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Instituti Për Ekonomi Të Tregut Të Lirë

KONRAD ADENAUER STIFTUNG

IMPACT OF COVID-19 ON FOREIGN DIRECT INVESTMENTS IN KOSOVO AND THE WESTERN BALKANS

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Research by:

Besa Zogaj Gashi
Executive Director, IETL
(besa.zogaj@ietl-oek.com)

Viola Brahushi
Project Coordinator, IETL
(viola.brahushi@ietl-oek.com)

About IETL:

The Institute for Free Market Economy (IFME) is an independent, non-partisan and non-profit public policy organization established by the Kosovo Chamber of Commerce (KCC), based in Pristina, Kosovo. In pursuit of its mission, the Institute for Free Market Economics conducts credible research focusing on key economic topics in the private sector in Kosovo and utilizes its research results for advocacy, discussion and public debate to influence better policy making for the private sector.

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Norë Potera

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Table of Contents

List of Figures

List of Tables

List of Abbreviations

CBK - Central Bank of Kosovo

CEFTA - Central European Free Trade Agreement

EIC - European Investors Council

EU - European Union

FDI - Foreign Direct Investments

GDP - Gross Domestic Product

IETL - Institute for Free Market Economy

IMF - International Monetary Fund

KAS - Kosovo Agency of Statistics

KIESA - Kosovo Investment and Enterprise Support agency

OECD - Organization for Economic Co-operation and Development

Q1 - First Quarter

Q2 - Second Quarter

RCC - Regional Cooperation Council

SME - Small and Medium Enterprises

TEG - Tourism Expert Group

UNCTAD - United Nations Conference on Trade and Development

WB - Western Balkans

WB - World Bank

WBG - World Bank Group

Introduction

The COVID-19 pandemic has been defined as a global health crisis and the greatest challenge we have faced since World War II. Globally, from 31 December 2019 until the end of September 2020, the number of individuals affected by Covid-19 has exceeded 32 million confirmed cases, including 991,224 deaths, as reported to the World Health Organization (WHO)[1]. Considering the rapid spread of the pandemic, countries around the world have adopted several public health measures aimed at containing its spread, including social distancing and restricted hours of movement and curfews as preventive measures to deal with the pandemic surge. The COVID-19 pandemic represents a threat not only to our health but has also hit hard economies worldwide, bringing in its wake the third and biggest economic and financial shock of the 21st century (bigger the crisis following 9/11 and the 2008 global financial crisis). The containment of COVID-19 to reduce human casualties, economic harm and recovery measures remain fundamental concerns at the global and national levels in every country. Recent forecasts of the International Monetary Fund (IMF), in June 2020[2], compared to April, provide a more bleak outlook for the global economy due to the consequences of COVID-19, with a contraction of the global economy projected at 4.9 percent in 2020 and a slower recovery in 2021. The severity of the economic downturn will depend on the course of the pandemic in the coming months (where changing weather and the fall season may cause a spike in new COVID-19 cases), and on the extent to which economic life can be normalized.

The COVID-19 crisis will cause a dramatic decline in FDIs, bringing greater challenges to developing countries[3] including those in the Western Balkans (WB). According to the World Investment Report (2020)[4], and the United Nations Conference on Trade and Development (UNCTAD)[5], global FDIs were forecast to fall by up to 40 percent in 2020 compared to 2019, due to the effects of the economic recession caused by the COVID-19 pandemic. According to the above Report, global FDI flows are forecast to decrease by up to 40 per cent in 2020, from their 2019 value of $1.54 trillion, thus bringing FDIs below $1 trillion for the first time since 2005. Declining foreign investments will hit developing countries hardest, especially in countries dominated by export-oriented and commodity-oriented investments. In late March, the IMF announced that investors had withdrawn $83 billion from developing countries since the start of the COVID-19 crisis, the highest figure recorded to date in the world economy. According to the Report, the above investments could decrease by a further 5 to 10 percent in 2021. Investments will start to rebound in 2022. The World Investment Report, now in its thirtieth year, supports policymakers to take advantage of the new industrial revolution and overcome growing economic nationalism, enhancing collaboration and promoting resilience-seeking investment, building regional value chains and entering new markets through digital platforms.

This paper aims to address the impact of COVID-19 on economic indicators and FDI flows in the Western Balkan countries, possible scenarios of events and their reflections in Kosovo. This research paper comes in the wake of another paper by IETL, namely Foreign Direct Investment in Kosovo: Investment Climate, Potential and Barriers,[6] published at the end of 2019, providing valuable information regarding the barriers to FDI flows as encountered by foreign investors in Kosovo even before COVID-19, the reforms that the Government needs to make for the overall economic growth and to attract FDIs. Additionally, this paper is supported by the desk research of secondary data (documents, local and international reports produced by the IMF, World Bank (WB), Central Bank of Kosovo (CBK), Kosovo Investment and Enterprise Support Agency (KIESA), scientific and professional magazine articles, statistical data). For purposes of enhancing the content of the paper, further analysis of the FDI state of play in the face of the pandemic in Kosovo, IETL researchers also conducted interviews with the KIESA[7] and EIC leadership[8]. Focusing on the economy, the paper aims to provide recommendations for policy improvements to reduce the adverse effects that COVID-19 has caused in Kosovo, like in the rest of the Western Balkans region.

In addition, the paper aims to foster meaningful and impartial debate among stakeholders regarding the current health and economic situation in Kosovo and other factors, such as the low level of institutional trust, fiscal barriers, administrative barriers, corruption, and informal economy,

[1] WHO, Coronavirus Disease (COVID-19) Dashboard, September 2020, https://covid19.who.int/.
[2] International Monetary Fund (IMF), June 2020.
[3] Developing economies are expected to see the biggest decline in FDI because they rely heavily on investment in global value chain (GVC)-intensive and extractive industries, which have been severely hit, and because they are not able to put in place the same economic support measures as developed economies.
[4] https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf
[5] https://unctad.org/system/files/official-document/wir2020_en.pdf
[6] https://ietl-oek.com/wp-content/uploads/2020/09/19-12-24-Foreign-Direct-Investment-in-Kosovo-The-InvestmentClimate-Potential-and-Barriers-ENG.pdf
[7] Kreshnik Thaqi – Head of Investment Promotion Sector, Kosovo Investment and Enterprise Support Agency (KIESA).
[8] Emrush Ujkani – Executive Director, European Investors Council (EIC).

