

Reviewing Kosovo's investment attraction performance and measures in light of changing FDI patterns

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Executive summary

Kosovo could only partly tap its potential in terms of both quantity and quality of attracted investment in the last decade

- Inflows remained at a rather low level during the last decade without fully recovering after the global financial crisis
- Most neighbouring economies were more successful in terms of attracting investment projects in that period
- FDI largely went into the real estate sector. Knowledge- and export-oriented industries only accounted for a small share of inflows
- Investments from the diaspora have been an important driver for FDI in Kosovo. Germany, which is hosting the largest diaspora in the world, is the leading source country of FDI in Kosovo, followed by Switzerland and Turkey
- The specific composition of FDI inflows into Kosovo contributed to an above average performance during the pandemic in 2020
- Bucking the global and regional trend, FDI inflows into Kosovo increased in 2020. In particular, the real estate sector showed robust investment dynamics

Executive summary

In principle, Kosovo is well positioned to benefit from changes in investment patterns in the context of the pandemic, e.g. attracting nearshoring projects. However, success won't come automatically

- Despite a number of investment climate challenges, Kosovo's competitive position has recently improved
- Kosovo's key strengths (e.g. the competitive cost structures) as well as the integration process with the EU and at the regional level are of high relevance in the context of changing investment patterns and investors' needs
- Unlocking the potentials requires a pro-active, targeted and coherent approach generating synergies within the policy and institutional framework
 - Intensifying target-group-specific promotional measures based on a clearly defined strategy and segmentation
 - Extending investment facilitation and aftercare services
 - Increasing the effectiveness of economic zones
 - Aligning related policy tools / areas such as skills development and linkage promotion
 - Strengthening the structures and capacities for investment attraction

Outline

1. Introduction
 2. FDI inflows into Kosovo
 3. FDI composition in Kosovo
 4. Impact of the COVID-19 pandemic on FDI
 5. Conclusions and recommendations
- Annex: GET support in the area of investment attraction

1. Introduction

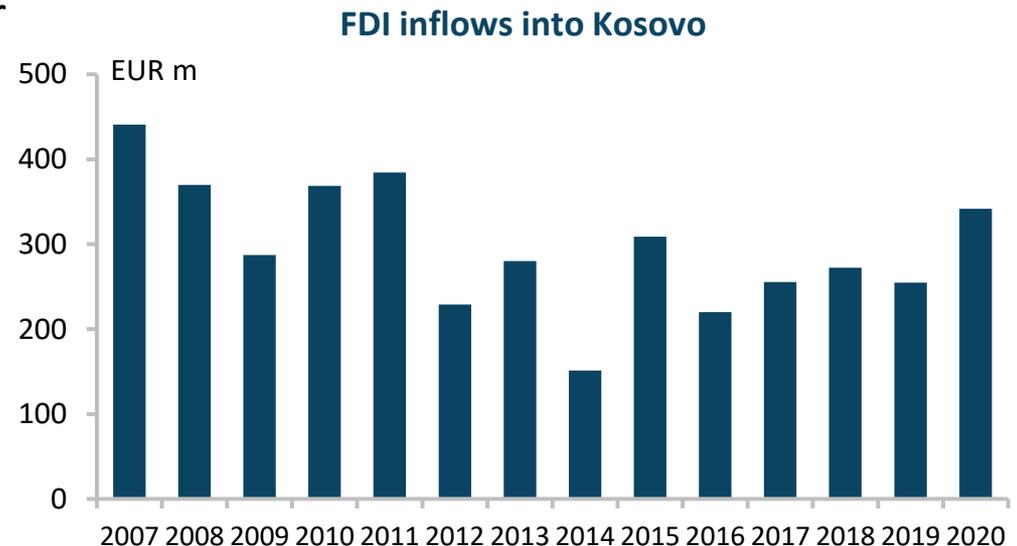
Based on a review of Kosovo's investment attraction performance, this briefing identifies strategic options to increase the effectiveness of relevant policy measures

