Republika e Kosovës

Republika Kosova-Republic of Kosova

Qeveria-Vlada-Government

Ministria e Tregtisë dhe Industrisë - Ministarstvo Trgovine i Industrije - Ministry of Trade and Industry

CONCEPT OF KOSOVA INDUSTRIAL POLICY

Department of Industry

November, 2014

1. Acknowledgements

This Concept paper is a result of professional contributions of each member of the Working Group, representing relevant government and non-governmental institutions representatives from (PM, KIESA, ECK, AMCHM, MEST, MF and MED) during three workshops and continual virtual discussions among them.

Contents

2. List of abbreviations

AmCham	American Chamber of Commerce
ECHK	Economic Chamber of Kosova
DEIPC	Department of European Integration and Policy Coordination
DI	Department of Industry
ECHK	Economic Chamber of Kosova (ECK)
EU	European Union
FDI	Foreign Direct Investment
GCI	Global Competitiveness Index
GTRI	Global Information Technology Readiness Index
GDP	Gross Domestic Product
IP	Industrial Policy
ICT	Information communication technology
KBRA	Kosova Business Registration Agency (KBRA)
KIP	Kosova Industrial Policy
KAS	Kosova Statistical Agency
MAD	Macroeconomic Analysis Department
MED	Ministry of Economic Development
MEST	Ministry of Education, Science and Technology
MF	Ministry of Finance
MTI	Ministry of Trade and Industry
NTB	Non-Tariff Barrier
NDS	National Development Strategy
NEET	Not in Education, Employment, or Training (young person)
OECD	Organization for Economic Co-operation and Development
PMO	Prime Minister's Office
R&D	Research and development
SME	Small and medium enterprise
TAK	Tax Administration of Kosova
UNDP	United Nations Development Programme
WB	World Bank
WEF	World Economic Forum

3. Executive Summary

A difficult transition process in the 90's followed by a destructive war of 1999-2000, was also reflected in the economy of Kosova, resulting with its basic economic infrastructure almost completely destroyed. Since then, it has continued to face major economic problems including, but not limited to, relatively slow pace of economic growth, high unemployment rate, low labor participation, weak and relatively small manufacturing sector, large negative net exports, and low level of investments.

Yet, Kosova has managed to have positive economic growth rates during the last years, integrate into regional and world markets, attract some qualitative FDI, improve its legal framework (harmonized with the Acquis Communautaire) improved its physical infrastructure, established solid democratic institutions and transformed into a market driven economy.

However, as a transitional economy, exposed to rapid changes with major challenges ahead, Kosova needs to continually "reinvent" itself, so that it enjoys a faster pace of economic growth, increase in welfare, and faster integration into the European Union.

In this regard, this Concept lays down the theoretical foundations of the first Kosovo Industrial Policy of Kosova (KIP), as it links sector specific policies with the imperative (economic transformation) of the National Development Strategy 2020 (NDS), the highest official strategic document. Further, this Concept provides an alternative approach (Modern Approach, complemented by the Cluster) for designing the KIP itself.

The policy measures proposed in this document are policy responses to key challenges to the economic growth of Kosova, focusing primarily in the six most contributing sectors and naturally born clusters within them.

The structure of this Document is arranged in this format: 4- Introduction, 5- Approach and Methodology on how this document is comprised; 6- Theory and Approach of the Industrial Policy; 7- Economic Landscape of Kosova; 8- Objectives, 9- Policy Measures and 10- Stakeholder Engagement Model.

4. Introduction

As a new born state, Kosova has been facing dramatic changes in all aspects of life within a relatively short period of time. Once a semi-industrialized and centrally planned economy, today, it has been transformed into a market driven one, where the Small and Medium Enterprises (SME) engaged into the lower part of the value chain, make the backbone of the economy.

Nevertheless, it is among the few countries in the region which has experienced a solid economic growth rate, even during the world financial crisis; however, it needs a much faster pace of growth, preferably financed by exports and higher private investments, so that it can improve the living standard and offset its large negative trade balance. In this regard, the medium term projections of the MF show an average annual increase of exports by 8%[1], while the remittances to remain relatively at the same level (roughly 12% of the GDP).[2]

However, the GDP share of the manufacturing sector for the last 7 years has been relatively low (rounded average of 10%), while the public administration and defense, agriculture and fishing, wholesale and retail trade have been the main contributors to it (rounded average of 13% each).[3] Simultaneously, consumption and private investments have been and are expected to be the main contributors to the estimated GDP growth rate of 4.1% in 2014.[4] Additionally, Kosova has had relatively low net export, while its large volume of imports is mainly financed by the transfers and Diaspora remittances. Other challenges that are deterring the economic development of Kosova include the relatively high rate of informality, unskilled labor force, lack of access to finance, low labour participation rate (youth, female and minorities, in particular) and relatively high level of perceived corruption.

Consequently, Kosova is in great need for unorthodox and more effective policy measures that would enhance its economic development. In contrast from the past though, when the industrial policy dominated as well as focused solely on a specific industry support, and the exclusivity of policy design was upheld mainly by the central government, this Concept argues for a Modern Approach of designing the industrial policy, which comprises of mainly cross-sectorial measures, designed in close collaboration with all the stakeholders, complemented by the cluster

[1] MF 2014
[2] CB 2014
[3] KAS 2013
[4] MF 2014

approach, which mainly deals with the strengthening links between such actors. On this basis, Kosovo government is committed to improve the economy by delivering the National Development Strategy of Kosovo (NDS), which will serve as an umbrella for all the sector strategies and policies, including the Industrial Policy.

This Concept shall serve as the theoretical foundation of the KIP as well as policy outline for stakeholder discussion. It is comprised of information about theory and rationale behind the industrial policy, analysis of the Kosovo economic background, including challenges of the main industrial sectors, objectives and specific measures. However, it differs from a full scale strategic planning document due to the fact that it does not include a detailed action and financial plan to be elaborated post-consultation phase.

Additionally, this Concept outlines a platform of objectives and proposed measures intended to intensify a strategic collaboration between all the stakeholders i.e. government, industry and private sector in general, academy, and donors' community, in order for Kosova to tap in its comparative advantages and transform from a low added value economy to an advanced knowledge based one over time.

KIP designed to tackle cross-sectorial constraints to economic development and facilitate the development of internationally competitive clusters, in particular. It is focused particularly in the enhancement of industrial policy capacity development, coordination and cooperation; improvement of access to finance at all stages of enterprise development; facilitation of access to foreign markets and export promotion; improvement of environment for entrepreneurship development and growth of SMEs; support for the modernization of technology and business processes; reduction of the skills gap; attraction of more and "better" FDI; stimulation of product development, innovation, and R&D.

Recommendations from referenced studies and the late dialog process with the private and public sector representatives, implied the existing of great potential of Kosova's industry to prosper, however, the "capitalization" of this prosperity mainly depends on elements such as: more intensive and "smarter" support from the Government, further improvement of the doing business environment and improvement of policy making and coordination capacities at the central and local governmental levels with regard to the private sector development.

Despite that, the success of the KIP is completely dependent on the coherent response by all relevant stakeholders and the support of donors, in particular.

5. Approach and Methodology

The Approach used for this document was a twofold one: top down and bottom-up. In terms of top down approach, key Strategic Documents, studies, and Government Institutions have been consulted and involved in the process from the initial stage, whereas from the bottom up approach, several round tables with the private sector have been organized as part of the dialogue process.

The data used in this Document is derived from official institutions, interviews, roundtable discussions with businesses representatives and the most recent studies conducted by foreign and local experts for the MTI.

In particular, the process of preparing this document included these phases:

Specifically, the process of preparing this Document included these phases:

1. Expert and stakeholder engagement
2. Economic (industrial) trends diagnosis
3. Government and market failures identification
4. Objectives and industrial policy measures definition

Further, upon the request of the MTI and support provided by the UNDP, the following studies were conducted by local and foreign experts. The data utilized for these studies were derived from the enterprise surveys and official institutions (KAS, KBRA, CK and TAK). Such studies have been consulted throughout this Document.

- 2 draft Reports of Kosova Industrial Policy,
- Natural-born clusters Study,
- 6 (six) sector studies for the industry of metal processing, textile, food-processing, tourism, ICT and wood processing,
- Assessment of the fiscal policy effects on the manufacturing sectors,
- 3 policy assessments for priority trade and human development

For benchmarking purposes assessment of the competitive and comparative advantages of Kosova in the international, regional, national and sector context was performed through the following means:

- Assessment of the position of the Kosovar economy
- Identification of the sectors with the highest contribution to the economy and growth potential
- Conduct of the sector studies for those flagship industries

In particular, the international competitiveness of Kosova was assessed through a comparative (gap) analysis with closest competitors of Kosova. The selection of such countries was done based on the following criteria:

- ✓ The exports of other economies and their similarity with the six most contributing and highest growth potential industrial sectors of Kosova (Metal, Wood, Food and Processing, Textile, IT, and Tourism)
- ✓ The main trade partners of those economies and their similarity with Kosova's destination of exports

Next, some countries were excluded as their conditions were too different from Kosova (China for instance) and, to determine the final list, the following additional criteria were added:

- ✓ Economies from different continents, to open perspectives and widen the potential lessons to be learned
- ✓ Economies that are voluntarily a step ahead, but faced a similar economic situation in a recent past years,
- ✓ The recent adoption of strategies that could be of interest and the possibility to assess results

Further, to be able to understand Kosova's competitiveness position relative to its neighboring countries, a set of global and regional indices was utilized:

- ✓ World Economic Forum (WEF) Global Competitiveness Index (GCI) 2013-2014
- ✓ WEF GCI 2012-2013
- ✓ World Bank (WB) Doing Business 2014
- ✓ OECD SME Policy Index 2012
- ✓ WEF Global Information Technology Readiness Index (WEF GTRI) 2013

Then, the following twelve criteria, set by the World Economic Forum (the Forum), were used to assess the Kosova's national competitiveness:

- Institutions
- Infrastructures
- Macro-economic environment
- Health and primary Education

} Basic requirements

- Higher education and training
- Goods market efficiency
- Labor market efficiency
- Financial market development
- Technology readiness
- Market size

} Efficiency enhancers

- Business sophistication
- Innovation

} Innovation and sophistication factors

In addition, the sectorial competitiveness analysis was performed taking into account mainly the six sectorial profiles and Natural-Born Clusters Study. The sectorial profiles were conducted for six industrial sectors with the highest contribution and greatest potentials for the economic development such as agro-food processing and packaging, textile, metal, wood, tourism, and ICT; consequently, such sectors serve as flagships for the whole Kosovar industry/economy.