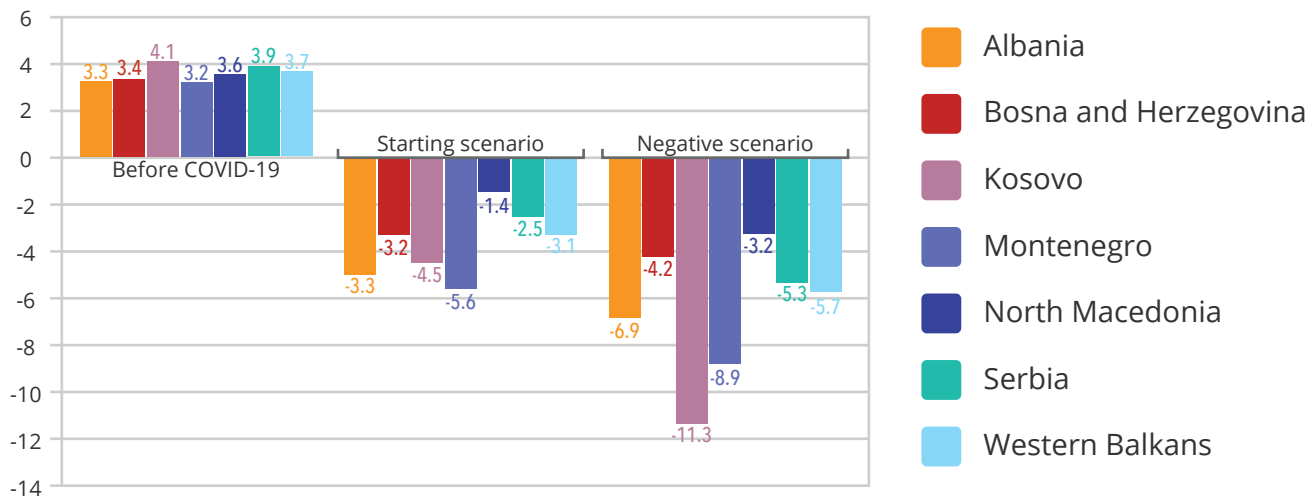
which remain key obstacles to doing business in Kosovo and constantly threaten the business environment in terms of attracting FDIs to Kosovo[9]. Further, the paper aims to spark purposeful debates during the process of drafting a new strategy for medium-term economic recovery over a 5-year period, with clear growth objectives and concrete steps to induce foreign investments, which declined significantly even before the pandemic during both 2018 and 2017, rendering Kosovo an unattractive place for foreign investment and unable to attract investments from major global corporations and brands.

[9]Foreign Direct Investment in Kosovo: Investment Climate, Potential and Barriers, 2019, https://ietl-oek.com/wp-content/uploads/2020/09/19-12-24-Foreign-Direct-Investment-in-Kosovo-The-InvestmentClimate-Potential-and-Barriers-ENG.pdf

1. General Overview of the Impact of COVID-19 in the Western Balkans

In the Western Balkans (WB) countries, economic activity increased by 3.4 percent, which is a slower growth compared to the previous year at 4.0 percent (therefore, the economic growth model of WB countries was fragile even before the crisis started). While for 2020, mostly due to the economic and social crisis caused by the COVID-19 pandemic, the WBG projected that for the WB countries Gross Domestic Product (GDP) would fall by 3.1 percent according to the baseline scenario[10] and 5.6 percent according to the downside scenario[11], but with substantial differences in the six countries, based on their economic structure and vulnerabilities in the pre-crisis period[12]. Kosovo, Montenegro, and Albania would be hit with a larger percentage drop from pre-COVID-19 projections in 2020. While the economies of Bosnia and Herzegovina, Serbia and notably North Macedonia are expected to experience slightly smaller declines in GDP (see Figure 1). Sources from other prestigious data institutions, such as IMF, Organization for Economic Cooperation and Development (OECD, 2020), also provide similar projections.

Figure 1: Regional GDP growth in Western Balkans in 2020 projected to be between -3.1 and 5.6 percent (two scenarios)



Source: World Bank staff calculations.[13]
Note: For the Western Balkans, real GDP growth is the weighted average.

While the adverse impact of the pandemic in 2020 is expected to materialize in declining consumption, private investment, imports and exports, in the following pages in this chapter we will discuss separately the impact on these economic indicators (referring to the data according to the baseline scenario and the downside scenario).

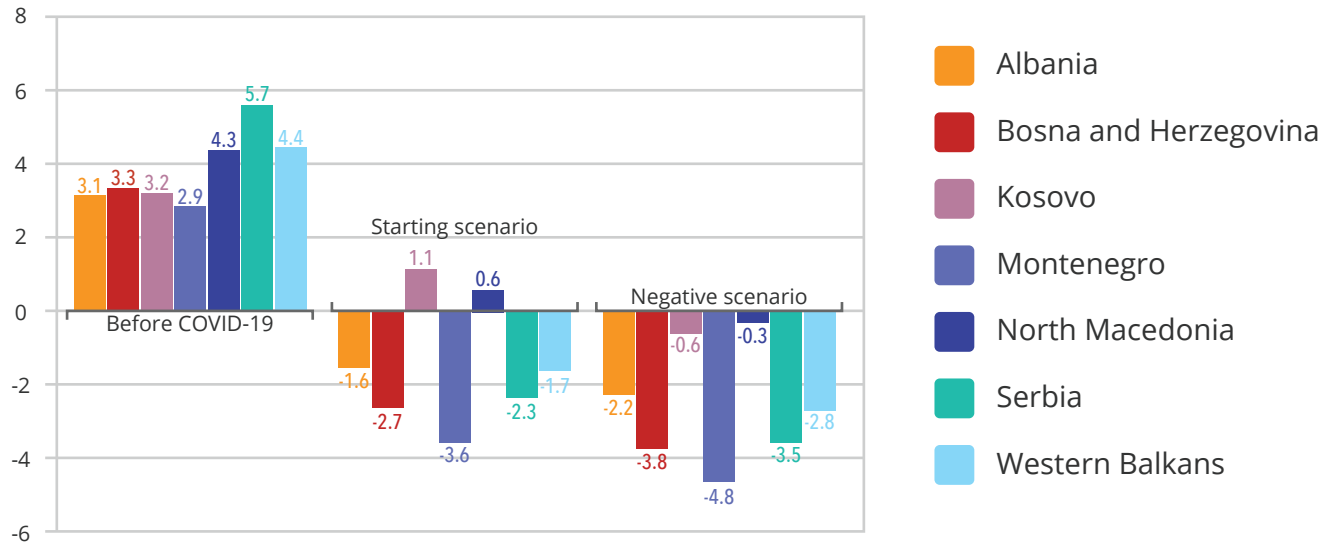
Consumption. Consumption accounted for the largest share in the economies of the region – comprising more than 60 percent of economic growth, which in recent years came as a result of increased public spending, special wage policies, and almost double-digit growth in household borrowing (consumer loans) and remittances.