- Current conditions for investment attraction measures are challenging, with global FDI declining in recent years and the severe impact of the COVID-19 pandemic
- At the same time, changes in investment patterns in the context of the pandemic also open up new opportunities to promote investment and develop new industries and value chains
- Against this background, this policy briefing reviews Kosovo's investment attraction performance in light of the transformation process
- Based on this review, recommendations for the design and alignment of policy tools are derived
- Main emphasis is on a targeted and coherent approach:
 - Addressing the entire investment attraction cycle as well as interfaces to related policy tools and areas such as economic zones, skills development, promotion of linkages and further investment climate reforms
 - Reflecting the relevant institutional framework and necessary capacities

2. FDI inflows into Kosovo

Despite several policy measures by Kosovo's Government, FDI inflows remained at a rather low level during the last decade

- A range of measures was implemented in the last decade to stimulate FDI, incl.:
 - Introduction of a flat corporate tax rate at 10%
 - Establishment of economic zones with a range of benefits for investors
 - Adoption of the “Law on Strategic Investments” facilitating the transfer of public assets and infrastructure support for investors in key sectors
- However, FDI remained at a rather low level without fully recovering after the global financial crisis
- FDI inflows had peaked in 2007 with the announcement of the privatisation of several state-owned enterprises and the upcoming independence
- In 2020, the FDI stock amounted to EUR 4.3 bn



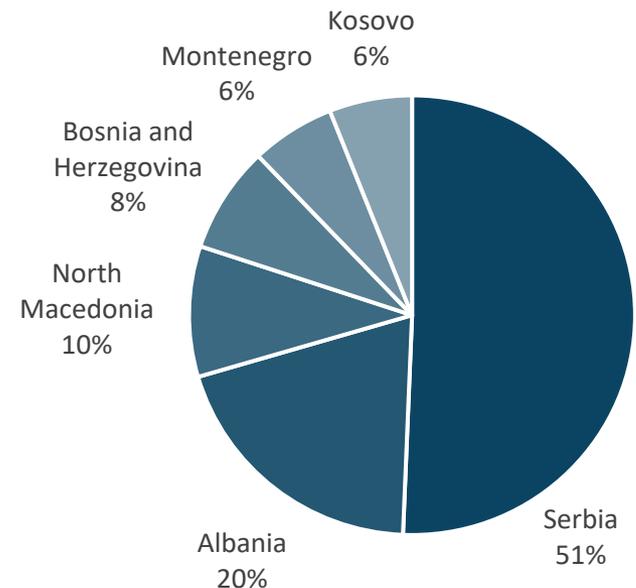
Source: Central Bank of Kosovo

2. FDI inflows into Kosovo

Kosovo could attract only a small share of total FDI inflows into the Western Balkan economies in the last decade

- Most of the neighbouring economies were more successful in terms of attracting FDI
- The major share of total FDI inflows into the region entered Serbia (51%), followed by Albania (20%)
- Kosovo as well as Montenegro could each attract only a share of 6%
- In all Western Balkan economies, FDI inflows fluctuated considerably in the last decade
- However, only Kosovo and North Macedonia had lower FDI inflows at the end of the decade than at the beginning