Further, it represents one of the key reference documents in the process of drafting the CKIP. Such a Study utilizes the Porter Diamond Model as a key analytical approach. Although this Study explored only one of the two elements (value chain and value stream) of the Cluster Model, it provided rather important information for the case of Kosova due to mainly two reasons: 1 - the value chain, from the global point of view, takes place in difference areas, mainly due to the competitive costs, and 2 – as the first phenomena takes place, the Kosovar SMEs (bulk of the economy) simultaneously face fiercer competition as well as greater opportunities for

engaging into more complex as well as higher value added tasks, i.e. research and development, procurement, human resources management, and many other activities which can now be regarded as higher value adding activities.[5] Nevertheless, it provides detailed information about the ongoing natural born clusters in Kosova, whose recommendations have been taken into consideration in the proposed policy measures in the CKIP.

As far as the product level analysis is concerned, we have prepared the list of the main exports of Kosova in 2013, as the literature dictates a well-established positive and persisting linkage between the efficiency (competitiveness) and exports. [6]

Lastly, KIP's targets were set by adding an estimated effect deriving from the KIP measures on the projections made by the MF, and the DPI using the coefficients of correlation between of the respective indicators and GDP for the period of 2009-2012/2013 (details can be found at the Table 8 in the Annex). The year 2009 was chosen as it was the first year after the Kosovars received full responsibility for running economic policies from the UNMIK, whereas that of 2012/2013 was dictated by the availability of data. Then, the projections were made using the Future Value formula, in which the coefficients of correlations were included for respective indicators. Nevertheless, we expect a higher accuracy of estimating the targets, after we will know the exact value of input into the economy from our policies, expressed in the financial plan and time-frame of the KIP.

6. Theory and Approach of the Kosova Industrial Policy

In this Section, we elaborate some of the key differences between the Classical and Modern Approaches of the Industrial Policy (complimented by the cluster policy on a sector / industry / firm level). Also, we argue in favor of the latter one.

In today's free market economies, public investment and state planning are not expected to act as the dominant driving force of economic development. However, it is also true that there is an increasing trend of recognizing the need, in developing countries in particular, to encourage

[5] Ong 2014
[6] Tybout (1997)

economic restructuring, diversification, and technological dynamism beyond what market forces alone would generate, through embedding the private initiative in the public action framework.[7]

In accordance with the theoretical foundations of the Neoclassical Welfare economics, the highest level of economic efficiency (firms would produce at the lowest cost and allocated resources among them and industries in the most efficient way) is expected to be achieved through an "invisible hand" driven by self-interest-oriented market participants.[8]

However, the reality does not always hold to such assumptions, as many market failures are present across the economy. The pervasiveness of such market outcomes (failures) during the process of the structural change represents one the main argument in favor of industrial policy. Besides, the term market failure is used to define market outcomes different from the most economically efficient ones; in this regard, there are numerous reasons behind such outcomes including, but not limited to, externalities, wrong market structure, public merit and demerit goods, etc. Moreover, market failures are mostly derived from these externalities: technological (static or dynamic), information (related to discovering the cost structure) and coordination (related to the presence of scale economies).[9]

In addition, the "misbehavior" of market participants is not the exclusive cause of market failures; indeed, the governments may also contribute to the creation of market failures (inefficiencies and misallocation of resources) due to their policy interventions.

Consequently, there are government (Framework and Institutional) and market (Capacities and Network) failures, which imply for certain discrepancies between the public and private benefits, thus, serving as the rationale for collective action to be undertaken; as far as the capacity market failures are concerned, they represent the failure of reaching economic efficiency because of lack of cooperation between the market participants;[10] whereas, the network failures result from the existence of network externalities i.e. the number of users of a certain product impacting the total utility an individual receives from that product.[11]

[7] Rodrik (2004)
[8] Keech et al. (2012)
[9] Rodrik (2004)
[10] Stiglitz (2000)
[11] Gillingham and James (2000)

On the other hand, the framework failures represent the main governmental failures, which at the national level are linked with risk-management rules, technical standards, health and safety regulations, etc.; also, they relate to the regulatory system linked to contracts, employment, intellectual property right; whereas, institutional failures are mainly related to the political culture and the social values which together make up the public policy objectives and the macroeconomic policy environment; taking into account that the performance of the government institutions and its framework do shape the technological opportunities, capabilities and performance of private firms and macroeconomics of a country.[12]

Economic experience has shown that such failures were tackled by governments through different models of industrial policy, however, Rodrik (2004) states that: "the right one is not that of an autonomous government applying Pigovian taxes or subsidies, but of strategic collaboration between the private sector and the government with the aim of uncovering where the most significant obstacles to restructuring lie and what type of interventions are most likely to remove them".

Specifically in his paper titled "The Industrial Policy of the XXI century," he defines Modern industrial policy as a state of mind established through building private-public mechanisms, where profitable activities and useful information is shared and further implemented; hence, the Government's role is still strongly related to creation of an enabling environment for the overall economic development through various incentives and regulations to this effect.[13] In other words, industrial policies are expected to assist the market forces in maximizing their contribution to the economic growth while greater caution is taken to select from the range of available policies the ones which cause the least, if none, amount of inefficiencies such as waste and rent-seeking along the way.

With regard to the case of Kosova, there is a need for a modern industrial policy in order to enhance an important and delicate process of economic transformation that moves from a natural resource-based economy towards an economy dominated by knowledge based, higher value added and competitive industries.

[12] Smith (2010)
[13] Rodrik 2004

Of equal importance stands the path which is chosen by the governments to accomplish such a vision. Typically industrial policy makers tend to focus on firms which are expected to deliver the highest growth and transformation potential; however, it is important to have new and emerging industries in the loop too.

In the past there have been countries which applied certain industrial policies derived from the Classical Approach and as a result faced cases when dominant firms and sectors were very good at capturing attention and gaining political prominence, and managed to extract subsidies and rents from the public sector. As result, such policies did not only distort the market, but also stopped the economy from shifting to a more competitive position.

Hence, we argue that the approach of designing the KIP must be done through stakeholder collaboration practices that go far beyond traditional public policy consultation processes. The industrial dialogue has to be regular and structured, which implies building capacities and coordination structures both on policy makers' (including academia) and industry side in order to enable quality dialogue on economic development issues. Surely, the best and only source of micro economic firm and industry information is the firms themselves.

The approach of designing the KIP should represent a collaborative policy planning process, which would prevent capture of economic policy by a few industries, but would rather establish a level playing field for all economic agents willing to develop their own business and advance Kosovar economy.

Also, it demands that the policy decisions and incentives be made through a collaborative process involving government at multiple levels, companies, educational and research institutions. It requires a better institutional coordination too. This way, the chances will be much higher that it will ensure a market driven and sustainable private sector growth, and enable government interventions to be more accurate with minimum distortions.[14]

[14] Porter (2003).

Cluster Model represents the complementary part to the modern industrial policy approach; it is used specifically for understanding the dynamics of industrial organization, international trade, and regional development, whose collaborative focus pertains to the firm-level.[15]

According to Porter (1998), "clusters are geographic concentrations of firms, suppliers, producers of related products, specialized infrastructure and specialized institutions (e.g. business associations and training programes) that arise in particular fields in particular location; also, they represent key drivers of job growth, wage growth, new business formation and innovation". Factors of advantage that support a business idea, specific demand, natural resources or skills may trigger the establishment of the new clusters.[16]

In other words, the process of cluster initiative is an organized attempt to improve the collaborative environment among the private sector, the academia, and the public institutions considering that their leaders are competitiveness oriented. Further, when this attempt originates from the private public dialog it can generate important tips for the policy making process by orienting the focus to more critical constrains through an improved channel of communication between relevant stakeholders.[17]

Also, cluster initiatives tend to stimulate the activities within the cluster itself and other entities (traders, processors, manufacturers, exporters, training institutes, government standard bureaus, etc.) by further enhancing the supply chain, decreasing the information externalities, improving the workforce skills, and increasing the quality of standards and products/services.[18]

In addition, relative to the advanced economies where many fully developed clusters exist, Kosovar economy consists of a number of industries which are at their early stage of cluster development. As such, the aim of the KIP is to foster the development of clusters primarily within the six flagship industrial sectors, mentioned earlier in this Document, which are estimated to have contributed the most to the Kosovar economy as well as estimated to have the greatest potential for growth. However, it is necessary to be alert of emerging clusters in technology intensive and innovative industries, in particular.

[15] Porter (1990)
[16] Porter (1998)
[17] Ong (2014)
[18] Cortright (2006)

Consequently, the Cluster Approach is a widely used economic policy and is productive for targeting economic transformation of firms and industries. On this regard, the CKIP combines horizontal and cluster oriented measures, with the latter focusing on firm and industry level.

The KIP is not a sectorial policy; instead, it employs a horizontal approach that incorporates various policy planning areas such as fiscal policy, education policy, infrastructure, rural development, agriculture, natural resources, environment, energy, telecommunications, etc. Thus, it differs fundamentally from the traditional sectorial policies in terms of the intellectual foundations as well as governmental implications.

Another distinguishing feature of the Modern Approach is the fact that it is systemic; in other words, it includes an analysis of a cluster's value chain as well as a strategic orientation; also, it focuses on solving information and coordination failures through better participation of supporting institutions outside the value chain.[19] So, it generally represents an attempt to identify areas of policy intervention, where certain distortions are made for the sake of stimulating higher value added economic activities, while the principle of neutrality is maintained throughout.