Referring to the World Bank, according to the baseline scenario consumption is projected to decline by 1.7 percent, while in the downside scenario it would contract by 2.8 percent in all Western Balkan countries during 2020[14], where Montenegro is projected to experience the largest decline with 3.6 percent according to the baseline scenario and 4.8 percent in the downside scenario. Factors that contributed to the decline in consumption are rising unemployment, reduced household incomes, deteriorating financial situation of businesses, and lower remittances, which they are projected to drop by 10 percentage points (pp) year-over-year in the region, with Serbia and Montenegro likely to experience declines of almost 20 percent. Public consumption in the countries of the region is expected to support aggregate demand, however insufficiently to offset the contraction of other components, (for more detail, see Figure 2).

[10]The baseline scenario assumes that the outbreak in Europe begins to slow at such rates that containment measures can be lifted by the end of June and normal economic activity can resume in the second half of 2020.
[11] In the downside scenario, the outbreak lingers so that containment measures cannot be lifted until late in August.

[12]WB, The Economic and Social Impact of COVID-19 – Western Balkans Outlook, Spring 2020, http://documents1.worldbank.org/curated/en/606131588087679463/pdf/The-Economic-and-Social-Impact-of-COVID-19-Western-Balkans-Outlook.pdf
[13]Ibid.
[14]WB, Western Balkans Outlook: Hard Times Require Good Economics, Spring 2020, http://documents1.worldbank.org/curated/en/606131588087679463/pdf/The-Economic-and-Social-Impact-of-COVID-19-Western-Balkans-Outlook.pdf

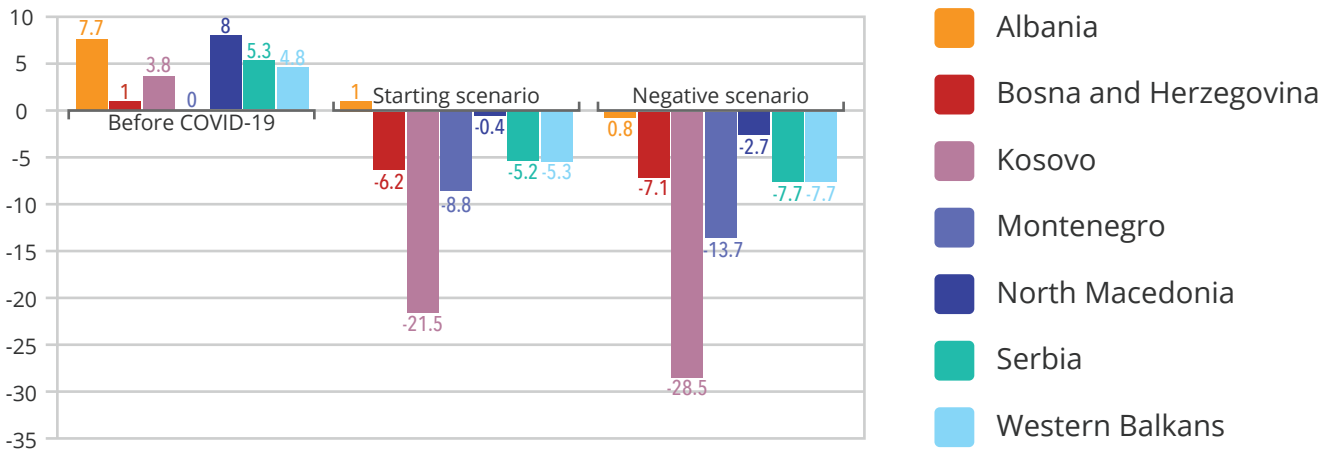
Figure 2: Regional Consumption Growth in Western Balkans, 2020 Projection, Two Scenarios



Source: World Bank staff calculations[15]
Note: For Albania, the pre-COVID scenario includes the effects of the earthquake and reconstruction.

Investments. The plunge in aggregate demand in EU countries as a result of the economic and social crisis from the COVID-19 pandemic in 2020, in the Western Balkan countries will be followed by shrinking investments (domestic and foreign), in the baseline scenario projected at 5.3 percent, while in the downside scenario at 7.7 percent. This projection is based on the fact that the EU is the destination of 94.9 percent of exports and the source of 44 percent of FDIs in the region. Referring to WBG data from countries in the region, Kosovo is expected to be hit hardest by a fall of 21.5 pp[16] according to the baseline scenario and 28.5 pp according to the downside scenario, due to delayed public investment and consumption oriented remittances rather than construction and real estate sector oriented remittances during this year (Figure 3).

Figure 3: Regional Investment Growth in Western Balkans, 2020 Projection, Two Scenarios



Source: World Bank staff calculations[17]
Note: For Albania, the pre-COVID scenario includes the effects of the earthquake and reconstruction.

