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ANNUAL ECONOMIC FORUM

A NEW MODEL FOR SUSTAINABLE ECONOMIC GROWTH

labour market dynamics: current and future challenges

NOVEMBER, 2023

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SUPPORTED BY:

KFOS
Fondacioni i Kosovës për Shoqëri të Hapur
Kosovo Foundation for Open Society
Kosovska Fondacija za Otvoreno Društvo

EYE Enhancing Youth Employment

PUBLISHED BY:

RIINVEST INSTITUTE
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The original was written in Albanian.

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Abbreviations

KAS	Statistics Agency of Kosovo
WB	World Bank
EU	European Community
BP6	Western Balkan countries
CBK	Central Bank of Kosovo
HR	Human Resources
CEFTA	Central European Free Trade Agreement
EBRD	European Bank for Reconstruction and Development
IMF	International Monetary Fund
KFOS	Kosovar Foundation for Open Society
Trust	Pension Savings Fund
GDP	Gross Domestic Product
ICT	Information and Communications Technology
FDI	Foreign direct investment
KASH	Medium-Term Expenditure Framework
MFPT	Ministry of Finance, Labor and Transfers
MFPT	Ministry of Finance, Labor and Transfers
SME	Small and Medium Enterprises
OECD	Organization for Economic Co-operation and Development
PRBO	Procurement Review Body
PIP	Public Investment Program
GDP	Gross Domestic Product
R&I	Research and development
ROA	Return on assets
ROE	return on equity
S3	Smart Specialization Strategy
VAT	Value Added Tax
VET	Vocational Education and Training
wiiw	Vienna Institute for International Economic Studies

EXECUTIVE SUMMARY AND RECOMMENDATIONS

Following the decline in COVID-19 prevalence and a notable economic expansion of 10.7 percent in 2021, Kosovo is expected to sustain a characteristic growth rate of 3-4 percent in the coming years. This aligns with the average growth observed over the past decade, and the growth rate of 2022 which stood at 3.5. The first and second quarters of 2023 exhibit a deceleration trend, marked by growth rates of 2.9% and 2.06%, respectively, accompanied by a decline in export performance and an expanding trade deficit. Based on projections and considering economic trends within the European Union (EU) and globally, it is highly probable that this trend will persist into 2024. This growth level is below the expectations and determinations of the Government of Kosovo in the Government Program and the Medium-Term Expenditure Framework (MTEF), which had projected an increase of over 5 percent for the three years within the period 2022-2024. In the documents accompanying the 2024 draft Budget, an increase of 4.6 percent is forecasted.

Kosovo is ensnared within a framework of policies and factors that, as statistics have shown for over a decade and a half, keep the structure of Gross Domestic Product (GDP) unchanged. The manufacturing sectors and processing industry have not experienced any improvement. As a result, the existing model of economic growth, based on external factors, has nearly exhausted its potential for transformative economic growth. It lacks developmental impetus and is, in fact, perpetuating a state that is recognized in the theory and practice of development as the development trap of middle-income countries.

Overcoming this problem, even in the case of Kosovo, should be done **by promoting a new model of economic growth based on policies that enhance the competitiveness** of products and services for both domestic and international markets. This also implies a more effective use of public funds, especially for a more fruitful investment in education, healthcare, research, and innovation. This creates the necessary conditions for building long-term potential for sustainable economic growth, especially in connection with current crucial commitments related to the formulation and approval of the Smart Specialization Strategy (S3), the 2030 Industrial Development and Business Support Strategy, the implementation of the Green Agenda, and Digitalization.

Within this framework, public and private investments in research and innovation (R&I) should be significantly increased, and these investments should at least reach the regional average (around 0.5% of GDP) over a 2-3 year period. An integral component of this coherent policy system is also the active support of export-oriented sectors, improving the access and position of these sectors in long-term finance and credit, advancing fiscal and budgetary policies, and, above all, overcoming the weaknesses and inefficiencies highlighted in the implementation of the Public Investment Program (PIP).