Despite all these arguments in favor of the Modern Approach, it is essential to bear in mind two elements regarding the Industrial Policy: 1- the quality of industrial policy depends not only on traditional ability of economic policy-makers to analyze and reflect on macroeconomic processes, but to also be able to infer consequences of policy on industry and firm level decisions; 2- KIP cannot and shall not cover everything, meaning every government policy area that on some level affects entrepreneurship and economic development (functional requirements) including the rule of law, fiscal policy and other macro policies.

Indeed, the success of the KIP on achieving its objectives is conditioned on fact whether such issues are effectively addressed by coherent sector / policy issue level strategies. Such strategies shall consist of policy measures derived from industrial dialogue activities, case studies on strategic sectors, emerging clusters as well as existing and emerging sectorial documents. Their base level agenda should emerge from strengthening capacity and supporting formation of industry/cluster level bodies.

[19] Cortright (2006)

6.1. Industrial Policy Architecture

As it can be seen in the Figure 1 in the Annex, the KIP aims to cover several dimensions of economic development/competitiveness/industrial policy aspects including:

i. Ongoing analysis of external trends: monitoring of global and regional economic trends (emerging technologies, value and supply chains, industry convergence etc.), shifts in comparative / competitive advantages

ii. Sound macro environment and functional factors (overall government policy – other policies) increasing factor productivity for everyone allowing for sector/ industry/cluster specific approaches

iii. Effective removal of specific cross-sectorial binding constraints (object of IP) to turn comparative advantages into competitive ones

iv. Cluster and industry specific activities (object of IP) for existing revealed growth clusters.

7. Economic Landscape of Kosova

7.1. Key Challenges of Economic Development in Kosova

It is interesting to state that due to its low exposure to the global economy and its small export rates, Kosova was not affected heavily by the Global Financial Crisis. However, Kosova economy is still facing some key economic problems, which are addressed and analyzed below and are a key source for identifying and prioritizing this Concept's main objectives. This part elaborates in more detail the key economic problems of Kosova, in line with the challenges identified on the NDS 2020 draft.

Low GDP per capita, slow pace of economic growth and poverty - as it can be seen from the Fig. 2 in the Annex, Kosova's GDP trend from 2009 until 2013 experienced a relatively high average economic growth rate of 3.34% in the last five years. However, considering the high unemployment rate and the small size of the economy, Kosova needs a much faster pace of

growth rate to make a significant impact on its welfare. Indeed, facing a GDP per capita of EUR 2,757[20] and an unemployment rate of 25%[21], makes Kosova as one of the poorest state in Europe (the poverty headcount ratio at national poverty line (% of population) in 2011 was 29.7%[22]), especially affecting the most vulnerable groups of the society (youth, female and minorities).

Large current account deficit – as presented in the Fig. 3a and 3b, during the last 5 years Kosova has experienced a large current account deficit (EUR 1,794 million in 2013), which is a reflection of lack of competitiveness of the Kosova's products, misallocation of remittances and low inflow of FDI.[23]

Low net export – Despite trade integration of Kosova market with the region, Turkey as well as to a certain extent to that of European Union, it continues to face relatively low net exports. Trade deficit in 2013 amounted EUR 2,155 million with a total export of EUR 293 million and imports of EUR 2,449 million. Also, referring to Fig. 4 one may see the trend of ratio of import to export for the main economic sectors of Kosova during the period of 2005 – 2013, [24] the yearly growth rate of exports has outpaced the yearly growth rate of imports; however, considering the pool of trade this pace is still insignificant to improve the trade balance of the economy of Kosova. This is rather critical for Kosova, due to the fact that the bulk of Kosova's exports is base metals, which are highly sensitive to fluctuations of their prices and demand in the international market; consequentially, these fluctuations of prices result in overall fluctuations of Kosova exports as well as other economic indicators.

Misallocation of current transfers (Remittances) – Remittances are part of current transfers, which in general consist of governmental and private transfers but most of all are dominated by private transfers (remittances). This is also the account that contributes the most in softening the current account deficit (Fig 5). In 2012, revenues from remittances equaled EUR 605.6 million and represented an increase of 3.6% compared to a year earlier, though, remittances count for a significant portion of the GDP (roughly 12 % in 2013), 96% of them are used for consumption

[20] World Bank 2013
[21] KAS 2014
[22] World Bank 2012
[23] CBK 2014
[24] KAS 2014

and as expense for the imported goods, whereas remaining portion is used as a productive investment.[25]

Furthermore, the economic growth rate consisted mainly of the consumption component and only a small share of it originates from investments and net exports,[26] signaling for the need of measures stimulating the shift of such capital into relatively more productive investment.

Low Direct Investments – In 2013, the FDI in Kosova amounted to EUR 241 million, presenting an increase of 13.1% compared to the previous year (EUR 213 million). Further, referring to Fig. 6, it can be noticed that from 2008 until 2011 the share of FDI relative to the GDP was above 8.3%, whereas in 2012 FDI dropped at 5%.

FDI are mainly concentrated in these sectors: real estate at 31.7%, construction at 20.8% whereas manufacturing at only 12.1%, followed by the financial sector at 10.4%, and in the end by the transport and telecommunications at 7.9% of the total FDI.[27] Taking that into account, there is a great need for reorientation of FDI's toward sectors of higher value added.

Relatively high level of unemployment, but low participation in the labor market - Kosova's economic growth has not been enough to address effectively the issue of the relatively high unemployment rate (30.0% in 2013); on this regard, in 2013, the number of unemployed people in Kosova (16 -64 years old) was 144,829 (Male: 95,942, Female: 48, 887);

Besides, these issues are disproportionally affecting the youth, females and unskilled workers; indeed, out of 80,398 persons categorized as the youth labor force (aging from 15-24), only 44% (27,713 males and 7,763 females) are employed.

While the abundant and available relatively large youth population represent a great national asset, at the same time having approximately 2/3 of the active youth in the labor market unemployed, only 1/3 of them active in the labour market, and 35.3% of them belonging to the NEET category (people who are neither employed nor in education/training), makes it a burden instead; moreover, as it can be seen from the Table 1 in the Annex, only 2/10 of working age women were employed, whereas more than 6/10 men, in 2012.[28] It's important to state that there

[25] CBK 2014
[26] CBK 2014
[27] CBK 2014
[28] KAS 2014

is a strong correlation between unemployment and higher education, as the workforce with a tertiary degree represents 25.6% of those employed and only 5.3% of the unemployed.[29]

In order to address relatively high unemployment, there is a need for improving the skills of the unemployed and decrease the mismatch between the demand and supply of skills in the labor market. Indeed, one of the main components of efficiency enhancer is higher education and vocational training, which refers to training suited to market needs, managerial and technical skills of workforce.

Regarding the higher education and vocational training, although some efforts have been made by the government of Kosova and EU projects in order to develop and prepare Kosova youth for high skilled employment, the affiliation with the private sector is still lagging behind.

Cost and Access to Finance - During the first half of 2014 Kosova's financial system continued to expand its activities. Banks continue to remain the dominant sector with 70.8% of the total financial sectors assets.

In June 2014, total loans equaled EUR 1.89 billion; in comparison to June 2013 this amount represented an annual increase of 3.5%. Loans to enterprises continue to dominate the loan portfolio with a share of 67.3%. On the other hand, deposits equaled to EUR 2.42 billion in June 2014, representing an annual increase of 10%. Overall, the liquidity position of the banking sector until 2014 in Kosova has continued to be satisfactory. The loans to deposit ratio decreased to 78.1% in June 2014 from 82.9% in June 2013. Non-performing loans in June 2014 increased at 8.2% from 7.8% in June 2013, but they still remain well covered by loan-loss provisions (116.4% in June 2014).

The banking sector remains well capitalized with a capital adequacy ratio of 17.4% that is well above the minimum regulatory requirement of 12%. The average interest rates on loans decreased to 10.6% in June 2014 from 12% in June 2013. The average interest rates on deposit in June 2014 decreased to 0.6% from 3.5% in June 2013.[30]

[29] KAS LFS 2013
[30] CBK 2014

In general, the banking sector in Kosova has been a success story in reference to sector stability due to its low exposure in the international financial sectors and the prudential approach of the CBK. However, Kosova banks do not lend at levels compared to the countries of the region. Hence, mainly for this reason, in the dialog with the private, access to finance is identified as one of the major barriers at all stages of business development. Moreover, due to high collateral requirement the cost of borrowing for startups in particular, is very high. In addition, the high interest rate spread, as measured by the difference between lending and deposit rates provides strong evidence that the cost of finance is high in Kosova. For comparison purposes, the Kosova interest rate spread is about 11.5%, twice as large as those in Albania and Serbia, and about four times larger than interest rate spread in Macedonia. Furthermore, collateral and other conditions for loans are more restrictive than in the comparator countries. This is a contradictory outcome since Kosova has the lowest level of nonperforming loans in the region.

Nevertheless, various studies on this filed suggest that, borrowing costs are relatively high, due to higher operational and risk costs of Kosova banks. In particular, they argue that the primary cause for the high cost and limited access to capital is the relatively difficult enforcement of judgments decisions, and contracts.

7.2. Competitive and Comparative Advantage of Kosova

7.2.1. International Level

In this Sub-section is presented the international position of Kosova relative to similar economies around the world such as Chile, Turkey, Mexico, Morocco, and Vietnam.

Kosova has been found to be doing relatively better than Turkey in terms of economic decentralization, providing a lower cost labor force, more favorable tax rates and regulatory framework as well as less bureaucracy. On the other hand, Kosova is falling behind Turkey on these aspects: market size, capacity to attract FDI, innovation and SME support.

Relative to the state of Morocco, Kosova is found to be doing better in terms of protection of investors, regulatory framework, and education system in the rural areas in particular to sectorial

programs and investments. In contrast, Morocco has shown some competitive advantage relative to Kosova in the area of specialized clusters and priority sectors of high value added and engagement of Diaspora.

