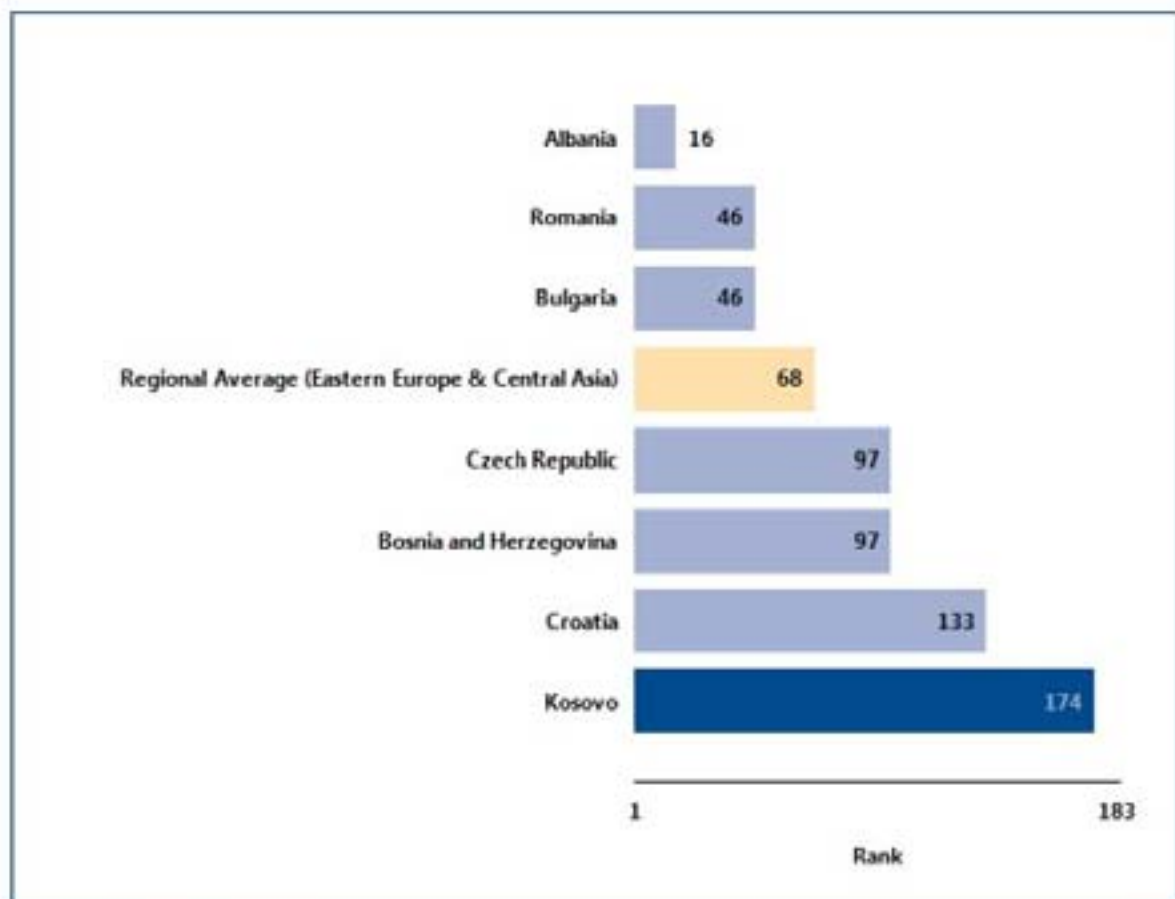


Figure 2.5 Kosovo ranking on the strength of investor protection index.  
Source: Doing Business database.

According to the World Bank Doing Business Report that measured the efficiency of the judicial system in resolving a commercial dispute before local courts, Kosovo stands at 157 in the ranking of 183 economies on the ease of enforcing contracts.