Despite the numerous challenges systematically faced by the private sector in Kosovo over the past two decades, institutional efforts to improve the business environment in the country have not been lacking. According to reports from various sources, there has been a trend of improvement. Therefore, improving the business climate – including legal, financial, regulatory, and institutional aspects – through strengthening the rule of law and implementing favourable policies for the private sector is a crucial step towards sustainable economic growth. However, businesses' perceptions of this development are not satisfactory.

Regarding the intensity of barriers, this year, workforce migration stands out significantly, with a score of 75 out of a maximum of 100. This is followed by a series of barriers with above-average intensity (between 57-66 points), including market size, tax regulations, charges and administrative obstacles, cost of financing, informality and tax evasion as sources of unfair competition, corruption and crime, interaction with tax authorities and customs, electricity supply, debt collection, and political stability.

It's worth noting that last year, the Government of Kosovo approved the Administrative Burden Prevention Program (2020-2027) – an inter-institutional initiative aimed at reducing administrative burdens for citizens, businesses, and society. As part of this program, Kosovo has initiated a baseline assessment of all administrative burdens for businesses, identifying 11 laws, 26 sub-legal acts, and 2 ministerial decisions that need to be amended or repealed to improve the business environment for small and medium-sized enterprises (SMEs) (OGK, 2022). There is a need for intensified efforts to implement this program.

In the survey conducted by the Riinvest Institute with a thousand businesses, it appears that Kosovo continues to face significant challenges in the labour market. While the unemployment rate has decreased (to 12.6 percent in 2022), the employment rate as a percentage of the population remains low (33.8 percent). Low labour force participation (38.6 percent), influenced partly by migration, has also had an impact. These data are particularly concerning for young people and women.

Approximately half of the businesses expect to increase the number of employees in the next three years. The highest demand for workers will be in elementary professions (ISCO 9), followed by agricultural workers (ISCO 6) and workers in crafts and related trades (ISCO 7). However, businesses face significant challenges in meeting their demand for workers. These challenges are particularly associated with high emigration trends and a strong inclination for emigration, a lack of qualified workers, and a mismatch of expectations regarding wages and working conditions.

Starting from 2016, each year, around 1 percent of the population of Kosovo has emigrated to Germany for work, or approximately 120,000 individuals in working age. In relative terms, this percentage is on average twice as high as in other Western Balkan countries.

Work permits for Kosovars in Germany have been primarily issued in the construction sector (NACE Section F), encompassing more than 50 percent of work permits. The second-largest sector employing Kosovar workers is the sector of accommodation and food service activities (NACE Section I), constituting over 16 percent of the workforce. Around 15 percent of workers are employed in administrative and support service activities (NACE Section N).

Furthermore, businesses report that 17.59 percent of their employees have already informed them that they plan to emigrate next year. Business estimates suggest that around 32.72 percent of workers will emigrate during the upcoming year when visa liberalization for the Schengen area is expected. To curb this trend, in just the past year, 79 percent of businesses have increased their wages, with a wage growth of 22.23 percent. More than a third of businesses report that they will continue to raise wages, while 24.5 percent plan to improve working conditions. Additionally, 20.6 percent plan to hire women (mainly in middle age), and 10.4 percent plan to invest in new technologies aimed at automating work processes.

On the supply side, there is a noticeable high tendency toward emigration. Almost half of the surveyed young individuals have stated that they plan to emigrate in the next two years. Moreover, one-third of those who have left their jobs did so due to emigration. Policymakers should focus on minimizing push factors to reduce the inclination to emigrate. It is important to note that unemployment seems to be just one of the significant push factors. The main reason for emigration remains the opportunity for a 'better quality of life for oneself or the family' (27 percent), followed by 'finding a job or a better job' (26 percent), 'pursuing further studies' (14 percent), or 'combined factors' (32 percent). Analysing the inclination to migrate and the determined response to migration has significant political and managerial implications. In this regard, two models have been examined: (i) determinants that drive emigration from Kosovo, with a particular focus on the demographics of young people, and (ii) characteristics of businesses that have lost workers due to migration. The results from these models, along with descriptive analysis, provide important policy recommendations.