FDI inflows in Western Balkan economies
2010-2019

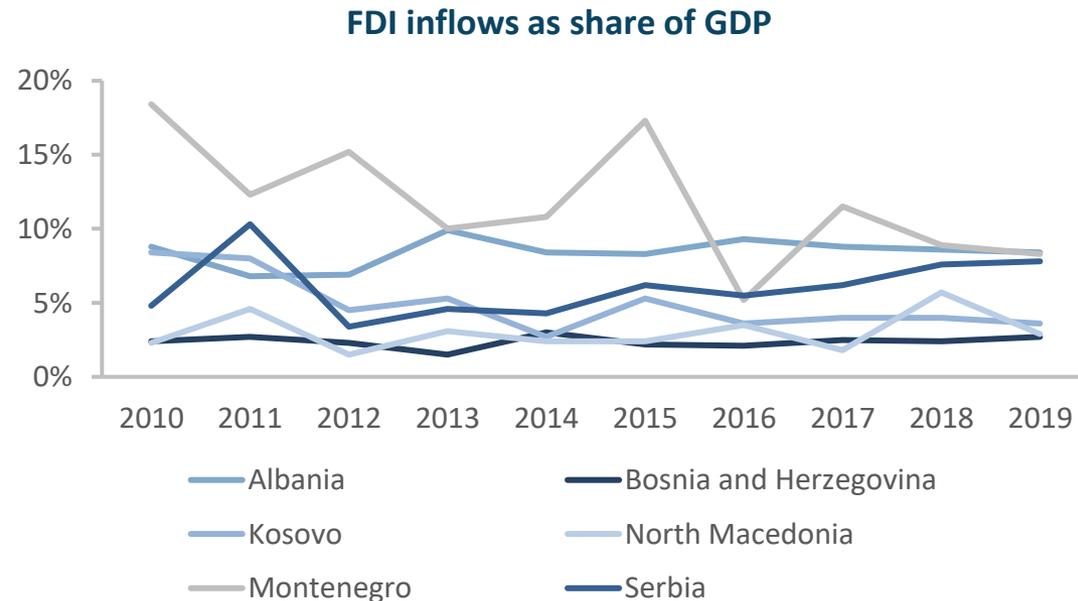


Source: OECD Competitiveness in South East Europe 2021

2. FDI inflows into Kosovo

As a share of GDP, FDI inflows into Kosovo were also significantly lower in 2019 compared with 2010

- In 2019, FDI inflows as share of Kosovo's GDP amounted to 3.6%, which is significantly lower than at the beginning of the decade (8.4%)
- In the best performing economies in the region, FDI inflows represented 8.4% of GDP for Albania, 8.3% for Montenegro and 7.8% for Serbia in 2019
- However, it should be noted that the Western Balkan region has been quite successful in terms of attracting investment in this period
- FDI inflows into the Western Balkan region as share of GDP were significantly above the average in Central, East and South-East Europe



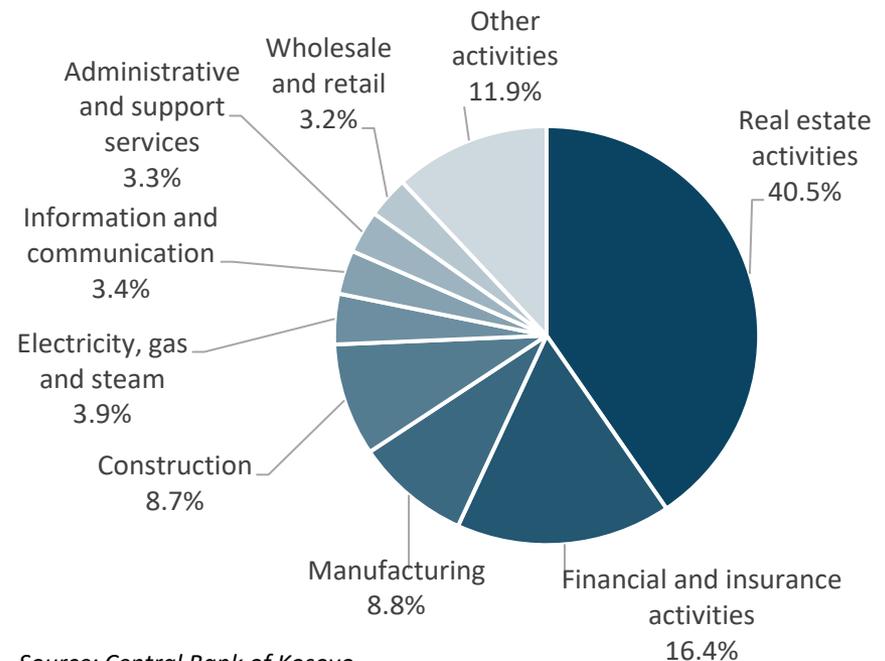
Source: OECD Competitiveness in South East Europe 2021