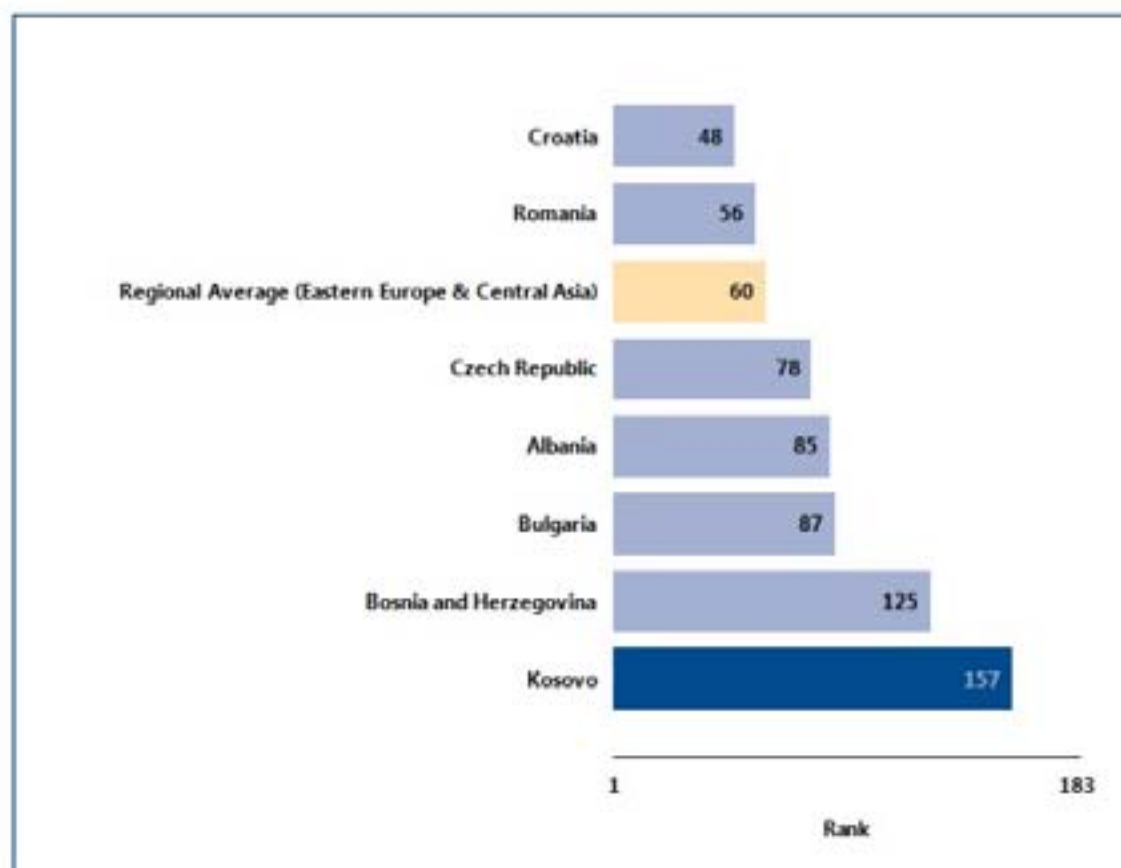


Figure 2.6 Kosovo ranking on the ease of enforcing contracts index  
Source: Doing Business database.

The current commercial legal framework is compatible with international standards and best practices. However, there are laws in force that regulate the same issue in different ways such as the 31st paragraph of the law on contested procedure (concerning an arbitration award can be appealed; in conflict with the law on arbitration providing that an arbitral award cannot be appealed). Foreign investment shies away from an environment of uncertainty. This example reveals poor drafting skills and lack of

analysis of the laws before drafting new legislation dealing with the same matter. Moreover, there is a lack of experts in contract law, Alternative Dispute Resolution, trade law, IP law, financial and investment law, property law, financial crime, good governance and rule of law.

Current estimates indicate that the backlog of cases in Kosovo's court system continues to expand. The scale of the backlog suggests that adjudication and enforcement of every outstanding case via the formal judiciary is unlikely to be accomplished in the short-term. Alternative dispute resolution represents a possible means of transferring many less-sensitive cases from the courts to informal but regulated mediation or arbitration.

### **2.3. Overview of Investing in Kosovo**

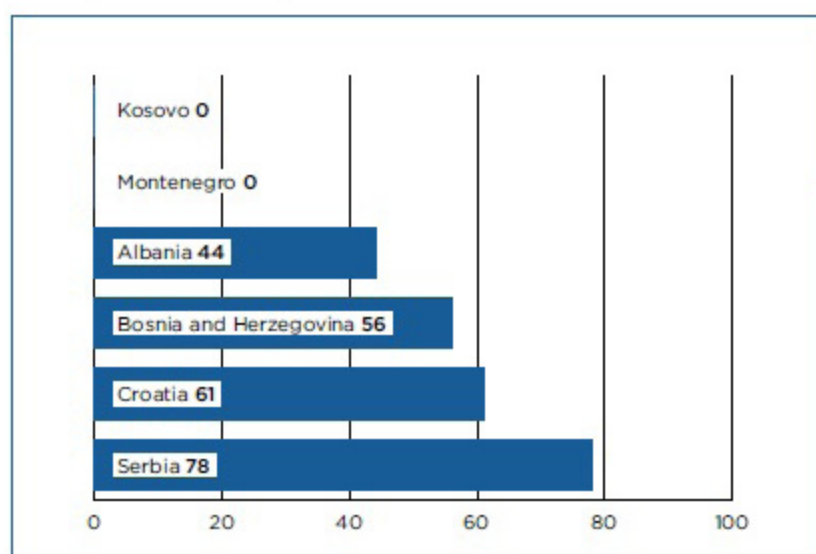
#### **Youngest population in Europe**

Kosovo's population average age is 25 years, which is the youngest population in Europe. Albanian and Serbian are the official languages, while English and German are widely used. With two public and numerous private universities (over 40,000 students), a high knowledge and cosmopolitan society is emerging from the young and dynamic population. Many Kosovo's who have lived and studied abroad are acting as a bridge to Western cultures and guarantee business success for foreign operations in Kosovo.