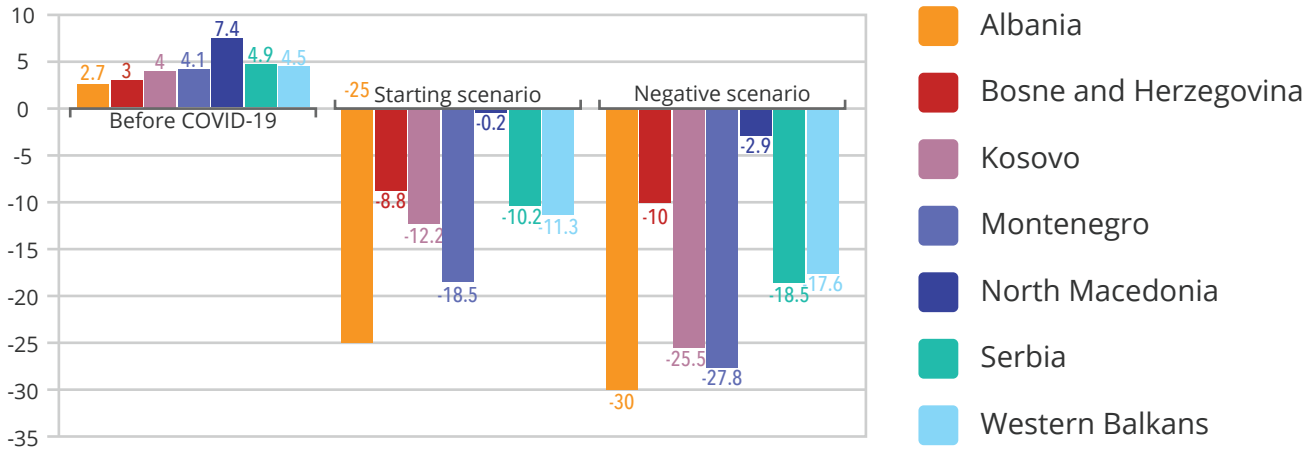
Export (of goods and services). The relatively low level of pre-COVID-19 crisis new export order intakes, combined with pandemic-related export bans, limited and reduced production, retail closures, restrictions on people movement, result in a decline in external demand and significant exports. In its baseline scenario for the Western Balkans countries, the WBG projection provides for a fall in exports by 11.3 percent, while in the negative scenario exports are projected to go down by 17.6 percent in 2020. This projection is based on the fact that the EU is the principal export partner (68 percent). (Figure 4)

[15] Ibid.
[16] Ibid.
[17] Ibid.

Export of goods in the Western Balkans countries will experience significant declines in North Macedonia, Serbia and Bosnia and Herzegovina. Exports of goods in these countries are linked to global value chains and automotive and spare parts industries, where demand for such goods is declining due to changes in consumer behavior after the pandemic.[18]

Export of services have been affected significantly by the pandemic situation. The economies of Albania, Montenegro, and Kosovo are highly dependent on services exports, mainly tourism; hence according to projections, these countries may be more vulnerable to the economic impact of the crisis than the rest of the countries in the region, not only directly through travel restrictions but also perhaps through a change in consumer behavior after the outbreak.[19]

Figure 4: Regional Exports Growth in Western Balkans, 2020 Projection, Two Scenarios (percent)

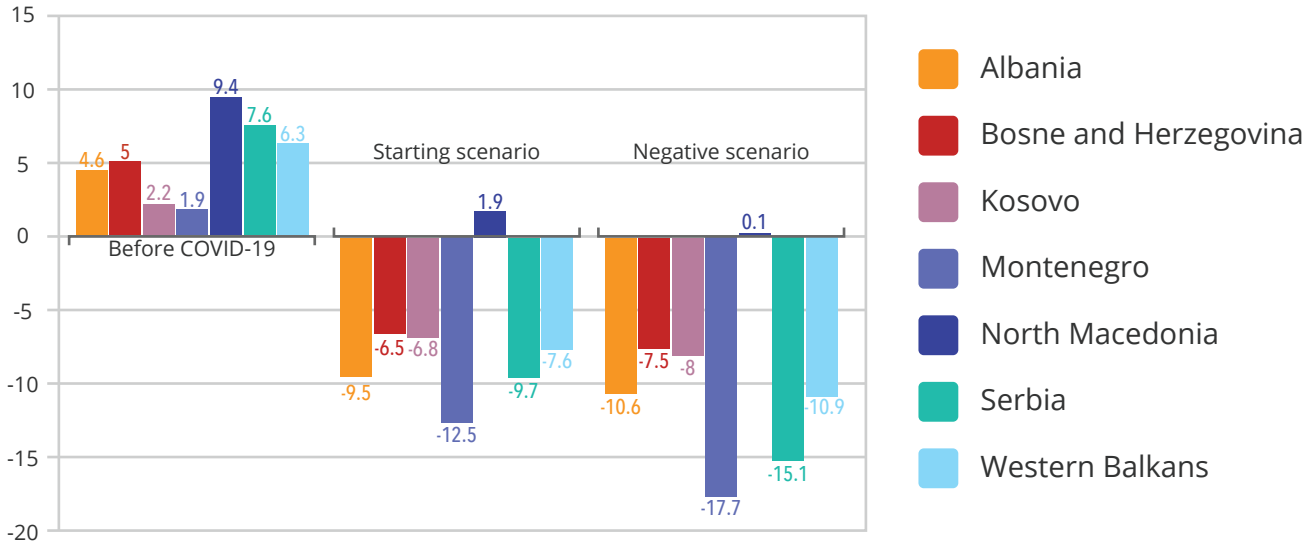


Source: World Bank staff calculations[20]

Note: For Albania, the pre-COVID scenario includes the effects of the earthquake and reconstruction.

Imports, are also expected to slow down significantly in 2020, according to the baseline scenario by 7.6 percent and in the downside scenario by 10.9 percent. This projection comes as the impact of the pandemic led to a contraction in economic activity in the EU Member States, as principal import partners for the countries of the region (61 percent) and the drop in demand and personal consumption in these countries. (Figure 5)

Figure 5: Regional Imports Growth in Western Balkans, 2020 Projection, Two Scenarios (percent)



Source: World Bank staff calculations[21]

Note: For Albania, the pre-COVID scenario includes the effects of the earthquake and reconstruction.

[18]WB, Setting the Stage: Reviewing the state and vulnerabilities of the Western Balkan Economies as they face COVID-19, http://documents1.worldbank.org/curated/en/301261588088338100/pdf/The-Economic-and-Social-Impact-of-COVID-19-Setting-the-Stage.pdf
[19]Ibid.
[20]Ibid.
[21]Ibid.

1.1. Impact of COVID-19 on Foreign Direct Investments (FDI) in Western Balkans

The contributions of Foreign Direct Investment (FDI) flows to the economies of the Western Balkans (WB) have been relatively substantial in recent years, especially in the manufacturing sector, creating thousands of new jobs, and providing support to economic growth, innovation and technological advancement. In 2018, the countries with the largest net inflows of foreign investment, by share of GDP, were: Montenegro with 8.8 percent, Albania and Serbia with 8 percent[22]. Foreign investments in the region originate mainly from the EU Member States (Austria, Germany, Greece, Italy, the Netherlands and Slovenia), as well as the United Kingdom, the United States and the Russian Federation.