Whereas, relative to the Mexico, Kosova is found to be more competitive in the areas of bureaucracy, investment climate and labor market, however, it is disadvantaged regarding the market size, business sophistication and SME growth, sector prioritization and international cooperation.

Investments in basic education and innovation capacity are the areas where Kosova is found to be doing relative better than Chile, whereas the opposite case relates to the political stability which is pivotal to the economic growth, ICT development, domestic competition, business environment and free economic zones.

Labor market flexibility, domestic competition (excluding the rule of law) and technological readiness are the areas where Kosova is found as more competitive than Vietnam; however, Kosova is relatively lagging behind in terms of quality of transport and energy infrastructure, market size, and doing business reform.

7.2.2. Regional level

In the Table 2 in the Annex is presented the competitiveness position of Kosova in WB, relative to the seven Western Balkan economies such as Albania, Montenegro, Macedonia, Serbia, Croatia, and Bosnia. This assessment is based on the consistently ranking of these countries achieved across a set of indexes used to measure competitiveness – WEF GCI, WB Doing Business, OECD, SME Policy Index, and WEF NRI.

Regarding the Ease of Doing Business report of 2014, Kosova stands better than Serbia and Bosnia, however, it falls behind Montenegro, Macedonia, Croatia, and Albania. Besides, with respect to the OECD SME Policy 2012 Report, Kosova does better than Bosnia, but it lags behind Montenegro, Croatia, Macedonia, Albania and Serbia.

7.2.3. National level

In this Sub-section, we have presented some of the main strengths and weaknesses of Kosova at the national level, through utilizing a set of three broad categories of criteria:

a. Basic requirements: Competitiveness factors

Institutions: there has been made a good progress on strengthening governance and the rule of law; however, corruption and bureaucracy remain pervasive, while implementation and enforcement remain weak. The civil society is integrated into the state and public-private dialogue and is relatively effective and open throughout the country.

Infrastructures: significant investments, privatization, and improvements have been realized. Main areas of investments include highways and energy.[31]

Macro-economic environment: generally, the macroeconomic environment has been stable but an insufficient rate of economic growth prevailed. Besides, Kosova still remains dependent on remittances, which are mainly oriented in housing and consumption. Simultaneously, it needs It needs more and higher quality FDI, more effective policies for tacking the relatively high informal sector and negative current account. [32]

Health and primary education: the healthcare system has been established and it is operational; however, the school enrolment is still low.

b. Efficiency enhancers: competitiveness – efficiency

Higher education and vocational training: considerable efforts have been made to develop and prepare young Kosovars for high-skilled employment, but the connection with private sector needs to be improved; besides, there is a low level of enrollment overall, especially at the university level.[33]

Furthermore, Kosova needs job placement programs as well as higher education and VET systems, which are better aligned with the market demands. In addition, improvement of the

[31] Lattanzio (2013)
[32] KIPRED Report
[33] KAS 2014

vocational training administration and curricula as well as the strengthening of skills and capacity of teachers, trainers, and facilitators is required.

Efficiency of goods and services market: recent reforms have significantly improved the business environment.[34] More details are presented in the Table 2 in the annex section.

The major constraints remain trading across borders and enforcing contracts. Moreover, the taxation system in Kosova has been streamlined and simplified to help ease tax burden for individuals and businesses. Also, Kosova is known for its relatively low tax rate for individuals and businesses. It is the most favorable system of the Balkans together with Montenegro as far as VAT (16%), corporate (10%) and personal income taxes (0-10%) are concerned.

In addition, Kosova is a relatively rather open economy; its trade policy includes the CETA, nonreciprocal and duty-free trade regime with the EU market based-on the EU Autonomous Trade Preference Regime, Generalized System of Preferences (GSP) privileges from the US and a progressive FTA with Turkey.

Efficiency of labor market: The labor market in Kosova is young, flexible and dynamic. Its general conditions have improved and fundamental labor policies as well legal framework are set, however, the informal labor remains a critical concern. Yet, there is a relatively high unemployment rate, but a relatively low labor participation rate.

Maturity of financial market: there is a stable financial system that has grown rapidly; also, it represents as one of the most stable in the region.

Use of technology: transfer of technology through partnerships and development of renewable energy solutions are relatively under-used. Despite that, Kosova has made considerable progress in overhauling and revamping its ageing and dilapidated technology. Moreover, the use of renewable energy and green technologies is set in a legal framework, but not implemented yet.

Market size: Kosova's market is a relatively small one; also, the domestic demand, although growing, remains relatively small, making local SMEs vulnerable to foreign competition and informal sector; besides, the proximity to the giant European market as well as membership in CEFTA represent great opportunities for SMEs to engage into larger markets.

[34] WB 2014

c. Innovation and sophistication: competitiveness - innovation

Business sophistication: business and management know-how have yet to be developed in Kosova. The SMEs have been developing without a clear logical framework, resulting in the emergence of diverse activities, relatively scattered and lacking complementarities. As a consequence, the width of value chains is limited while synergies as well as local value generation are relatively low and insufficient, respectively.

Innovation: the SME dominated economies is considered a contributing factor for innovation. However, there is insufficient human capital and knowledge base needed for a more significant transfer of skills and information, research and development; besides, there are limited links and access to global network for research, teaching, and learning.

7.2.4. Sector level

According to the official statistics, manufacturing sectors contributing the most to the Kosova's economy in terms of employment, turnover, and exports are Agriculture (food processing), Metal, Textile and Wood. On the other hand, based on the growth potential the IT and Tourism have been estimated with the highest growth potential.

A SWOT analysis for the Industry of Kosova is presented in the table below, whereas more detailed ones for each of the above mentioned industrial sectors can be found at the Table 4 in the Annex section.

7.2.5. Product level

As it can be seen from the Table 5 in the Annex, the main exports of Kosova in 2013 were of low value added category.

Nevertheless, as it was mentioned at the SWOT Analysis for the Industry of Kosova, there are great potentials, regarding the production and exportation of higher value added goods and services. However, specific measures, which would be part of the KIP must economic activities

for which various research studies identify with the greatest potential i.e. processed agriculture goods (bio-food), wood/furniture), IT and Tourism services, etc.

7.3. Market and Governmental Failures

Table 6: Perceived market and government failures

Governmental (policy) failures	Market failures
Framework failures: - Flat fiscal policy - Complex and low rate of contract enforcement - High levels of perceived endemic corruption - Education system detached from the industry - skills gap - Insufficient infrastructure investment (e.g. roads and electricity) - Lack and relatively expensive inputs (e.g. electricity) - Privatization to some extent - Insufficient incentives for relatively big capital private investments	Capacity failures: - Low level of investment in production capacities of firms, - Obsolete technology and low levels of technology absorption - Low levels of R&D and innovation - Local market orientation and focus on non-tradables - Lack of know-how and tacit knowledge - High and flat Interest rates
Institutional failure: - Higher education and vocational training systems unable to respond to private sector demand - Lack of capacity to develop links between state funded scientific and research bodies with private sector in applied research, innovation and R&D - Difficulties in enforcing copyright-intellectual property protection - Tax collection method (prior to sales and at the borders)	Network failure: - Lack of coordination and cooperation among firms, industries and sectors

7.4. SWOT Analysis of the Industry of Kosovo

Table 3: SWOT Analysis

Strengths	Weaknesses
• Abundant natural resources (coal, nickel, zinc) and long operational tradition and growing export potential in related industries • Potential for rapid growth industry sectors with higher private sector investment opportunities in agriculture and food processing, metal, wood and textile industries, ICTs and tourism • Emerging natural-born clusters, e.g. agriculture and food processing, leather goods and footwear, mining and metal processing, forestry and wood products, ICTs etc. • Location in proximity with large consumer markets for on-time delivery • Relatively abundant and low-cost labor, dynamic labor market • Abundant high quality agricultural land • Stable and favorable fiscal environment, low overall taxation levels • Relatively friendly business environment (easy business registration, good export infrastructure, EU compatible legislation)	• Absence of proactive government policy to effect structural transformation, underdeveloped public-private sector industrial dialogue • Quality of business environment still lagging behind regional competitors • Shortage of technically skilled labor force, lack of cooperation between vocation and higher education institutions and employers • Obsolete production technologies in manufacturing • FDI primarily in non-tradable sectors, low level of FDI in manufacturing • Reliance on imported inputs and low levels of value added • Limited firm level cooperation and lack of well-developed networks in the value chains • Domination of micro and small size firms • Low level of diversification of export markets for key industries • Low productivity levels in companies, low penetration of basic ICT application • Low level of innovation and sophistication (access to technology) on firm level • Lack of regional competitiveness • Cost and access to finance by SMEs • Cost and access to energy (particularly electricity) • Dependency on imported raw materials • Lack of infrastructure, especially in the rural areas • Large informal sector

Opportunities	Threats
• Maintaining stable macro-economic and fiscal environment and sound tax policy • Continued regulatory reform to improve ease of doing business • Implementation of proactive, smart cross-government policy to enable industrial development • Development of public-private sector industrial dialogue • Incentivizing and supporting industrial efficiency and productivity improvements, technological modernization and application of ICT • Supporting attraction of strategic FDI to manufacturing and tradable services, to transfer knowledge, technology, development of local value chains and access to foreign markets • Development of specialized niche-production in agriculture and food processing • Increasing level of sophistication of products in existing manufacturing sectors based on available natural resources • Incentivizing in house, contracted and joint R&D investment by firms • Developing export potential in services industries • Developing potential for firm cooperation and cluster formation • Development of VET, including on the job training, facilitating closer education system and employer cooperation • Develop support base for startups and development of new tradable or efficiency enhancing industries • Establish a coherent development finance system covering the gaps in private sector financing needs	• Inadequate energy supply and relatively high energy price • Political instability • Lack of coordinated and purposeful government economic policy • Lack of targeted response to market failures, continued disconnect between public and private sector strategic planning • Slow progress of reforms in education and other sectors, persistence of existing government failures • Lack of coordination in resource allocation among the government, private sector and donors • Lack or absence of funding to finance the necessary interventions for structural change • Continued high cost and difficulty in accessing financing • Lack of investment in infrastructure, especially in the rural areas • Application of ad-hoc trade barriers by the regional countries

8. Objectives of the KIP

In the Table below are presented the main targets for the KIP, whereas, in the Table 8 in the Annex section, additional targets and details are presented.