Based on the findings and observations of this report, we recommend:

1. Within a reasonable timeframe, a review of existing economic policies and the effectiveness of their implementation should be conducted in harmony with the need to promote and implement a new model of economic growth focused on sustainable growth in the supply of products and services.

2. Design and implement effective policy models to enhance competitive capacity, especially by supporting export sectors.

3. In collaboration with international financial institutions and banks, launch support programs (credit lines) for long-term investments in industrial and service sectors.

4. Direct foreign investments, especially those from the diaspora, should be channelled with specific incentives into high-value-added production and service sectors.

5. Budgetary policies should be reviewed to favour better structural allocation, primarily in favour of capital investments and to achieve a more favourable financing position for education, healthcare, research, and innovation, at least at a regional level and aligned with European standards.

6. To prevent high levels of emigration, a comprehensive strategy is required that seeks improvements, among other things, in the general education system, healthcare system, overall working conditions, and wage systems in both the public and private sectors.

7. A focused and systematic effort is needed to eliminate administrative barriers and law enforcement by all responsible institutions and agencies and to implement the Government's Administrative Burden Prevention Program (2020-2027)

INTRODUCTION

This report was compiled to support the debate at the Annual Economic Forum of the Riinvest Institute (15th November 2023). To enhance the quality of the economic debate, Riinvest Institute aims to organise an annual event in the first part of the fourth quarter of each year with representatives from institutions, business associations, business leaders, experts from financial institutions, and research and academic circles. In preparation for this Forum, the Riinvest Institute compiles a comprehensive report covering various aspects of economic developments. This report delves into current issues and their corresponding strategies, anticipates future expectations (especially for the upcoming year), and outlines economic policies that should address both ongoing and expected developments. The Institute's report, combined with the active participation of attendees, aims to establish this event as a 'brand' and as the foremost platform for rigorous economic discussions in the country. As such, it would be eagerly expected to shed light on what happened in the three quarters of the current year and what is expected to happen in the coming year.

The report will address:

- The current situation and anticipated future developments, considering the broader context and trends at the regional, European, and global scales;
- Key problems that challenge economic growth dynamics and macroeconomic stability, assessing the way responsible stakeholders address these problems;
- Developments related to the business environment;
- A selected area of focus for each year; this year, the focus will be on the labour market and migration trends;
- Recommendations and necessary responses through public policies.

This report has been drawn up by analysing studies of the Riinvest Institute, the Government Program and its reflections, the Public Debt Management Report, the Budget for 2023, Medium-Term Expenditure Framework (MTEF) 2024-2026, and the Draft Budget of Kosovo for 2024, budget consumption reports, monthly and annual reports from the Central Bank of Kosovo (CBK), latest reports from the International Monetary Fund (IMF), the World Bank (WB), the European Bank for Reconstruction and Development (EBRD), and the European Union (EU), as well as estimates from Vienna Institute for International Economic Studies (wiiw). Additionally, a survey was conducted with businesses (September-October 2023), and separate discussions were held with executive leaders of several private companies that have a significant impact on economic growth.

The report is divided into three parts. After this introduction, the first part addresses the economic growth trends in recent years, particularly in the context of Kosovo's macroeconomic configuration characterised by imbalances, especially high unemployment and a very high trade deficit. In relation to this, the need to modify the economic development model is argued, i.e. the need for a new model of economic growth to address these long-lasting imbalances. In this part, opportunities arising from the domestic context and those from the regional and global context are discussed. These create some constraints and risks related to global economic movements, both within the EU and the region. While the COVID-19 situation is largely under control, economic trends are expected to be impacted by the ongoing conflict in Ukraine, instability in the northern part of Kosovo, and worsening conditions in the Middle East.