The deterioration of the FDI outlook in the countries of the region is expected to have an impact with substantial sector driven differences, based on their economic structure and vulnerabilities in the pre-crisis period.

The **manufacturing sector** accounts for the largest share of FDI reserves in North Macedonia (36 percent of FDI shares), Serbia (32 per cent), Bosnia and Herzegovina (28 percent). EU investors have homed in on export-oriented businesses in the region to serve their home markets[23]. Manufacturing suffers from social distancing safeguards that disrupt production, a collapse in orders, and supply chain problems, which have also had an impact on the downturn of FDI inflows in these countries of the region.

The tourism sector contributes to the region's GDP with over 10%, supporting a large number of jobs and industries, accounting for about 11.4 percent of employees in the Western Balkans (according to the Tourism Expert Group (TEG))[24]. This sector is projected to be one of the sectors most affected by the consequences of COVID-19, due to travel restrictions, social distancing measures and booking cancellations. This economic shock in the tourism industry will negatively affect jobs and have spillover effects in other related sectors, such as agri-food industry, gastronomy, etc.[25]

Among the countries of the region, the hardest blow to the tourism sector was experienced in Montenegro, where in contrast to other countries of the region, its borders with neighboring countries were closed yet again in the summer season due to spikes in cases of COVID-19 infections. Persons wishing to enter Montenegro were allowed only with a certificate from the relevant institutions, proving that they were not infected with COVID-19. Statistical data show that the number of tourists compared to same time last year decreased by up to 90 percent.

Relatively more robust are essential sectors like medicine, the food supply chain, the public sector, and sectors that can more easily shift to telework, such as professional services related to the digital economy.

[22]WB, World Development Indicators: Global Private Financial Flows, 2018 http://wdi.worldbank.org/table/6.9

[23]OECD, Competitiveness in Southeast Europe: A Policy Outlook, 2018, https://www.oecd-ilibrary.org/docserver/9789264298576-en.pdf?expires=1600765057&id=id&accname=guest&checksum=2282B6E3EBD9215E5E4DB5480B765B11

[24]RCC, Tourism in the Western Balkans: Where and how in the times of the pandemic?, 2020, https://www.rcc.int/news/629/tourism-in-the-western-balkans-where-and-how-in-the-times-of-the-pandemic

[25]RCC, BREGU: Tourism in the Western Balkans already feels the pinch of COVID-19 pandemic, 2020, https://www.rcc.int/news/618/bregu-tourism-in-the-western-balkans-already-feels-the-pinch-of-covid-19-pandemic

2. General Overview of the Impact of COVID-19 in Kosovo

Before the pandemic outbreak, the World Bank Group (WBG) had projected that Kosovo's economy would grow by about 4.1 percent in 2020;[26] however, in light of the economic and social crisis caused by the COVID-19 pandemic, WBG updated its projections with a baseline scenario, whereby GDP is projected to fall up to 4.5 percent during 2020, and a downside scenario, providing for a GDP drop of 11.3 percent and Kosovo falling into a deep recession; for more detail see Table 1.

Table 1: Kosovo 2020 Outlook (pre- and post-COVID-19)

Kosovo	2018	2019	2020		
			Projections		
			Pre-COVID-19	Post-COVID-19 Baseline Scenario	Post-COVID-19 Downside Scenario
Real GDP growth (percent)	3.8	4.2	4.1	-4.5	-11.3
Consumption	5.4	2.3	3.2	1.1	-0.6
Investment	2.1	1.7	3.8	-21.5	-28.5
Exports	1.0	2.8	4.0	-12.2	-25.5
Imports	4.8	2.5	2.2	-6.8	-8.0

Source: World Bank staff calculations[27]
Note: For Kosovo, real GDP growth is the weighted average.

The deterioration of the economic growth outlook has led to a significant decline not only in GDP, but is also expected to have a negative impact on other economic indicators, such as: consumption, investment, imports, and exports.

Consumer spending, is among key indicators of economic growth (especially in 2018 accounting for about 5.4 percent of GDP). The increase in private consumption was attributed to improved lending conditions (consumer credit growth), increased imports of consumer goods; increased inflows of remittances.[28] While the increase in public consumption was a result of increased government spending on goods and services, wages and salaries, and subsidies and transfers, also indirectly contributing to the growth of private consumption. See Table 1.

According to the WBG baseline and downside scenario, consumption is expected to fall by 1.1 and 0.6 percent, respectively. The main factors driving the decline in consumption are the rise in unemployment and the decline in economic activities of businesses, where citizens' purchases, especially in March and April, focused only on essential products. Meanwhile, although both WB and CBK had announced a decrease in remittances by 4.7 percent, the opposite happened in real life. Based on CBK data, for the first six months of 2020, the diaspora sent EUR 27.8 million more than in the same period last year (diaspora remittances in Kosovo for six months totaled EUR 433.2 million)[29]. While government final consumption expenditure is expected to grow significantly based on budget projections due to the necessary response to COVID-19.

Investments, during the last two years (2018 and 2019), are estimated to have accounted for about 2.1 percent of GDP, attributed to the growth of public and private investments. Public investments during these two years remain in nominal terms. Meanwhile, the increase in private investments was due to the growth in new investment loans and investments in the construction and real estate sector. At the same time, another driver of investment growth is the improvement

[26]Economic growth has been mainly fueled by consumption, remittances and imports, rather than manufacturing, investments and exports; being extensively quantitative rather than qualitative growth, stemming from high-efficiency sectors and activities and modern technology and innovation.
[27]WB, Western Balkans RER – KOSOVO, 2020, https://openknowledge.worldbank.org/bitstream/handle/10986/33670/The-Economic-and-Social-Impact-of-COVID-19-The-Country-Notes.pdf?sequence=5&isAllowed=y
[28]Remittances in Kosovo have marked a steady increase year-over-year, referring to CBK data: 2017 (EUR 759.2 million), 2019 (EUR 800.5 million) and 2019 (EUR 851.5 million).
[29]In terms of diaspora remittances by country, Germany leads the pack with the most money sent to Kosovo, followed by Switzerland, and the United States of America.

of the doing business environment, which is also reflected in the results of the World Bank Doing Business Report 2019 (see Table 1).