## High availability of skilled and cost effective labor

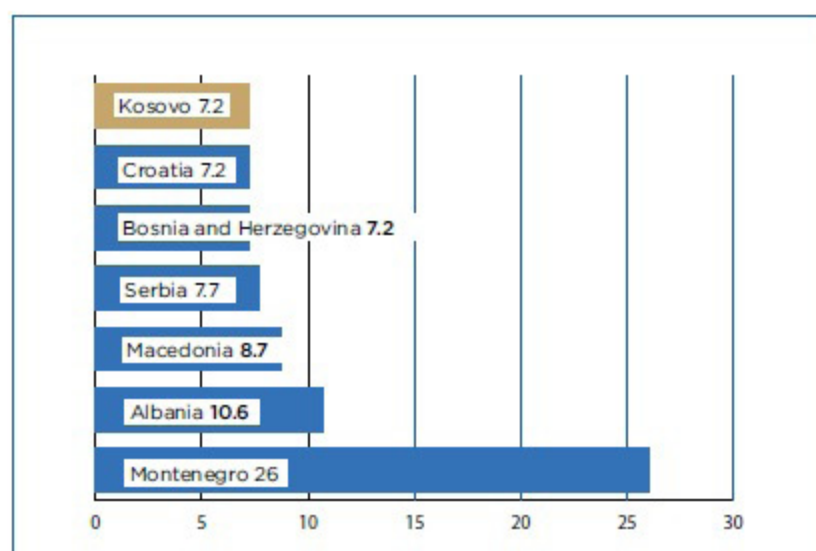
Kosovo's strong work ethic, excellent industrial relations record and abundant labor supply combined with low costs makes for a productive and highly cost effective workforce. While Kosovo is blessed with a young and motivated workforce imbued with a strong entrepreneurial spirit, due to a severe shortage of job opportunities, the country suffers from a persistently high unemployment rate. Although the majority of the labor market supply consists of basic semi-skilled labor, there is also an excess supply of highly educated labor.

The average monthly cost of labor in Kosovo is slightly over 330 Euro. Wages in Kosovo are unburdened by costly social contributions, unlike those in the countries of the region. With ca. 300,000 existing jobseekers and ca. 20,000 (8,000 graduates) new jobseekers entering the labor market every year, a sufficient stream of labor of all profiles is guaranteed. Any foreigner who has visited Kosovo will confirm the exceptional dynamic and entrepreneurial spirit of the Kosovo's.



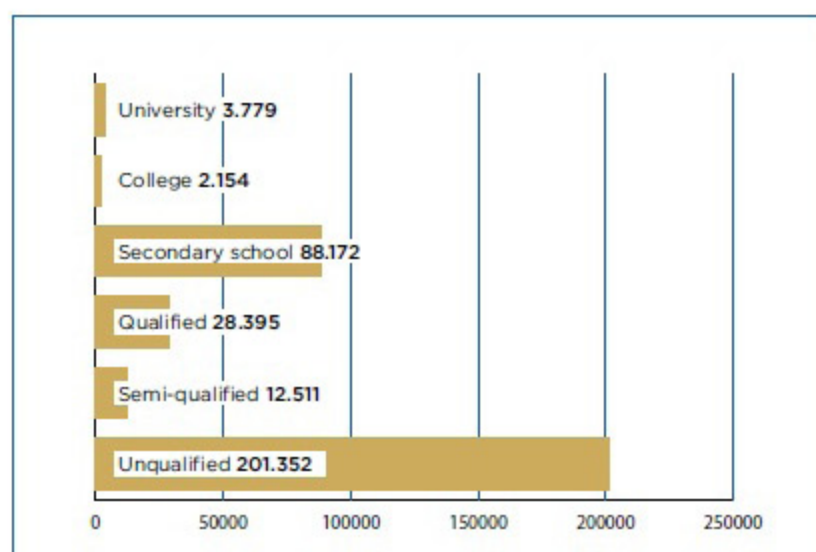
Graph 16: Difficulty of hiring index (0-100)