Table 7.a: Indicative model of NDS and KIP objectives

NDS level objectives (as perceived)	Proposed KIP objectives
1. Sustainable economic growth and income growth, GDP growth at 7-8% **2. Productive public and private investment** **3. Job creation** **4. Increased well-being and social inclusion**	a. Industry modernization - Capacity development, technology and skills upgrade, technology and skills transfer, energy efficiency b. Internationally competitive clusters - Smart use of FDI and export promotion to help shift focus to export orientation and value added, support to innovation and R&D, getting firms working together, availability of finance c. Agricultural development and efficient use of natural resources - Use of land, agricultural production, minerals and other natural resources for economic growth and extracting more value added d. Environment for entrepreneurship development - Promotion of entrepreneurship, startup culture, support to SMEs and new emerging industries, being faster than others in the region

Table 7.b: KIP targets

Indicator	2013	2020 without KIP[35]	2020 with KIP
Value added and share of manufacturing of GDP	EUR 603.76 million or 11.3%	EUR 711.42 million or 9.4%	EUR 746.9 million or 9.8%
Value added and share of high tech of GDP	EUR 1,173.8 million or 25.10%	EUR 1,738 million or 22.10%	EUR 1,824.9 million or 23.2%
Monthly average pre-tax salary in the private sector	412 Euro	442 Euro	464 Euro
Current Account balance share of GDP	-31.60%	-28.40%	-28.26%
Value and share of exports of GDP	EUR 927 million 17.40%	EUR 1,462 or 19.4%	EUR 1,535.1 or 20.37%
Value and share of exports of goods of GDP	EUR 305 million or 5.7%	EUR 575.5 million or 7.6%	EUR 604.2 million or 7.9%
Value and share of exports of services of GDP	EUR 622 million or 11.7%	EUR 886.5 million or 11.8%	EUR 930.82 million or 12.39%
Unemployment rate	30.00%	20.80%	18.72%
Female	38.80%	26.90%	24.41%
Male	26.90%	18.70%	16.83%
Labor participation	40.50%	57.30%	63.03%
Female	21.10%	29.90%	32.89%
Male	60.20%	85.20%	93.72%
Value and share of Government Expenditure in Education of GDP	EUR 204.4 million or 3.8%	EUR 286.66 million or 3.8%	EUR 300.99 million or 3.99%
Value and share of FDI of GDP	EUR 241 million or 4.5%	EUR 398 million or 5.3%	EUR 417.9 million or 5.56%
Monthly average pre-tax salary in the public sector	429 Euro	461 Euro	507 Euro

[35] All the raw projections (without inclusion of the estimated effect of KIP measures) are presented on the Table 8 in the Annex

9. Measures of the KIP

The main focus of KIP is the transformation of Kosovo economy through mainly horizontal (cross sectional) measures. Out of that, we have come up with four priorities and respective measures, as presented in the table below.

Table 9: KIP priorities and respective measures

Priority	Proposed measures
Industry modernization	- Finance capacity building and skills upgrade at the MTI, KIESA, Private Sector, Academia, the education system (lowering the skill gap) and relevant stakeholders included in the IP. - Improve the establishment of a regular industrial dialogue, hire specialists in strategic industry / emerging cluster areas. - Allocate funds in supporting SMEs in technology upgrade - Allocate funding for the support of industry associations and cluster bodies to engage in industrial dialogue, for gathering of statistics and enrich of the current database, for increase of strategic and analytical capacity. - Allocate funds for industry cluster organizations and meeting certain criteria (size, activities, joint projects) - Facilitate development of mandatory industry strategies / cluster master plans and other projects below the IP. - Facilitate joint investment by cluster members - Incentivize cluster formation on renewable energy and energy efficiency - Set up on the job training grants to companies training long-term unemployed

	- Set up first-time employment paid internship programs for employment of youth and women - Establish vocational training competence centers in cooperation between industry bodies, vocation training schools and municipalities - Provide program financing transfer of knowledge and provision of technical and managerial expertise among non-competing firms - Improve coordination between the education sector and businesses by establishing industry councils - Pilot and introduce dual-model approach – work placement as part of formal education curriculum - Subsidize study tours in industrial enterprises abroad and scholarships to specialists in programs / skills only available abroad - Set up industry employee training programs implemented by clusters / industry associations, with particular focus on minorities, youth and women

Access to finance at all stages of enterprise development	- Establish a coherent development finance system (institution) in partnership with private sector and external donors, covering all stages of enterprise financing not served by private sector (addressing market failures and complementing market, not replacing the market):
	  o Early stage funding instruments, growth and working capital (e.g. guarantees, mezzanine etc.),
	  o Partial credit guarantees etc.
	- Risk-sharing (partnership) financing alternative
	- Provide tax incentives facilitating investment of capital and reinvestment of profits into productive assets

	- Provide training and education for financial literacy - Continuous conduct of research to evaluate the impact of access to financial services on development outcomes (firms and households), in order to design more effective policy interventions, if necessary - Reducing cost (monetary and time terms) of registering and repossessing collateral
Internationally competitive clusters	- Develop export-oriented clusters/incubators for collective efforts in entering new foreign markets. - Reduce costs of market entry by co-financing market entry costs / improve further ease of doing business (certification, compliance requirements, testing etc.) - Finance training programs to develop export / international transaction skills of entrepreneurs - Develop risk sharing mechanism for entering riskier markets (export guarantees) - Develop young people entrepreneurship programs, tax breaks for young entrepreneurs and skilled employees - Organize public entrepreneurship promotion activities (soft) - Promote entrepreneurship training in schools - Develop network of incubators and their services, include pre-incubation services - Set up micro / family enterprise incentives for small scale (rural) entrepreneurship, with particular focus on youth and women entrepreneurial activity, as well as minority participation - Set up Diaspora matching grant funds to support innovation and R&D (reward skills and technology transfer) - Ensure vertical integration and growth of micro and small businesses by financing expansion - Define criteria for “high added-value” investment (e.g. cluster development, spillover effects)

	and provide targeted incentives - Establish job creation grants for technology / skills transfer intensive investments according to set of criteria - Engage KIESA in proactive industry and target selection according to strategic industries, based on supply and value chain analysis
Industry and agricultural development and efficient use of natural resources	- Set up matching grants / subsidized loans for replacing existing manufacturing technology, for automation of industrial and business processes - Set up matching grants for productivity / LEAN / 6 SIGMA consultations / process oriented solutions - Finance industrial energy efficiency audits - Provide energy efficiency matching grants for improving industrial energy efficiency - Make public investment decisions channel investments in complementary activities of the value chain
Environment for entrepreneurship development	- Set up matching grant mechanism for facilitating the investment in enterprise-oriented infrastructure by offsetting additional costs of underdeveloped public infrastructure (access roads, electricity, water / sewage etc.) to individual firms of sufficient size and firm clusters. - Develop cluster-based Industrial parks – specialized and located where clusters are, providing public infrastructure - Set up grant program to encourage renovation of degraded industrial properties - Set up facility or land for establishment and operation of specialized industrial zones. - Establish specialized technology incubators / parks in areas of high concentration of innovative firms (e.g. ICT)

	- Finance joint industry research grants, engaging industry bodies, public and private research entities - Set up small scale R&D voucher program for procuring product development services by local firms - Set up technology transfer centers at a few key universities (primarily technical) in collaboration with industry bodies - Introduce R&D tax incentives to facilitate firm investment in research and development

10. Stakeholder Engagement Model

As it can be seen from the Table below, in every priority of the KIP, to some extent we have the involvement the same main stakeholders.

Table 10: KIP priorities and stakeholders

Priority	**Stakeholders**
Industry modernization	PMO, MAFRD, MF, MEST, MLSW, MLGA, MED, MESP, Academia, Chambers of Commerce (Cluster organizations) and Donors
Access to finance	
Internationally competitive clusters	
Industry and agricultural development and efficient use of natural resources	
Environment for entrepreneurship development	

11. References

- Cortright, Joseph. Making sense of clusters: Regional competitiveness and economic development. Brookings Institution, Metropolitan Policy Program, 2006.
- Gillingham, Kenneth, and James Sweeney. "Market failure and the structure of externalities." Harnessing Renewable Energy in Electric Power Systems: Theory, Practice (2010): 69-92.
- Keech, William R., Michael C. Munger, and Carl Simon. "Market failure and government failure." Public Choice World Congress, Miami. 2012.
- Kosovo Statistical Agency (KAS). 2014.
- Lattanzio, Richard K. "The World Bank Group Energy Sector Strategy."Congressional Research Service (2013): 7-5700.
- Ministry of Finance. “Law on Budget of Republic of Kosovo for year 2015”. 2014.
- OECD “Moving Up the Value Chain: Staying Competitive in the Global Economy” July, 2007
- Porter, Michael E. Clusters and the new economics of competition. Vol. 76. No. 6. Boston: Harvard Business Review, 1998.
- Porter Michael. (1990) “The Competitive Advantage of Nations”, The Free Press: New York.
- Porter, Michael E., “The Economic Performance of Regions,” Regional Studies 37, nos.6& 7 (August/October 2003): 549-578
- Roberts, Mark and James Tybout. (1997). “An Empirical Model of Sunk Costs and the Decision to Export.” American Economic Review v87, n4: 545-64.
- Rodrik, Dani. "Industrial policy for the twenty-first century." 2004
- Smith, Keith. "Innovation as a systemic phenomenon: rethinking the role of policy." Enterprise and innovation
- Stiglitz, Joseph E. "Capital market liberalization, economic growth, and instability." World development 28.6 (2000): 1075-1086.
- World Bank. "World Bank Indicators." 2012. Data. World Bank, n.d. Web. 22 Sept. 2014.
- World Bank. Country income classifications. 01 July 2013.
- World Bank. Doing Business report 2015. Nov 2014.