In 2020, according to the WBG baseline and downside scenario investments are expected to fall by 21.5 percent and 28.5 percent respectively, due to reduced public investment with Kosovo budget funding in favor of spending in response to the pandemic to mitigate the negative economic effects of COVID-19.[30] Several large public investment projects that were expected to advance, notably railway and road projects financed by international financial institutions (IFIs), may also be delayed.[31] Additionally, capital investments affecting municipalities, notably about EUR 10 million of new investments, have been suspended by the ministries.[32] Private investments, on the other hand, are expected to drop due to the uncertainty of businesses on whether to invest and their liquidity constraints, as well as the decline in diaspora demand for real estate. A rebound in growth is expected in 2021, following the contraction in 2020.

Exports. In 2019, there was growth associated with Ferronikel's reactivation and a solid increase in exports of services from diaspora tourism (80 percent related to diaspora travel and visits to Kosovo). According to the Kosovo Statistics Agency (KAS), in 2019 Kosovo's main exports were: machinery, mechanical and electrical equipment; plastics, rubber and articles thereof; stone, plaster, ceramic and glass articles; chemical industry products; textiles and textile articles; base metals and articles thereof; prepared foodstuffs, beverages, alcoholic beverages and tobacco; wood and articles thereof.[33]

In 2019, Kosovo traded mainly with its neighbors, with CEFTA countries accounting for EUR 164.8 million or 43.0 percent of its exports at the end of 2019 (Albania 17.6 percent, Macedonia 11.5 percent, Serbia 7.1 percent and Montenegro 5.1 percent). The EU accounted for EUR 138.5 million or 36.1 percent of total exports, mainly to Germany 8.1 percent, Italy 5.9 percent, the Netherlands 4.3 percent, and the UK 2.9 percent). While exports to other countries of the world amounted to EUR 80.1 million or 20.9 percent, where the most important export partners were: India (8.6 percent), Switzerland (7.4 percent).[34]

According to WBG, due to the COVID-19 pandemic, in the baseline scenario exports are expected to drop from the overall growth by 12.2 percent, while in the downside scenario, exports are expected to decline in real terms by 25.5 percent, mainly because of steep nominal declines in exports of services (25.9 percent) and goods (18.6 percent). Not only because of lower services exports, but also because of a projected decline in nickel prices.

While according to the Kosovo Agency of Statistics (KAS), data on the Kosovo International Trade of Goods indicate a lower trade deficit by (-18.2%) in August 2020, compared to the same period of 2019, specifically in the amount of EUR 228.9 million, compared to the deficit of EUR 279.9 million in 2019. Exports cover imports by 13.0 percent. However, this downturn is smaller compared to April 2020, where data indicated a lower trade deficit by (-37.6%) compared to the same period in 2019, resulting from the many restrictions introduced by the Government of Kosovo and other EU countries to counter the COVID-19 pandemic. (Table 2)

[30]Based on economic categories, it can be noted that in the period since the beginning of the pandemic, capital investments have halved from EUR 71.5 million in March-May 2019 to EUR 34.8 million in 2020.
[31]Ibid.
[32]Among the main projects planned to be implemented by MIE in the municipalities of Kosovo and that have since been suspended are: construction of plants in the municipalities of Gjilan (EUR 1 million) and Ferizaj (EUR 500 thousand), expansion of water supply network in Vushtrri (EUR 750 thousand), construction of houses in the northern part of Kosovo (EUR 500 thousand), and more. Whereas, under MCYS, the main projects that have been suspended are: construction of the National Tennis Center of Kosovo in Pristina (EUR 200 thousand) and refurbishment of the stadium in Pozheran, Viti (EUR 200 thousand). Projects under MEST purview that will be affected are: construction of "Fan Noli" school in Kamenica (EUR 200 thousand) and construction of the school in Damjan, Gjakova (EUR 169 thousand euros).
[33]Societe Generale, Country Risk of Kosovo: International Trade, July 2020, https://import-export.societegenerale.fr/en/country/kosovo/trade-country-risk

[34] KAS, International Trade Statistics, 2019, https://ask.rks-gov.net/media/5602/external-trade-2019.pdf

Table 2: International Trade in Goods Flows (January-August 2019, 2020), in Euro

Exports			Imports		Trade Balance	
Month:	**Year (2019)**	**Year (2020)**	**Year (2019)**	**Year (2020)**	**Year (2019)**	**Year (2020)**
January	23,480	28,939	190,442	221,216	-166,962	-192,277
February	24,050	35,933	232,701	263,392	-208,651	-227,459
March	29,572	32,164	289,192	252,070	-259,620	-219,905
April	36,940	32,688	295,496	193,974	-258,556	-161,285
May	31,891	38,766	321,619	239,079	-289,728	-200,313
June	32,115	44,627	275,202	290,804	-243,087	-246,177
July	40,464	42,636	336,878	306,377	-296,414	-263,741
August	31,906	34,317	311,857	263,305	-279,952	-228,987

Source: Kosovo Agency of Statistics, January-August 2020, by month

Imports. According to WBG 2020 projections for Kosovo, imports will fall by 6.8 percent in the baseline scenario, while in the downside scenario by 8 percent.

Also referring to data on International Trade of Goods in Kosovo according to KAS, from March to August there was a steady decline in imports except in June, and this has resulted in reduced customs revenues.[35] Kosovo is reliant on imports of foreign products, either from the region or from European Union countries, as the domestic production industry still remains underdeveloped.

According to KAS, in terms of imports in 2019, the EU supplied 50.0 percent of total imports in Kosovo (Germany 12.8 percent, Italy 6.4 percent, Greece 5.6 percent, Slovenia 3.8 percent, and Bulgaria 3.5 percent, etc.). Imports from CEFTA countries were 14.4 percent (Macedonia 6.9 percent, Albania 6.4 percent, Montenegro 0.8 percent, and Serbia 0.2 percent); while Kosovo's imports from other countries reached 35.6 percent, with the highest shares coming from: Turkey (12.3 percent) and China (9.7 percent).[36]

Kosovo has a small domestic market and limited industrial production, and its imports remain higher than exports. According to the Kosovo Agency of Statistics, in 2018, Kosovo's trade deficit continued to widen to EUR 3.1 billion, from EUR 2.97 billion one year earlier, with imports rising to EUR 3.5 billion from EUR 3.34 billion, while exports increased by 4.4 percent compared to last year, to EUR 383.4 million from EUR 367 million one year earlier.