3. FDI composition in Kosovo

Despite some successes in manufacturing, IT/BPO and renewable energy, knowledge- and export-oriented industries still account for a low share of FDI

- In the recent past, Kosovo was able to slightly diversify the composition of FDI attracting investment projects in industries such as manufacturing (e.g. KIVO LLC), IT/BPO (e.g. Imbus AG and ABIDAT) and renewable energy (e.g. SOWI Kosovo)
- However, FDI is still largely going into the real estate sector, which:
 - Played a strong role in the process of privatisation
 - Accounts for more than 40% of total FDI inflows between 2007 and 2020
- FDI into manufacturing is considerably lower than in neighbouring countries
- Recent OECD reports point out, that FDI in Kosovo has not been a major driver of structural transformation towards more export-oriented growth

Composition of FDI inflows 2007-2020



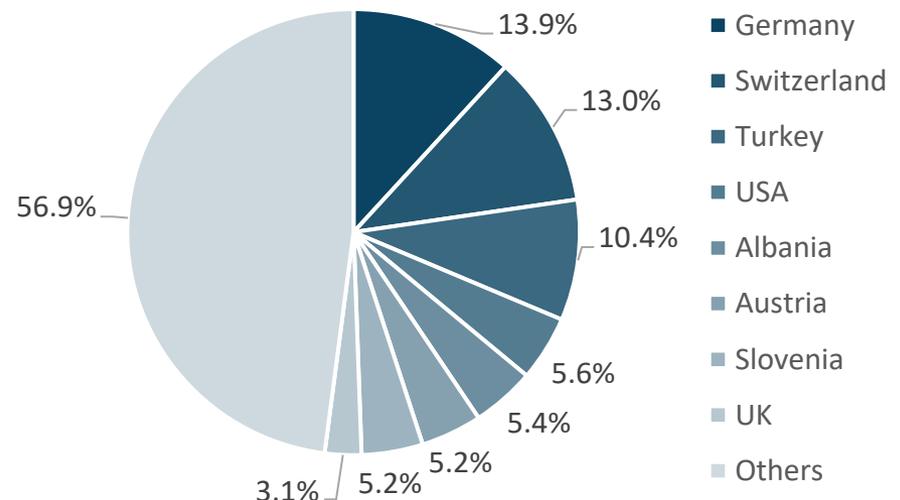
Source: Central Bank of Kosovo

3. FDI composition in Kosovo

The vast majority of FDI in Kosovo originates in Central Europe, Turkey and further Western Balkan economies

- Germany is the leading source country of FDI in Kosovo, followed by Switzerland and Turkey
- Investments from the diaspora have been an important driver for FDI in Kosovo. Germany is hosting the largest Kosovo diaspora in the world. It has been estimated that more than 400,000 Kosovars live in Germany
- Turkish investors have been involved particularly in infrastructure projects such as Pristina International Airport and the energy sector
- While strongly engaged in the region, countries such as Russia and China, which do not recognise Kosovo as independent state, play only a marginal role in terms of FDI activity