Source: IPAK (Investor Guide 2011)



**Graph 17:** Redundancy costs (week salary)

Source: IPAK (Investor Guide 2011)



**Graph 18:** Registered jobseekers (2011)

Source: IPAK (Investor Guide 2011)

## **EURO as the official currency**

Kosovo runs a very stable monetary policy. Kosovo is one of the few countries outside the EU-zone that has adopted the Euro as its official currency on 1 January 2002, thereby eliminating currency and exchange rate risks. The Euro gives Kosovo a considerable advantage over its competitors in the region by making it more

attractive to foreign investment and by ensuring financial and macroeconomic stability. With the use of this stable currency as an official mean of payment, the prerequisites for the development of an efficient financial sector and stable macroeconomic environment were in place. Benefits arising from the introduction of the Euro in Kosovo have been obvious and resulted in low inflation rates and strict financial discipline. In particular, the Euro has given Kosovo a considerable advantage over its competitors in the region by making it more attractive to foreign investment, due to low transaction costs as well as the elimination of exchange rate and currency risk.

Country	Average monthly labour cost (euro)
Kosovo	330
Macedonia	490
Serbia	566
Croatia	1055
Bosnia and Herzegovina	480

**Table 3:** Overview of the monthly labour cost in the region - 2010

Source: IPAk (Investor Guide 2011)

### **Free access to markets of EU, US and CEFTA**

Kosovo has a liberal trade regime and derives three major benefits from trade liberalization, namely improved export possibilities, a better investment environment, and stable relations with its neighbors. Exporters enjoy free access to a market of over 500 million consumers. Committed to establishing principles for the stable development of a pure market economy, since a very early stage of development, Kosovo's government has been working towards establishing a system for the free movement of goods and



services throughout the country's borders. As a result, Kosovo is a member of CEFTA enabling its businesses and producers of goods to access the regional market comprising of 30 million consumers, free of any customs duties. Kosovo benefits from non-reciprocal, customs free access to the EU market based on the EU Autonomous Trade Preference (ATP) Regime. Kosovo goods also enjoy preferential treatment in the US market. This allows all investors to export to EU and US without any customs tariff.

Kosovo is still an import-based economy. Imports have been increasing steadily in recent years (as the figure shows) reaching some 2.14 billion Euro at the end of 2010. The main importing countries in Kosovo are EU-countries followed by CEFTA-members. Even though local production is increasing steadily, Kosovo is still forced to import goods and raw materials that are not offered by the local market. The main imports of commodity goods range therefore from transport means, chemical products and base metals to machinery and mineral products.

Recognizing the opportunities that the local market is offering, and benefiting from various cross-sector incentives introduced by the Government, local production has grown exponentially in recent years. Not only does local demand continuously rely on local production but Kosovo is increasing its exports to its main trade partners, EU-countries and CEFTA-members. At the end of 2010, exports reached 294 million, an increase of 81 percent in comparison to 2009. The main exports of Kosovo comprise mainly base metals and mineral products, as well as vegetables and prepared foodstuff.

Given that the country has a very favorable business climate, a modern legal framework and a cost effective work force, and taking into consideration that there is still immense opportunity for local producers to fulfill market demand and also approach the regional market, local production as well as exports are expected to increase further in the future.

However, trade liberalization did not increase competitiveness in the market, thus leaving Kosovo with an enormous trade deficit (EUR 1.85 billion) (CBK, 2010). The CEFTA agreement was not fully implemented due to trade blockages imposed by Serbia and Bosnia and Herzegovina for Kosovo products. Such disputes hamper economic progress and continue to be a major challenge for the development of the Kosovo economy.

### **Low taxes**

Kosovo has a simple and straightforward tax system. International Accounting Standards apply. The tax burden is very low and attractive. The Kosovo tax system is a young system. The first state duties were introduced in 1999 by the implementation of a customs regulation. Since 2000, further taxes have been implemented continuously, e.g. municipal taxes. However, until now there has been no integrated fiscal code governing all tax aspects, but rather several regulations issued to cover the main taxes applicable in Kosovo. Recently the government of Kosovo has approved a package of tax cuts which are valid starting from 1 January 2009. Corporate income tax was reduced to a flat-rate of 10%, VAT was increased to 16%.



The regulations aim to strengthen the development of the economy and be generally consistent with European Standards.

The most important taxes are

- Personal Income Tax 0-10 max %
- VAT 16 %, which is the lowest in the region.
- Corporate Income Tax 10 %
- Mandatory contributions for employees only 5 % of gross salaries

### **Stabilizing political environment**

Kosovo's independence marks the end to a long period of economic and political uncertainty. In addition to increased stability being created in the entire region, it presents a perspective of regional economic development and EU integration. So far, Kosovo has been recognized by the most powerful nations worldwide and has become a member of international institutions such as the International Monetary Fund and the World Bank. The international presence in Kosovo is strengthening the stabilization process and the rule of law and is bringing legal security to foreign investments.