2.1. Impact of COVID-19 on Foreign Direct Investments (FDI) in Kosovo

Notwithstanding the positive trend (a small increase) of FDIs in 2019 compared to 2018, according to data from the Central Bank of Kosovo (CBK), FDIs suffered a significant decline during both 2018 and 2017, rendering Kosovo an unattractive place for foreign investment and unable to attract investments from major global corporations and brands. The increase in FDI flows was mainly recorded in the real estate sector, mining sector, electrical energy, and trade, while those in the financial services and construction sector declined.

In comparing foreign investments by country, then over the years Germany, Switzerland, Great Britain, Turkey, Austria, and Albania are the countries that have made great contributions in terms of FDIs in Kosovo. Table 3 presents the amounts invested by these countries, where Germany leads the pack with a very large difference over other countries, with EUR 715.03 million of investment inflows since 2007, making it the largest investor in Kosovo. (Table 3)

[35]Kosovo Customs contributes the most to filling Kosovo's coffers. According to pre-COVID-19 forecasts, Kosovo's budget for 2020 was projected to be EUR 2.3 billion. According to this projection, Kosovo Customs would have had to collect over EUR 1.2 billion euros, while the Tax Administration of Kosovo about EUR 600 million.
[36]Ibid.

Table 3: FDI inflows in Kosovo by country (for the period 2007 - June 2020)

FDI by Country 2007 - June 2020	
Country	**Invested Amount**
Germany	€ 715.03 million
Switzerland	€ 593.70 million
GB	€ 388.12 million
Turkey	€ 374.23 million
Austria	€ 283.09 million
Albania	€ 281.62 million

Source: KIESA, 2020 (survey responses)

To analyze the impact of the COVID-19 pandemic on foreign direct investment in Kosovo, we have compared the data of 2019 and 2020 in the first half of the year (first quarter Q1 and second quarter Q2), referring to statistics published by the CBK. The data shows that in the first and second quarter of 2020 there was an increase in foreign investment, compared to 2019. In Q1, there was an increase of EUR 34.5 million, while in Q2 it was EUR 28.2 million. Table 4 also shows the amounts of foreign investments by sector in EUR million, where Real Estate, Leasing, and other business activities are consistently top FDI options in Kosovo over the years.

Table 4: FDI Inflows in Kosovo - by economic activity for the period January - July 2019 and January - July 2020 (in EUR million)

Time Period	**2019**			**2020**		
	Q1	**Q2**	**July**	**Q1**	**Q2**	**July**
Total	**70.0**	**40.8**	**36.9**	**104.5**	**69.0**	**29.1**
Agriculture	0.1	0.8	0.1	1.2	0.9	0.1
Mines	-5.8	-1.3	0.6	9.7	11.7	1.5
Industry	2.3	-1.8	3.3	-3.0	4.5	0.2
Energy	2.7	2.7	1.4	24.6	-2.3	-1.0
Construction	15.4	-6.1	-0.6	-3.4	1.5	5.0
Trade service	-2.5	-4.4	0.0	-3.9	1.5	0.7
Hotels and Restaurants	0.6	0.2	0.1	0.2	0.7	0.1
Transport and communications	-4.3	4.2	1.5	5.0	-13.1	0.3
Financial services	16.4	-12.8	10.5	19.8	30.6	4.1
Immovable properties, rental and other business activities	44.1	54.2	19.3	51.3	32.2	17.1
Other services*	0.7	0.9	0.4	1.9	0.5	0.3
Other activities not classified elsewhere	0.4	4.2	0.2	1.1	0.5	0.7

** Other services: education, health and social work, social and personal services.*
Source: CBK, Monthly Bulletin of Statistics (August 2020)

Due to their significance to the well-being of a large number of Kosovo citizens, but also to financing the economy by fueling consumption and private investment as well as for the country economy as a whole, this study addresses the impact of COVID-19 on diaspora remittances as well. According to World Bank Group forecasts, remittances were projected to decline by about 4.7 percent, due to the plummeting economic activity in many countries where the Kosovo diaspora is present, but this did not happen. Notwithstanding the COVID-19 pandemic, the Kosovo diaspora has broken the record of remittance flows towards our country. There was an increase in remittances in the first two quarters, and also in July 2020.[37] (Table 5)

Table 5: Diaspora remittances - by remittance channel for January-July 2019 and January-July 2020 (in EUR million)

Time Frame	Total	Commercial Banks	Money Transfer Agencies	Others
2019				
Q1	**184.9**	23.7	94.2	67.0
Q2	**220.7**	26.9	113.8	80.0
July	**73.9**	15.7	31.5	26.8
2019				
Q1	**187.3**	23.3	105.3	58.7
Q2	**247.2**	36.8	199.0	11.3
July	**92.3**	15.0	69.3	8.1

Source: CBK, Monthly Bulletin of Statistics (August 2020)

According to KIESA officials, it is important to note that during these months, although current investors have encountered considerable challenges from the crisis caused by the COVID-19 pandemic, there have been no cases of investors withdrawing or closing their subsidiaries in Kosovo. According to KIESA and EIC officials, the Economic Recovery Package should provide for government involvement and assistance to current investors. Additionally, according to EIC, our institutions should do more in this direction while enhancing their cooperation with the financial institutions present in our country, to better articulate needs together and address such needs in a more effective way. The problem lies not only in the projected monetary value, but also in the delays in the implementation of this package. Further according to EIC, if the Law on Economic Recovery is not adopted and implemented quickly, a small number of FDIs will have a hard time surviving, due to uncertainty and declining profit, which may be reflected in the second half of this year.

Interests for new investment inflows in Kosovo, which according to KIESA officials have not been missing even during this year, are quite promising. Mostly they have expressed interest in investing in the energy sector, renewable energy resources (RES), energy efficiency (EE), tourism, and agriculture, which are also priority sectors under the Law on Strategic Investments in the Republic of Kosovo.

[37] Ibid.

3. Conclusions and Recommendations

The application of restrictions aiming to contain and slow down the spread of the virus has hit hard the economies of every country, producing negative effects on all economic indicators, including FDI inflows. Prestigious international institutions, such as the World Bank and the IMF, have corrected their initial projections leaning towards forecasts of economic recession according to downside scenarios. A similar situation is observed in Kosovo, where almost all economic indicators have declined (apart from an increase in remittances by 5 percent).

IETL considers that the Government of the Republic of Kosovo (GoK) should prioritize its five-year national strategy of economic development and recovery, including a concrete plan to induce foreign investments, which had dropped significantly even before the pandemic during both 2018 and 2017, rendering Kosovo an unattractive place for foreign investment and unable to attract investments from major global corporations and brands. We must have clear development objectives and a model of economic growth prepared with the necessary political and scientific consensus and with the compliance of the entire political spectrum.