12. Annex

Fig. 1: Architecture of strategic documents

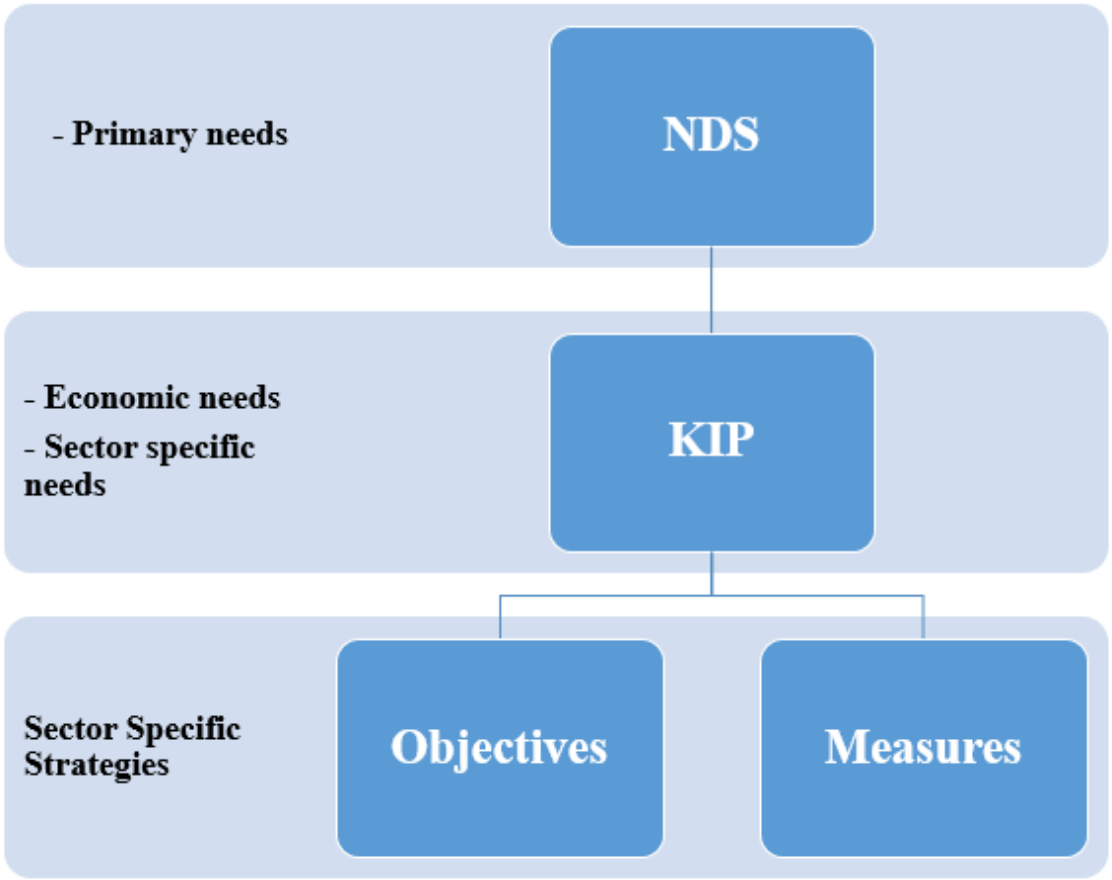
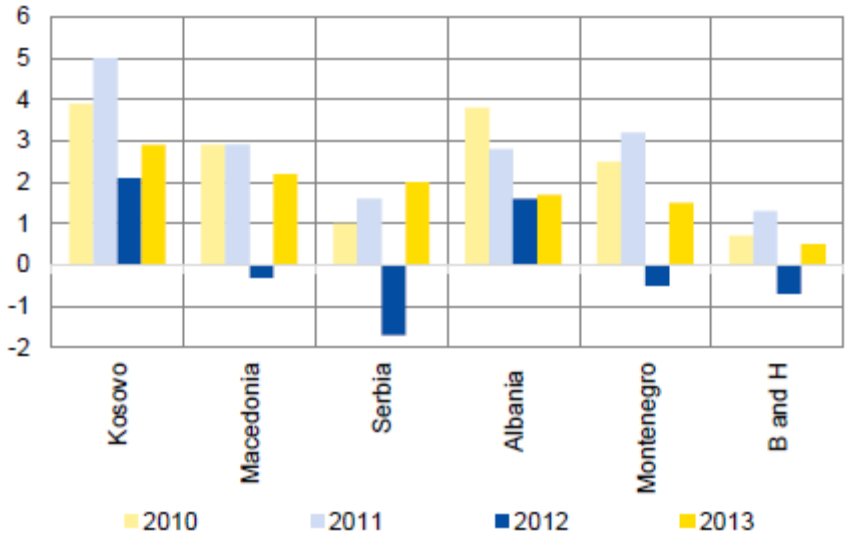
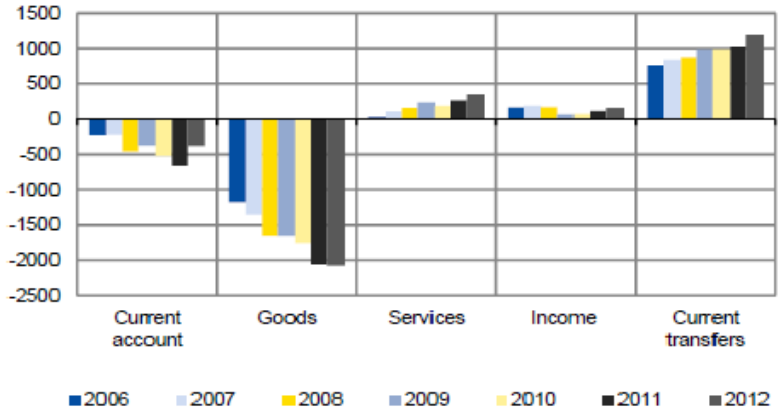


Fig 2: Real GDP growth rate of the SEE countries, in %[36]



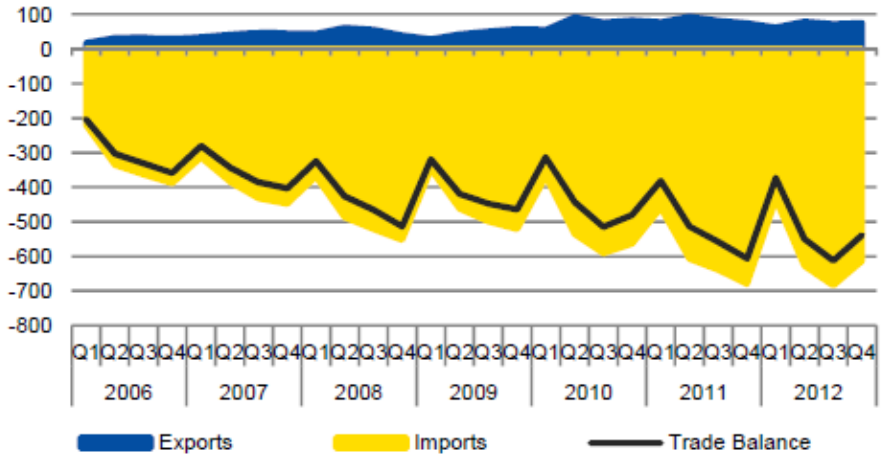
[36] Source: CBK, 2013

Figure 3a: Current Account Balance, in millions of euro[37]



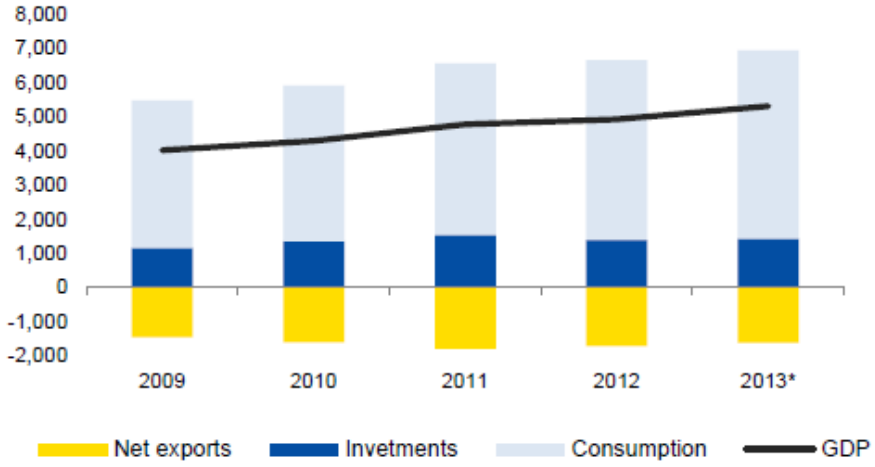
[37] Source: CBK, 2013

Fig. 3b: Imports, exports and trade balance, non-cumulative[38]



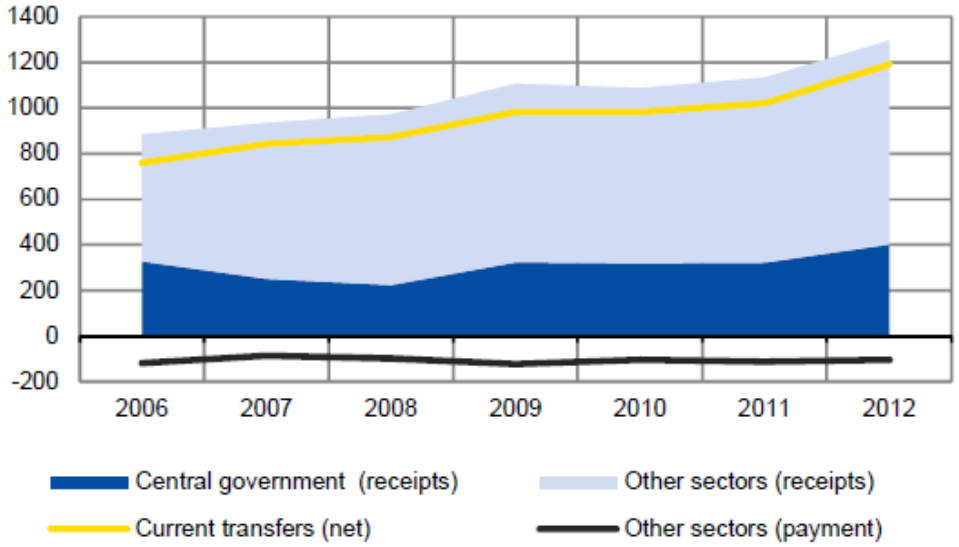
[38] Source: CBK, 2013

Fig.4: Main components of GDP of Kosova[39]