### **EU-compatible legislation**

Since 1999, Kosovo's legal system has been re-built and is now completely compatible with the EU legislation. Foreign investors enjoy national treatment, protection against expropriation and nationalization. The repatriation of profits and transfer of invested capital is free and unrestricted. All laws and regulation in Kosovo are available online and in English, making Kosovo's legislation system the most transparent in the region.

### **Strategic location and developing infrastructure**

Strategic geographic position, located in the heart of the Balkans, connected through highways with the major's sea ports, railways connections. Kosovo's capital Prishtina is one hour driving time to any neighboring country. Ongoing infrastructure projects include modern highway connections to Albania, Serbia, and Macedonia. The driving time to the Albanian Sea Port of Durrës is three hours, and Thessaloniki Sea Port four hours. In addition, the recently concessioned - Prishtina International Airport offers daily air connections to many major European cities. The international airport in the capital Prishtina caters for over 1 million passengers per year and is ranked as one of the most frequented airports in the region.

### **Sound banking system**

Kosovo's financial sector has been built on completely new foundations. All financial institutions in Kosovo are private and have remained stable despite the financial crisis. The absence of traditional monetary policy instruments also enabled the establishment of a very strict and efficient regulatory framework, upon which a sound banking system has been developed. Achievements in the banking sector in Kosovo have been significant in the last five years. They have resulted in the improvement of public confidence in the banking sector.

With banking sector assets accounting for 55 percent of GDP at the end of 2010, Kosovo ranks well with the countries of the region. Loans granted by the banking sector of Kosovo for the same period accounted for 33 percent of GDP. In addition, the lowering of interest rates and the shift from short-term to long-term

financing in the banking sector of Kosovo has had a very positive impact on overall economic growth enabling intensive long term capital investments.

## **CHAPTER 3**

### **RESEARCH METHODOLOGY AND SURVEY RESULTS**

#### **3.1. Research Methodology**

This research has followed mainly quantitative method and more concretely the tools such as questionnaire survey to collect the information from companies, interviews with judiciary stakeholders, field search, publication and literature review. A limitation has been the lack of an updated business registration database with elaborated data. There were a lot of cases when previous investors were not anymore active in Kosovo but they still appear in the registers. Research has been based on questionnaires that have been designed and structured in four parts including open and closed options. The questionnaire survey used the online survey monkey.

The questionnaires were distributed accordingly to 78 companies and 50 were responsive. In almost all cases the questionnaire was answered by the manager or chief executive officer (CEO). The notification about the research and the distribution of surveys was done by emails. The survey was conducted for two months, and during that period every company that participated in the survey has been contacted based on time-table plan. Further secondary research has been conducted throw data that has been gathered and analyzed throw other reliable source publications, such as government publications and throw field research.

### **3.2. Survey Results on Determinants of Kosovo Investment Climate**

The survey findings resulted from 50 foreign companies responses. The most representative industries in this sample were manufacturing, financial services, real estate, financial services, construction, trade and food, and beverages sectors.

FDI in Kosovo are mostly concentrated in the economical sectors such as construction with 36 percent, manufacturing with 12 percent, the financial sector with 12 percent, 16 percent real estate, followed by transport and telecommunications sector with a share of 20 percent of total FDI. There has been a decline in the Processing industry over the period, while the highest increase is seen in the construction sector and the transport sector and telecommunications.

### **3.3. Main motives of foreign investors**

In respect to the motives for foreign investment in Kosovo the research has identified that some of the main motives are low cost unskilled labour force, access to the regional market, especially companies with origin from European Union countries rated this factor quite high, other factors were, benefits from economy of scale, expected economic growth.