Share of total FDI stock as of March 2021

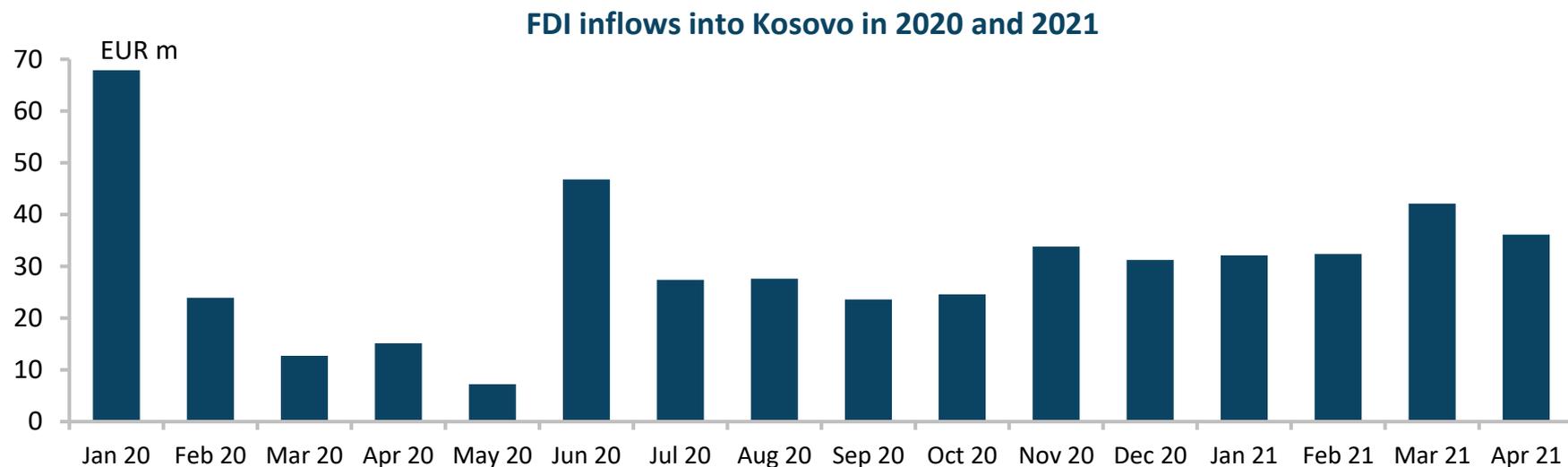


Source: Central Bank of Kosovo

4. Impact of the COVID-19 pandemic on FDI

The pandemic had a severe impact on international value chains and investment flows. Bucking the global trend, FDI inflows into Kosovo increased in 2020

- According to UNCTAD, global FDI decreased by 42% in 2020. A further fall by 5 to 10% is projected for 2021. Growth in inflows is not forecast to return before 2022
- The impact of the pandemic on FDI inflows varied across the region: In Kosovo and Montenegro FDI increased in 2020, while in the other countries – in particular in North Macedonia and Serbia – inflows were severely affected
- FDI inflows into Kosovo already rebounded in June 2020