The second part addresses the business environment in Kosovo and its reflections on the economic situation this year and the following year. Meanwhile, the primary focus of this report revolves around recent labour market dynamics influenced by persistent population trends and workforce migration, particularly to the EU. Additionally, it addresses the matter of wages in both the private and public sectors. This has exacerbated structural unemployment challenges, particularly the shortage of workers in specific occupations and sectors, necessitating the unprecedented need to import labour to Kosovo, primarily from select Asian countries.

The research conducted to compile this report has received support through a grant from the Kosovo Foundation for Open Society (KFOS) and is closely aligned with the initiatives of Forum 2015. The insights presented herein reflect the perspectives of the research team, specifically the Riinvest Institute. The study and the organization of the forum were also supported by the EYE (Enhancing Youth Employment) project, implemented by Helvetas and MDA and financed by the Swiss Office for Cooperation in Kosovo (SDC). The findings presented reflect the views of the research team, specifically those of the Riinvest Institute.

ECONOMIC GROWTH AND MACROECONOMIC CONFIGURATION

1

1.1 Global Context

During this period, the global economy faces significant uncertainties, manifesting due to the accumulated effects of the COVID-19 pandemic and the impact of Russia's aggression in Ukraine. Besides creating uncertainties for the current period, the prospects for the medium-term period do not seem to be very optimistic and continue to be highly dependent on developments in the conflict in Eastern Europe and the effects of tightening monetary policies in response to overall price increases.

In the first part of this year, the global economy showed signs of stability, albeit a fragile one. To a significant extent, supply chains recovered, and goods' costs and delivery time returned to pre-pandemic levels. However, despite the price increase of goods and energy slowed down compared to the previous year, the overall level of inflation remains high and significantly reduces households' purchasing power. As a result, central banks took action by tightening monetary policies, which are reflected in the difficulty of obtaining loans and rising interest rates. The effects of changes in monetary policies are being transmitted beyond the slowdown in economic activities. In advanced economies, financial stability and, in particular, the banking system's stability are being seriously tested, while in developing and low-income countries, high interest rates are straining public finances and overall levels of public debt. Therefore, the forces that dictated global economic developments over the past three years (the COVID-19 pandemic, the aggression in Ukraine, and the tightening of monetary policies to combat inflation) are expected to continue to shape economic trends during 2023 and potentially in the following years as well.

As a result of these determining factors and high geopolitical fragmentation with consequences for the overall free trade of goods, expectations for overall economic developments seem to be modest. According to the International Monetary Fund (IMF) and their semi-annual projections, global economic growth is expected to decline from 3.5% (2022) to around 3% in 2023 and 2024. Meanwhile, the overall inflation rate is expected to decrease from an estimated 8.7% in 2022 to around 7% in 2023 and about 5% in 2024. Developed economies are expected to have slower growth, with average economic growth not exceeding 1.5% in 2023 and 2024. Meanwhile, developing economies are expected to experience growth of around 4% in 2023 and 2024.

Table 1. Consensus Growth Forecast

	September survey	
	2023	2024
World	2.5	2.1 ↓
Emerging markets and developing economies	3.1	3.3 ↑
China	5.0	4.5 ↓
Developed economies	1.4	0.9 ↓
United States	2.1	0.9 ↓
Eurozone	0.5	0.7 ↑
Germany	-0.4	0.6 ↑