Below IETL provides some recommendations to the Government and other relevant institutions for overcoming the economic crisis caused by the pandemic and recommendations for overcoming other pre-pandemic obstacles, which are ongoing barriers to doing business in Kosovo (low level of institutional trust, institutional barriers, fiscal barriers, administrative barriers, corruption, informal economy, power supply) and constantly threaten the business environment and its attractiveness for FDI since Kosovo's declaration of independence.

- **Boosting digital skills for youth employment.** According to the International Labor Organization (ILO), the pandemic is inflicting a triple shock on young people, affecting young women more than young men. Similarly, the consequences of the pandemic in Kosovo are expected to hit young people harder than other age groups[38] (because our young people tend to work more in sectors featuring higher rates of informality). On the other hand, the pandemic has demonstrated the importance of the rise of digital technology worldwide to respond effectively to the economic crisis. Consequently, the post-pandemic period could provide a new beginning for many public policies in the area of employment.[39] From this perspective, digital skills development incentives for the youth of Kosovo should be at the center of public policy-making ensuring sustainable long-term growth that is attractive for Foreign Direct Investment in Kosovo.

- **Possibility of accelerating digital transformation.** During these months of the pandemic, businesses that operated through online sales or e-commerce have fared better in surviving the pandemic crisis. Amid this economic crisis, Kosovo has an unprecedented opportunity to reshape its economic structure and boost changes in important economic and social areas, which have so far undermined the country's economic progress. Obviously, the way forward depends very much on the bold measures that the Government will be willing and able to take. In well-developed and developing economies, Government interventions have been quite impressive, and Kosovo must follow suit. The Government should look at the possibility of encouraging enterprises through digital transformation training for e-commerce deploying digitalization to fight against COVID-19, in addition to facilitating their entry into new markets. Further improvement of infrastructure and digital capabilities will contribute to the country's economic stability and attract foreign investment.

- **Skills gap between education/training and labor market needs.** Referring to the findings of the survey conducted by IETL targeting enterprises with foreign capital shares registered in Kosovo,[40] it is disconcerting that many investors in Kosovo, speak of big problems in finding workers with adequate skills in different sectors of the economy. This indicates that the skills gap issue should be considered a Government priority, in terms of ongoing alignment of education programs with labor market demands.

- **Government incentives directed towards attracting foreign investment.** The Government of Kosovo should work on a concrete plan that is competitive regionally and geared towards attracting foreign investment, prioritizing several key incentives such as: a) introduc-

[38]The situation is particularly unsettling among young people. According to KAS, at national level in Kosovo, among young people aged 15-24 years old, the employment rate is about 14.4 percent (19.4 percent for men, and 8.6 percent for women). For those in the 25-34 age bracket, the overall employment rate is 36.6 percent).

[39]Reference from World Investment Report, 30th edition, 2020, (recommendations for developing countries), available at https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf

[40]https://ietl-oek.com/wp-content/uploads/2020/09/19-12-24-Foreign-Direct-Investment-in-Kosovo-The-InvestmentClimate-Potential-and-Barriers-ENG.pdf

tion of tax holidays, b) increase of infrastructure investments in Free Trade Zones/Special Customs Zones, c) designation of business park areas, d) creating packages to cover training costs for companies that employ a large number of employees, and e) covering a certain percentage of employee salaries to boost employment. The plan should be a priority and part of the economic recovery strategy.

- **Infrastructure improvements.** In infrastructure, inadequate and intermittent supply of electricity is still a major obstacle. In many cases, foreign and domestic businesses in the past years and during this pandemic period have faced power supply problems causing great damage to their businesses. All these should be handled with priority. While, compared to electricity supply issues, underdeveloped (rail) transport connections are considered as a less binding constraint, however quite significant for facilitating trade and attracting foreign investment.

- **Deep structural reforms.** For economic recovery to be as sustainable as possible in the medium and long term, the Government of Kosovo must work on deep structural reforms to transform the economy, enhance competitiveness, attract investment, and boost manufacturing in order to increase productivity.

- **Improve the Rule of Law and contract enforcement.** Notwithstanding the World Bank Governance Indicators showing some marginal improvements in the enforcement of contracts and the Rule of Law in general, still – according to survey conducted by IETL targeting enterprises with foreign capital shares registered in Kosovo,[41] one of the most critical challenges is the enforcement of contracts in Kosovo courts. This indicator brings to light a heavy burden for businesses in general and especially for foreign businesses considering investments in Kosovo under the perception that they will find a friendly environment, where their rights will be protected and respected. It is necessary to establish a commercial court to deal with such court cases where fair, transparent, and timely decisions are made.

- **The business environment and reduction of informal economy.** In recent years, notwithstanding the progress achieved in indicators that measure the environment of doing business, such as those of the World Bank Doing Business Report and of the European Commission Small Business Act, the informal economy, corruption, and other forms of the black market remain a major problem in Kosovo, leading to labor market disorder, unfair competition, and being a major barrier to attracting FDIs. For this reason, the Government should prioritize the development of a credible action plan to counter tax evasion.

- **Diverting remittances into investment vehicles.** Even during the pandemic period, remittances continued to be an important resource for Kosovan families and for the country's economy. However, much like in the previous years, their utilization focused on consumption spending and not on investments that would influence long-term economic development. Unfortunately, to date, there have been no initiatives, either by institutions or by various business associations, to divert remittances into investment vehicles. The Government of Kosovo should take measures to create appropriate policies for investing remittances in businesses, which would create new jobs and boost long-term economic growth and FDI inflows in Kosovo.

- **Kosovo must take advantage of its central position in the region.** All countries in the region lag far behind the Central European countries in terms of FDI inflows. Therefore, attracting serious investors in each of the countries of the region necessarily involves a regional dimension. The Government of Kosovo should look at the opportunities to take advantage of its central position in the region and capitalize on it by attracting investments that gravitate toward the regional market and beyond. Ultimately, Serbia's recognition of the reality of Kosovo is another step forward that further promotes the closer cooperation and regional integration of the Western Balkans countries.

[41] https://ietl-oek.com/wp-content/uploads/2020/09/19-12-24-Foreign-Direct-Investment-in-Kosovo-The-InvestmentClimate-Potential-and-Barriers-ENG.pdf

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