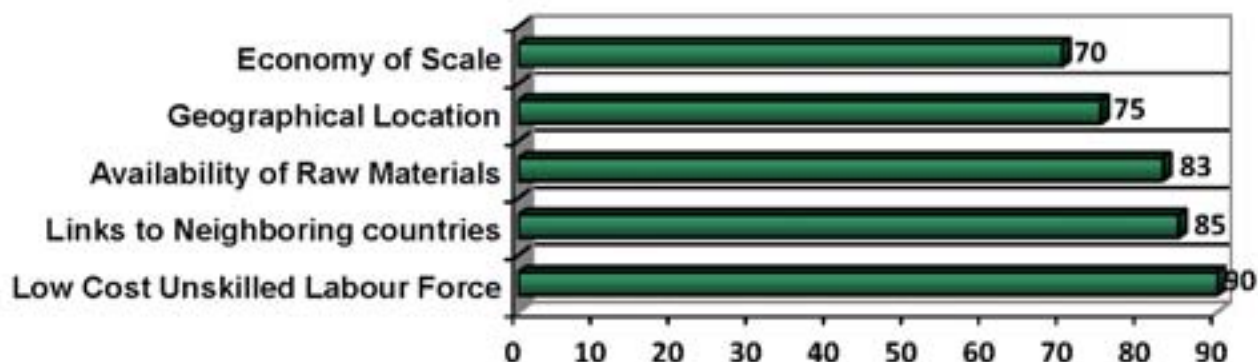


Figure 3.1. The top five FDI motives according to the 50 companies interviewed

The questionnaire results revealed that low – cost unskilled labour force was perceived as the main motive for investment in Kosovo. Second, largest incentives were links to neighboring countries, especially for metal producers, this finding can be explained by the prior relations of countries in the region especially ex-Yugoslavia countries with Kosovo. Availability of raw material was ranked high by metal producers (100%). According to IPAK (Investment promotion agency of Kosovo) Kosovo is rich with natural resources and it possesses one of the fifth world's largest reserves of lignite. Geographic location (proximity) is most important for the food and beverages industry. This high ranking can be explained by their main aim to export in the regional countries.

The main motives were found to be low cost unskilled labour force, links to neighboring countries, geographical location, economy of scale/scope, market size, expectation for economic growth etc.



### 3.4. Main barriers perceived by foreign investors

The research has identified that there are many institutional or administrative barriers that discourages foreign investors to engage on investment activity in Kosovo.

According to the survey the most significant barriers are: bureaucracy and corruption, lack of tax incentives, competition from grey economy, lack of law enforcement etc., while less sensitive barriers were considered: limited financial incentives, economic instability, lack of business infrastructure etc.

According to the questionnaire results corruption and bureaucracy were marked as the most significant barriers for foreign direct investment.

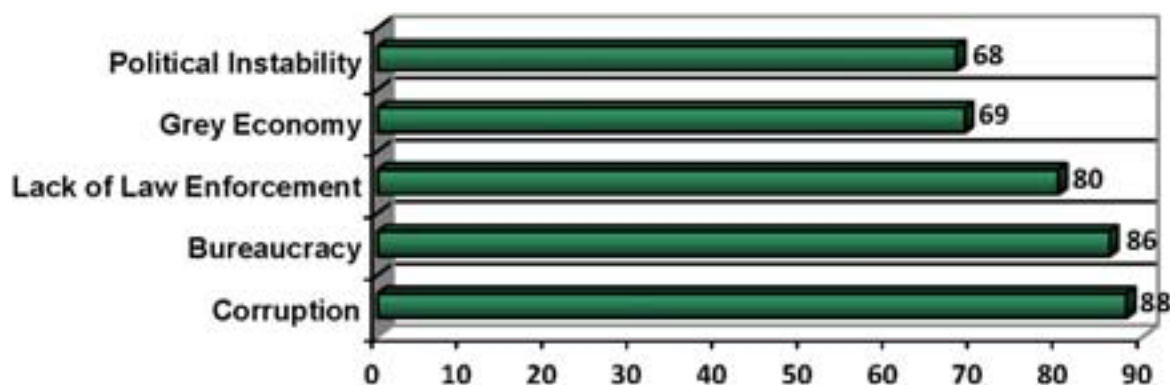


Figure 3.2. The top five FDI barriers according to the 50 companies interviewed

Another larger barrier was ranked lack of law enforcement, which was expected to be so due to the long process of transition that required establishing new legal framework right after the war in 1999 till now. In the progress report by European Commission (2011) it is stated that the legislative strategy is partially implemented, therefore, it leaves space for misuse.

Competition from the grey economy was also ranked high as a barrier. This finding was expected knowing the fact that there is lack of total control along the border of Kosovo with Serbia, in the northern part of Kosovo due to political circumstances that enables functionality of grey economy. Political instability is considered as a high significant barrier. This can be addressed again to the political problems with Serbia that does not recognize Kosovo status and does not fully allow Kosovo's products to be exported through their territory.

### **3.5. Case Study of the Privatization of the Hotel Grand**

Recently, allegations have started regarding the privatization of the Grand Hotel. This time, involved in the charges are high levels of the government of the Republic of Kosovo. First Deputy Prime Minister of the Republic of Kosovo responsible for promotion of FDI in Kosovo, who is also a powerful businessman in Kosovo and beneficiary of several privatization cases, in his testimony given to the prosecutor talked about how last year, Deputy Finance Minister had requested, on behalf of others, 3.6 million by First Deputy Prime Minister to finish the problem of Grand and bring the decision that will go in favor of him. The allegation started just a

few months after the death of the President of the Board of the Privatization Agency of Kosovo.