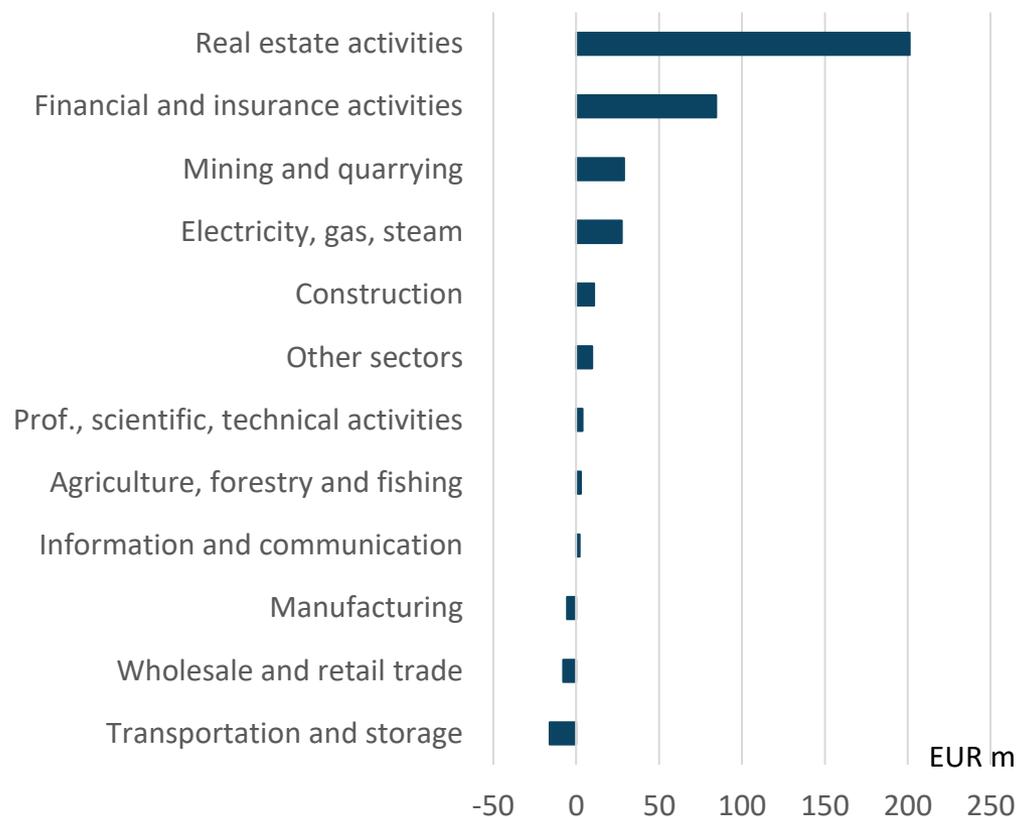
Source: Central Bank of Kosovo

4. Impact of the COVID-19 pandemic on FDI

The specific composition of FDI inflows into Kosovo contributed to the above average performance during the pandemic in 2020

- The real estate and financial industry, which play a key role in Kosovo's FDI pattern, showed robust investment dynamics
- Industries that were hard hit by the pandemic such as manufacturing account only for a small share of inflows
- Diaspora-related investments also tend to be more resilient
- Furthermore, lower repatriations contributed to Kosovo's above average performance in 2020

Composition of FDI inflows into Kosovo in 2020



Source: Central Bank of Kosovo

4. Impact of the COVID-19 pandemic on FDI

Current conditions for attracting investment are challenging. However, changes in FDI patterns caused or accelerated by the pandemic also open up new investment and development potentials

- The pandemic is a major challenge for the global as well as Kosovo's economy
- There will be less FDI available globally in the near future and competition between locations will intensify
- At the same time, the transformation of global value chains and investment patterns also brings new opportunities to attract investment and develop new industries and value chains, incl.:
 - Attracting nearshoring projects
 - Benefitting from a diversification and regionalisation of value chains

New potentials in the context of changing investment patterns

Nearshoring



EU investors concentrating activities in hubs close to their home countries – in particular in medium- and higher-technology value chains such as mechanical/electrical engineering and automotive

Diversification of value chains



Large international investors diversifying their locations and value chains – in particular in low-tech GVC-intensive industries such as textile and apparel as well as in higher value services such as IT/BPO

Regionalisation of value chains



Large international investors replicating operations and value chains in regions of strategic importance – in particular in regional processing industries such as food/beverages, energy and construction materials

5. Conclusions and recommendations

In principle, Kosovo is well positioned to benefit from the transformation of value chains and investment patterns. However, success won't come automatically

- Despite a number of structural weaknesses and investment climate challenges such as infrastructure deficits, the small size of the market and skills mismatch, Kosovo's competitive position has recently improved
 - Kosovo's key strengths such as the geographic location in proximity to the EU, the competitive labour costs and the low corporate tax rate are well received by investors looking at locations for nearshoring projects or a diversification of their value chains
 - The integration process with the EU (e.g. SAA Stabilisation and Association Agreement) and at the regional level (e.g. Multi-annual Action Plan for a Regional Economic Area in the Western Balkans) is of particular relevance for investors considering a regionalisation of their value chains
- In such a situation, it is essential that investment attraction measures are as effective as possible
- Efforts need to be intensified. The analysis of FDI inflows has shown, that in the past Kosovo could only partly tap its potential in terms of both quantity and quality of attracted investment

5. Conclusions and recommendations

Unlocking the potential requires a pro-active, targeted and coherent approach addressing the entire investment attraction cycle and generating synergies within the policy and institutional framework