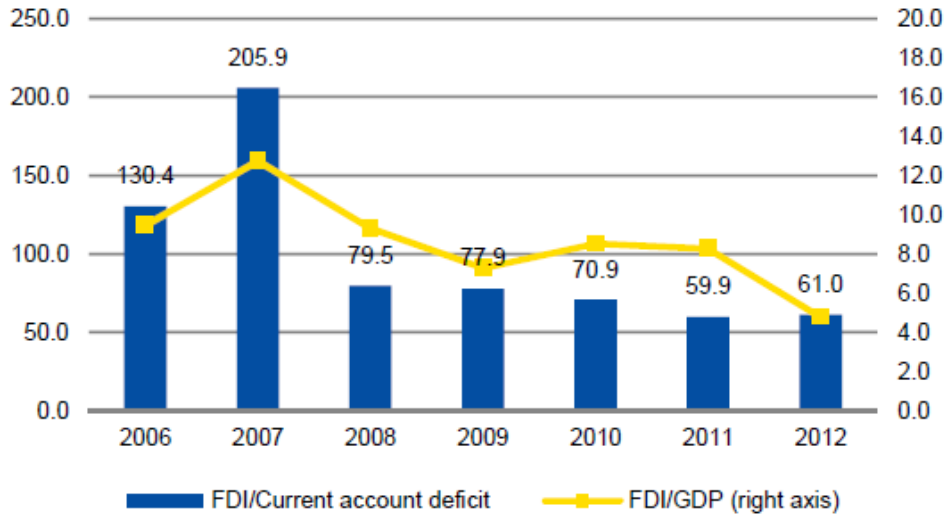
[39] KAS 2013 (CBK projections)

Fig. 5: Current transfers, in millions of euro[40]



[40] CBK 2013

Fig.6: Foreign direct investments as percentage to GDP and current account deficit[41]



[41] CBK 2013

Table 1: Labor market indicators [42]

Country	Labor force participation rate	Unemployment rate	Employment rate
Kosovo	40.5	30.0	28.4
Male	60.2	26.9	44.0
Female	21.1	38.8	12.9

[42] KAS 2014

Table 2 – Kosova Competitiveness Position in Western Balkan

	GNI per capita (US$)	WB Ease of Doing Business 2015 Rank (189 countries)	OECD SME Policy 2012 Rank (8 countries)	WEF Global Competiveness Index (GCI) 2014-2015 (144 countries)	WEF Networked Readiness Rank 2014 (144 countries)
Kosovo	3,890	75	7	N/A	N/A
Regional					
Albania	4,700	68	5	97	95
Bosnia and Herzegovina		107	8	N/A	68
Bulgaria	7,030	38	N/A	54	73
Croatia	13,330	65	2	77	46
Macedonia, FYR	4,800	30	4	63	53
Montenegro	7,260	36	6	67	61
Serbia	5,730	91	3	94	93
Global					
Chile	15,230	41	N/A	33	37
Mexico	9,940	39	N/A	61	59
Morocco	3,030	71	N/A	72	121
Turkey	10,950	55	1	45	51
Vietnam	1,730	78	N/A	68	84

Table 4 – SWOT Analysis at sector level

Sector	Strengths	Weaknesses	Opportunities	Threats
Base-metal	- Abundant natural resources (coal, nickel, zinc) - A traditional sector - A leading exporting sector in Kosovo - Expectations are for higher private se tor investments	- Shortage of technical skills (metal processing plant operator, sheet metal worker, machine tool operator metal wheel grinder, polishers and tool sharpeners, riggers and cable slicers, structural metal preparers, welders and flame cutters) - Low usage of the production capacities - Lack of cooperation in the value chain - Limited innovation and sophistication of process, - Low access in technology - Lack of product diversification - Small number of exporting firms with relatively low value of exports	- Easy access to land - Friendly business environment - Favorable VAT rate - Custom incentives - Diversification of the domestic production	- Inadequate energy supply - Relatively high energy prices (tendency to increase further) - Low incentives for new start ups - Difficult access to finance - Fully loaded with micro- firms producing similar goods and services. - High cost of bank guarantee - Dependency on imported inputs

Food procession and packaging	- One of the largest economic sector and with rapid growth - One of the main exporting sector (most competitive) - Good business network - Competitive subsector of packaging - Positive trend on producing their raw materials too	- Lack of quality versus similar imports - Lack of investment in innovation - Lack of on-the-job trainings for the staff - With few exceptions, firms are unable to compete in the region/globally	- Relative low labor cost - Abundant and high quality of agriculture land - Good export-infrastructure - Easy business and patent registration procedures - Clusters typically seeded because of the natural resources advantages (climate, ores) or entrepreneurs themselves - Potential increase of investments in technology	- Lack of adequate infrastructure at the rural areas - Lack of support and promotion of higher-value activities[43] - Difficult Access to finance - High cost of bank guarantee. - Raw material representing a major cost of production - Non-tariff-barriers from the regional countries (politically generated) - Lack of skilled workers (machine operators, agriculture experts and food technologists) - Production inputs are mainly imported
Textile	- Competitive in leather products, articles of clothing and apparel	- Fragmented sector into micro-businesses	- Adequate level of education for workers - Clusters typically seeded because of the	- Increasing dependency on energy - Relatively high costs

[43] Subsidies from the Ministry of agriculture are mostly channeled towards production, but not processing activities. Also, 6% of businesses produce 76% of the sector's value added. They are involved in dairy production and wine/beer production, which should be further promoted by the MTI

	(Wearing Apparel), and textiles, clothing and apparel manufacturing		natural resources advantages (climate, ores) or entrepreneurs themselves	of input factors - Difficulty of access to finance, especially for the start-ups - Competition from the informal sector - Lack of higher skills in support and management functions - Insufficient local demand - Production inputs are mainly imported
Wood	- Competitive in manufacturing of furniture, windows and doors - Improved technology in the manufacturing process - Beginning to provide on-the-job training provided by a few firms	- Underdeveloped value creation - Lack of abundant and qualitative natural resources - Improved product quality - Lack of spread of innovation among the firms - Limited network	- Growing foreign demand - Great exporting potential for intermediate and final goods, especially in the European markets	- High cost of bank guarantee - Lack of skilled workers for the managerial positions - Production inputs are mainly imported
Tourism	- A geographical location with rich history - All-year travel and leisure experience - Winter and skiing season at Sharri	- Underdeveloped sector - Unutilized growth capacities	- Greatest potential for growth, especially for artisans - PPP successful cooperation for the Brezovica Alpine resort - 22,000 hectares of	- Insufficient institutional capacities - Continual perception about the region as unstable and unsafe - Lack of strategic

	mountain - Potential for Eco-tourism: hiking, mountain biking, golfing, paragliding and other outdoor activities - The internationally-certified Alpine skiing resort of Brezovica		untouched mountainous land owned by the SOE Sharrprodhimi are available for privatization - Abundant thermal springs - Kosova has a rich history - Easy environment for doing business - Favorable tax policy - Simplified patenting procedures	policy - Lack of vocational schools - Insufficient supply of infrastructure - Lack of support for promotion of higher value added activities - Informality, mainly due to the predominance of micro and artisanal businesses
ICT	- Economy-wide important sector with great potential to grow fast - Most prominent sector for cluster formation - Cluster formation symptoms are showing up	- Internet penetration rate is still relatively low	- Market liberalization and the adoption of new legislation - Establishment of incubators - It is an unexploited market with great potential for investments - Relatively low labor cost	- Lack of country code and the overall telecom infrastructure - Insufficient institutional focus for e-services - Development and availability of industry data - Lack of highly skilled workers - Lack of networking and credit - Exclusion from the FTAs

Table 5: Top exports of Kosova in 2013

	Exports in 2014, by product	Value (in Euro)
1	7202:Ferro-alloys	88,402,350
2	2716: Electrical energy	21,684,622
3	7204:Ferrous waste and scrap; remelting scrap ingots of iron or steel (excl. slag, scale and other waste from the production of iron or steel; radioactive waste and scrap; fragments of pigs, blocks or other primary forms of pig iron or spiegeleisen)	20,639,335
4	2607: Lead ores and concentrates	15,195,630
5	4101:Raw hides and skins of bovine "incl. buffalo" or equine animals, fresh, or salted, dried, limed, pickled or otherwise preserved, whether or not dehaired or split (excl. tanned, parchment-dressed or further prepared)	11,373,614
6	7404: Waste and scrap of copper (excl. ingots or other similar unwrought shapes of remelted copper waste and scrap ashes and residues containing copper and waste and scrap of primary cells primary batteries and electric accumulators	10,105,266
7	1101:Wheat or meslin flour	8,420,856
8	5511:Yarn of man-made staple fibers, put up for retail sale (excl. sewing thread)	7,580,888
9	7306:Tubes, pipes and hollow profiles "e.g., open seam or welded, riveted or similarly closed", of iron or steel (excl. of cast iron, seamless tubes and pipes and tubes having internal and external circular cross-sections and an external diameter of > 406	7,533,675
10	2202:Waters, incl. mineral waters and aerated waters, containing added sugar or other sweetening matter or flavored, and other non-alcoholic beverages (excl. fruit or vegetable juices and milk)	6,978,462
11	4010:Conveyor or transmission belts or belting, of vulcanized rubber	6,207,107
12	7602: Waste and Scrap of Aluminum (excl. slags, scale and the like from iron and steel production, containing recoverable aluminum in the form of silicates, ingots or other similar unwrought shapes, of remelted waste and scrap of aluminum ashes	5,777,778
13	2608: Zinc ores and concentrates	5,069,753
14	2204:Wine of fresh grapes, incl. fortified wines; grape must, partly fermented and of an actual alcoholic strength of > 0,5% vol or grape must with added alcohol of an actual alcoholic strength of > 0,5% vol	4,067,690
15	3925:Builders' ware of plastics, n.e.s.	4,041,338
16	3921:Plates, sheets, film, foil and strip, of plastics, reinforced, laminated, supported or similarly combined with other materials, or of cellular plastic, unworked or merely surface-worked or merely	3,545,722