Grant affair is considered just one of the affairs that the high level politicians reveal the names in the abuses of the state budget, and other public assets and social life of Kosovo.

Many other continuous reports and concerns have been raised through the privatization process of many other public enterprises. The process of the privatization has been characterized with corruption, withdrawals of the highest bidders for the privatization of enterprises, failure to implement the proposed development plans, and all these have strengthened suspicions and arguments against the privatization.

## CHAPTER 4

### RECOMMENDATIONS

For years businesses and investors in Kosovo have been facing informal, bureaucratic and other similar technical obstacles.

According to the survey results the main barriers for investment were showed to be: (1) corruption, (2) bureaucracy, (3) lack of law enforcement (4) grey economy, and (5) political instability, etc.

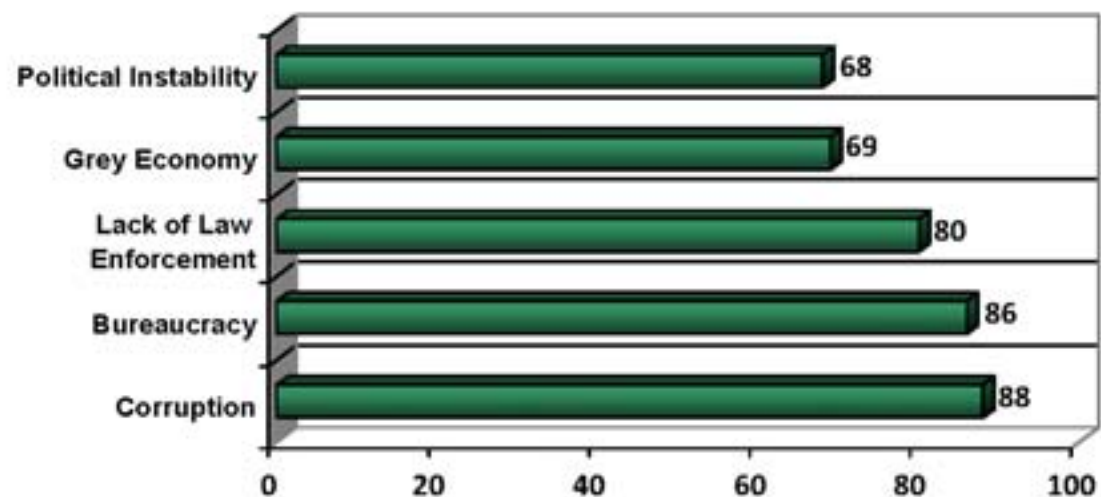


Figure 4.1. The top five FDI barriers according to the 50 companies interviewed

While, according to the survey results the most relevant motives for FDI's are (1) low cost un-skilled labour force, (2) links to neighboring countries, (3) availability of raw materials, (4) geographic location, (5) economy of scale, etc.

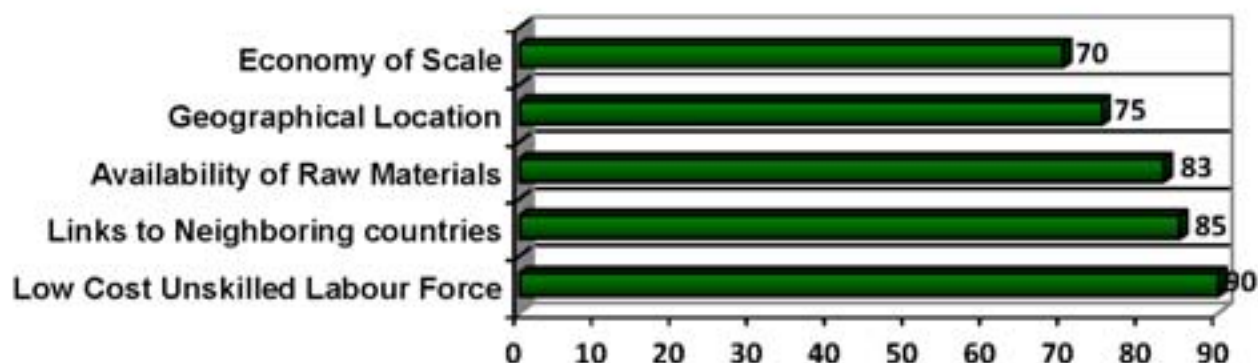


Figure 4.2. The top five FDI motives according to the 50 companies interviewed

Also based on the results of the survey, facts from the World Bank and Transparency International and the trend in fall of FDI it can be concluded that the economic climate for attracting FDI in Kosovo is not appropriate, therefore Kosovo's institution should put more attention to eliminating these barriers in order to attract the foreign investors.