- In light of the impact of the pandemic, it is critical to concentrate on the most promising target groups based on a clearly defined strategy and segmentation
- From today's perspective, the following target groups should be prioritised:
 - IT/BPO
 - Automotive, machinery, metal and wood-based products
 - Agro-processing
 - Renewable energy
- Measures should focus on segments that are less sensitive to (geo)political risks:
 - Mobilising the potentials of the diaspora is considered a promising approach
 - Particular emphasis should be on medium-sized enterprises across the different target groups. For instance, in Germany, privately owned medium-sized enterprises offer a substantial investment potential and tend to be less sensitive to (geo)political risks than publicly listed large companies

5. Conclusions and recommendations

Unlocking the potential requires a pro-active, targeted and coherent approach (cont.)

- In addition to promotional efforts, investment facilitation and aftercare services should be extended
- Facilitation services are critical in securing and fast-tracking investments
- The role of aftercare has been recently reinforced during the pandemic crisis
 - It is a cost-effective way to retain investment, secure reinvestment and enhance the impact
 - As confirmed by practical experience, up to 70% of FDI projects are expansions or reinvestments
- Political commitment and coordination at the top level of government constitute key success factors for both tasks



Source: Own research

5. Conclusions and recommendations

Unlocking the potential requires a pro-active, targeted and coherent approach (cont.)

- Efforts need to be intensified beyond investment attraction. The key to success lies in an alignment of all relevant policy tools and areas
- Increasing the effectiveness of economic zones – e.g. based on PPP models – plays a major role in this context
 - Zones are well received by investors and used by most competing locations
 - By attracting export-oriented investments, zones can make an important contribution to integration into international value chains and markets
- A main focus should also be placed on strengthening the skills base as well as on promoting linkages between investors, local suppliers, educational and research institutions
- Furthermore, as emphasised in recent reports by international organisations, Kosovo needs to address investment climate challenges such as corruption, unfair competition from the informal sector and inefficient contract enforcement to increase the quantity and quality of FDI

5. Conclusions and recommendations

Capacities and structures for investment attraction need to be strengthened throughout the entire investment attraction cycle

- Effective investment attraction requires adequate structures and specific expertise, e.g. for identifying and promoting promising value chains and developing contact networks
- As confirmed by the recent OECD Competitiveness Report, the Kosovo Investment and Enterprise Support Agency (KIESA) lacks capacity to execute its wide scope of mandates, which comprises investment, trade and tourism promotion as well as SME and zone development
- With 28 positions, KIESA is understaffed in international comparison
 - Human resources of investment promotion agencies (IPAs) vary considerably depending upon the agencies' scope of mandates
 - According to the latest survey by the World Association of Investment Promotion Agencies (WAIPA) and the World Bank Group, IPAs have on average 161 employees, incl. 38 investment promotion staff
 - OECD Mappings show, that IPAs in OECD countries employ on average 40 investment promotion staff (plus additional staff for further tasks) compared to 19 in Eurasia and 54 in Middle East and North Africa

Annex: GET support in the area of investment attraction

The German Economic Team (GET) supports IPAs, ministries and further government institutions throughout all stages of the investment attraction cycle as well as at the interface to other policy tools and areas

- In the recent past, the assistance provided in the area of investment attraction focused, amongst others, on:
 - Target group analyses and definitions
 - Reviews of investment attraction strategies
 - Assessments of organisational frameworks and main processes of IPAs
 - Tailored trainings on target-group-oriented investment promotion, facilitation and aftercare measures
 - Reviews of KPIs and monitoring systems
- Furthermore, GET experts can draw on a wide range of experience related to further tools within the investment policy package – such as special economic zones and incentives – as well as in related policy areas (e.g. cluster policy)
- Thus, particular emphasis is placed on unlocking development potentials at the interface between different policy tools and areas (e.g. leveraging clusters for the development and promotion of special economic zones)

About the German Economic Team



Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

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