	cut into squares or rectangles (excl. self-adhesive pr	
17	8409:Parts suitable for use solely or principally with internal combustion piston engine of heading 8407 or 8408	3,436,645
18	8548:Waste and scrap of primary cells, primary batteries and electric accumulators; spent primary cells, spent primary batteries and spent electric accumulators; electrical parts of machinery or apparatus, not specified or included elsewhere in chapter 85	3,132,654
19	7210:Flat-rolled products of iron or non-alloy steel, of a width >= 600 mm, hot-rolled or cold-rolled "cold-reduced", clad, plated or coated	2,837,049
20	2523:Cement, incl. cement clinkers, whether or not colored	2,323,198

Table 8: Actual and projected values of KIP indicators

YEAR	INDICATOR	GDP (nominal, in millions)	Annual GDP change rate (in %)	GDP per capita, in euros	Exports (nominal, in millions)	Exports of services (nominal, in millions)	Exports of goods (nominal, in millions)	Imports (nominal, in millions)	Imports of goods(nominal, in millions)	Imports of services (nominal, in millions)	FDI (flow, in millions)	Labor participation rate (in %)	Labor participation rate of females (in %)	Labor participation rate of men (in %)	Unemployment rate (in %)	Unemployment rate of females (in %)	Unemployment rate of men (in %)	Average salary in the private sector, per month (in Euro)	Average salary in the public sector, per month (Euro)	Government Expenditure in Education (in millions)	Value of manufacturing (in millions)	Electricity and water supply (in millions)	Transport and Communication (in millions)	Financial intermediation (in millions)	Current account balance (% of GDP)	Manufacturing (% of GDP)	Exports (% of GDP)	Exports of services (% of GDP)	Exports of goods (% of GDP)	Imports (% of GDP)	Importof goods (% of GDP)	Importof services (% of GDP)	Investment in Education (% of GDP) - Assumption: education=R&D	FDI (% of GDP) Assumption: FDI are more productive and sophisticated than domestic firms)	Medium and high tech economic activities (in million) Assumption: industry+electricity and water supply+transport and communication+financial intermediation employ medium or high level of technology	Medium and high tech economic activities (% of GDP) Assumption: industry+electricity and water supply+transport and communication+financial intermediation employ medium or high level of technology	Electricity and water supply (% of GDP)	Transport and Communication (% of GDP)	Financial intermediation (% of GDP)
	2020	7536.0	6.3%	3637.0	1462.0	886.5	575.5	3604.1	3149.6	454.5	398.0	57.3	29.9	85.2	20.8	26.9	18.7	442	461	286.7	711.4	126.0	332.0	208.6	-28.4%	9.4%	19.4%	11.8%	7.6%	47.8%	41.8%	6.0%	3.8%	5.3%	1378.0	22.1%	1.7%	9.1%	14.3%
	2019	7089.0	5.3%	3475.0	1383.0	837.9	545.1	3456.3	3022.3	434.0	377.0	53.9	28.1	80.1	22.2	28.7	19.9	437	455	270.1	691.1	128.9	312.8	205.2	-29.2%	9.7%	19.5%	11.8%	7.7%	48.8%	42.6%	6.1%	3.8%	5.3%	1337.9	22.7%	1.8%	9.0%	14.8%
	2018	6733.0	4.4%	3352.0	1303.0	799.0	510.0	3308.5	2895.0	413.5	377.0	51.2	26.7	76.1	23.5	30.3	21.0	434	452	256.8	674.4	131.4	297.4	202.3	-29.7%	10.0%	19.4%	11.9%	7.6%	49.1%	43.0%	6.1%	3.8%	5.6%	1305.6	23.2%	2.0%	8.9%	15.5%
	2017	6450.0	4.8%	3213.0	1209.0	768.0	441.0	3168.0	2774.0	394.0	354.0	49.0	25.6	72.9	24.5	31.7	22.0	428	446	246.3	660.9	133.5	285.2	200.0	-30.4%	10.2%	18.7%	11.9%	6.8%	49.1%	43.0%	6.1%	3.8%	5.5%	1279.7	23.7%	2.1%	8.9%	16.5%
	2016	6155.0	4.7%	3083.0	1139.0	731.0	408.0	3006.0	2635.0	371.0	333.0	46.8	24.4	69.6	25.8	33.3	23.1	423	441	235.3	646.5	135.9	272.5	197.5	-30.3%	10.5%	18.5%	11.9%	6.6%	48.8%	42.8%	6.0%	3.8%	5.4%	1252.4	24.2%	2.2%	8.8%	17.3%
	2015	5879.0	5.3%	2959.0	1075.0	696.0	379.0	2857.0	2505.0	352.0	304.0	44.7	23.3	66.4	27.0	35.0	24.2	419	437	225.0	632.6	138.2	260.5	195.1	-30.3%	10.8%	18.3%	11.8%	6.4%	48.6%	42.6%	6.0%	3.8%	5.2%	1226.5	24.7%	2.4%	8.8%	18.2%
	2014	5581.0	4.8%	2829.0	101.0	658.0	-557.0	2725.0	2393.0	332.0	264.0	42.4	22.1	63.1	28.6	36.9	25.6	415	432	213.9	617.2	140.9	247.6	192.4	-47.0%	10.8%	1.8%	11.8%	-10.0%	48.8%	42.9%	5.9%	3.8%	4.7%	1198.2	25.3%	2.5%	8.8%	130.5%
	2013	5326.6	5.3%	2763.0	927.0	622.0	305.0	2611.0	2297.1	313.9	241.0	40.5	21.1	60.2	30.0	38.8	26.9	412	429	204.4	603.8	143.4	236.6	190.0	-31.6%	11.3%	17.4%	11.7%	5.7%	49.0%	43.1%	5.9%	3.8%	4.5%	1173.8	25.9%	2.7%	8.6%	20.5%
	2012	5058.7	5.1%	2703.0	922.1	635.1	287.0	2648.8	2360.0	288.8	213.0	36.9	17.8	55.4	30.9	40.0	28.1	406	420	198.2	589.2	146.2	225.0	187.4	-34.1%	11.6%	18.2%	12.6%	5.7%	52.4%	46.7%	5.7%	3.9%	4.2%	1147.8	26.6%	2.9%	4.4%	3.7%
	2011	4814.5	9.4%	2671.0	943.4	618.5	324.9	2736.7	2383.9	352.8	378.0							395	404	194.3	588.4	190.2	207.7	231.2	-37.2%	8.3%	19.6%	12.8%	6.7%	56.8%	49.5%	7.3%	4.0%	7.9%	1028.5	25.4%	4.0%	4.3%	4.8%
	2010	4402.0	8.2%	2480.0	878.0	573.0	305.0	2443.1	2057.1	386.0	331.0							384	396	162.6	411.9	179.8	157.9	194.6	-35.6%	9.4%	19.3%	13.0%	6.3%	55.5%	46.7%	8.8%	3.7%	7.5%	944.2	25.1%	4.1%	3.6%	4.4%
	2009	4063.6	-	2328.0	695.0	517.6	177.4	2114.2	1828.9	285.3	295.5	48.1	28.8	67.5	45.4	56.4	40.7	363	378	145.5	465.6	170.9	149.0	190.5	-34.9%	11.4%	17.1%	12.7%	4.4%	52.0%	44.9%	7.0%	3.6%	7.3%	976.0	27.6%	4.2%	3.7%	4.7%
	CC			1.00	0.65	0.92	0.43	0.98			0.55	1.00	1.00	1.00	-1.00	-1.00	-1.00	0.99	0.97	0.97	0.47	-0.36	0.98	0.26	0.47															

Note:

- *Relevant data are in Euro*
- *The highlighted cells with yellow are actual (official) data, whereas the rest are projections (those highlighted with pink and the rest are those of MF and MTI, respectively).*
- *The targets for the indicators regarding the labour force were calculated using the historical trends in 2012 and 2013 only. There are two reasons for that: 1- there was no survey conducted in 2011 and 2010, and 2-althoguth there was a labour survey conducted in 2009, its methodology of measuring these indicators was not compatible with the one utilized since 2012.*
- *The Future Value formula used for calculating the projections of MTI:* $Y_t = Y_{t-1}*(1+(GDP_{grt} + r_{xy}))$, *where:*
  - Y_t *denotes the value of an indicator at the current (respective) year;*
  - Y_{t-1} *denotes the value of an indicator in the previous year*
  - $GDPgr_t$ *denotes the value of GDO growth rate in the current (respective) year*
  - r_{xy} *denotes the value of the Coefficient of Correlation between the annual growth rate of GDP and a specific indicator during for the period of 2009-2012/2013.*
- *The formula for calculating the Coefficient of Correlation is:* $r_{xy} = \frac{\sum_{i=1}^{n}(x_i - x)(y_i - y)}{\sqrt{\sum_{i=1}^{n}(x_i - \bar{x})^2 \sum_{i=1}^{n}(y_i - \bar{y})^2}}$ *where:*

- *Σ is Sigma, the symbol for "sum up"*
- $(x_i - \bar{x})$ *is each x-value minus the mean of x*
- $(y_i - \bar{y})$ *is each y-value minus the mean*