In order to improve the investment climate in Kosovo and attract the foreign direct investments, this project recommends for institutions as follows:

1. **Reform of Judicial processes / courts - The establishment of a Fast Tracking Mechanism** for dealing with the disputes of Investors. This mechanism will improve the independent judicial system by giving priority to business contacts with foreign investors.

2. **Enhance ADR mechanisms.** ADR represents a possible means of transferring many less-sensitive cases from the courts to informal but regulated mediation or arbitration. Build an effective alternative dispute resolution system.
3. **Establishment of database for Kosovo's main indicators of Kosovo Economic assets:** qualifications, employment, infrastructure, business environment, basic legislative information, state profile. IPAK could also serve as Information Hub for Investors, but in that case institutional capacity developed should be supported.
4. **Establishment of One Stop Centre (OSC)** for starting a business, to register business in two easy steps and receive certificate in 24 hours at the Kosovo One Stop Centre. OSC should provide trading license, sector specific certification and licenses, environment clearance and investment certificates. Delegated officers from Government agencies should provide quick services at the OSC – work permits and visas, tax exemption, and tax payment, land and construction permit, utilities (water, electricity), notary services.



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## APPENDICES

Questionnaire used in the survey with the foreign companies in Kosovo.

### 1. COMPANY PROFILE

COMPANY NAME	
COMPANY ADDRESS	
CONTACT PERSON	
TELEPHONE/FAX	
E-MAIL	

### 2. SECTOR OF OPERATION

- Heavy Industry
- Food and Beverages
- Textile
- Furniture
- Chemical & Pharmacy
- Financial service
- Manufacturing
- Health
- Agriculture and Rural Development
- Energy and Mining
- ICT

### 3. WHY DID YOU CHOOSE TO INVEST IN KOSOVO?

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### 4. What are the most significant advantages of investing in Kosovo?

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Please put (X) in the cell next to the following factors that you consider important for foreign investment: starting rating with (1) as Least Important factor and (5) as the most important factor for each variable.

No	LOCATION FACTORS	1	2	3	4	5
1.	Geographical Location					
2.	Cultural and Historical Similarities					
3.	Political Stability					
4.	Economic Stability					
5.	Access Regional Market					
	<b>ECONOMIC FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
6.	Expected Economic Growth					
7.	High Consumer Buying Power					
8.	Free Trade Zone					
9.	Stable Exchange Rate					
	<b>MARKET FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
10.	Expected Market Growth					
11.	Lack of Local Competition					
12.	Lack of other Foreign Investment					
13.	Market Size of Kosovo					
	<b>RESOURCES FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
14.	Skilled Labor Force					
15.	Cheap Unskilled Labour Force					
16.	Availability of Raw Materials					
17.	Low Transportation Costs					
	<b>REGULATORY FRAMEWORK FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
18.	Investment Incentives (Tax, Law, etc.)					
19.	Policy Stimulus					
20.	Law enforcement					
21.	Enforcing contracts					
22.	Protecting Investors					
	<b>OTHER FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
23.	Strong Branding					
24.	Globalization Pressure					
25.	Political Reason					

Please put (X) in the cell next to the following factors that you consider important for foreign investment: starting rating with (1) as Least Important factor and (5) as the most important factor for each variable.

No	LOCATION FACTORS	1	2	3	4	5
1.	Geographical Distance					
2.	Cultural Constrains					
3.	Political Instability					
4.	Economic Instability					
	<b>ECONOMIC FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
5.	Low Economic Growth					
6.	Low Consumer Buying Power					
7.	Unstable Exchange Rate					
	<b>MARKET FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
8.	Lack of tax incentives					
9.	Underdeveloped Business Infrastructure					
10.	Small Market Size					
11.	Free Economic Zone					
	<b>RESOURCES FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
12.	Lack of Skilled Labour Force					
13.	Lack of Managerial Skills					
14.	Lack of Natural Resources					
	<b>BUSINESS ENVIRONMENT FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
15.	Limited Financial Incentives					
16.	Lack of information regarding the business environment					
	<b>REGULATORY FRAMEWORK FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
17.	Weak law implementation					
18.	Poor contract enforcement					
19.	Disputes take lengthy time to resolve					
20.	Legal uncertainties					
21.	Property ownership					
22.	Bureaucratic procedures					
23.	Court management					
24.	Case backlog					
25.	Alternative dispute resolution mechanisms					
	<b>OTHER FACTORS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
26.	Corruption, Bribery and Nepotism					
27.	Economic Crime - competition from grey economy					