Source: World Bank: Consensus Economics

1.2 The trend of economic growth and the need for a new economic growth model

After an expected economic growth of over 10% in 2021, and exiting from the high incidence phase of COVID-19, in 2022 and 2023, Kosovo's economy returns to a growth rate characteristic of the last decade, around 3-4%. However, there appears to be a trend of slowdown. This is forewarned by the developments during this year, with a decline in the growth rate, from 3.5% in 2022 to 2.9% in the first quarter, and 2.06% in the second quarter of 2023. In all likelihood, as indicated in Table (1), this will remain a characteristic of the trends for 2024 when economic growth remains within the mentioned ranges of the economic activity slowdown trend, as predicted by international financial institutions. This is below the expectations and projections of the Government of Kosovo, which had estimated growth of over 5% for all three years within the 2022-2024 (MFPT, 2023) periods, specifically 4.6% for 2024, a prediction included in the Draft Budget for the upcoming year. The risks for the continuation of this growth slowdown are linked to the ongoing aggression in Ukraine and the slowing of economic growth in the EU, especially in Germany (World Bank, 2023), which may have a more significant impact considering the volume of trade and remittances.

Table 2. Projections for economic growth in Kosovo

	2023	2024
World Bank	3.2	3.9 ↑
IMF	3.8	4.0 ↑
wiiw Institute	2.7	3.3 ↑
EBRD	2.0	3.0 ↑
Budget Projections for 2024 (MF)	3.9	4.6 ↑

Source: World Bank, IMF, wiiw, EBRD

An economic growth that would surpass 5% and approach a growth rate of 6-7% means that Kosovo's economy has entered a new qualitative phase of development, aiming to escape the chronic trade deficit trap and high unemployment rate and to move more dynamically towards aligning with the development level of the Western Balkans (WB6) region and the EU[1]. It seems that the prerequisites for achieving this turning point have not been established yet. It is clear that Kosovo is trapped within a framework of policies and factors that only ensure economic growth within a historical trend, as evidenced by statistics for over a decade and a half. This growth has failed to address key economic and social development issues while maintaining an unfavourable economic structure (Annex 1). This is demonstrated by the almost unchanging structure of Gross Domestic Product (GDP), where the manufacturing and processing industry have not improved their position, maintaining more or less the same contribution to GDP. This also applies to the setbacks in high-value-added sectors and the research sector for development and innovation in particular.

In the Medium-Term Expenditure Framework (MTEF), the government rightfully proclaims its focus on «reorienting the economy towards production and exports in the coming three-year period». However, as presented below, this is not supported by the orientations in the MTEF regarding fiscal and budgetary interventions. Thus, there is no significant departure from the current path yet. An atypical structure has been created in government expenditures to the detriment of capital investments, with a significant share of transfers and social assistance (MFPT, 2023)[2]. Furthermore, private sector investments are not yet adequately monitored in statistical terms and appear to be overrated, judging by the value of imported equipment. There are serious issues regarding the effectiveness of projects related to the so-called investment clause. The foreign direct investment (FDI) structure is heavily dominated by real estate (World Bank, 2023)[3]. Similarly, the loan structure is not yet functioning properly to support the development of domestic supply, especially in the processing industry with export performance.

1 Note: Based on the categorizations of the World Bank, Kosovo is considered as a middle-income country. However, the IMF categorizes it as a developing country, an emerging economy, with a GDP per capita of 14% of the EU average (27% in terms of purchasing power parity - PPP), which is roughly around 70% of the average development level in the Western Balkans.

2 Note: In recent years, despite the improvements, the under-execution of capital expenditures on average **fluctuates around 35.0% of the budgeted amounts" (MTEF 2024-2026)**

3 Note: Only 0.8% of FDI goes into research and innovation and machinery, in contrast to 92% in real estate.

Here, one key obstacle that hinders economic growth should be considered. Private sector investments and FDI significantly lag behind their potential. This is influenced by limited access to regional and global markets due to still unconsolidated road and rail traffic links, limited access to capital markets, unreliable energy supply, and difficulties in recruiting a qualified workforce with the necessary skills. Although exports have shown dynamic growth, more than doubling during 2019-2022, the trade deficit is also increasing, and there is a worsening trend of exports in 2023 and 2024. This is another impediment to sustainable economic growth. Consequently, the issue of export support remains to be seriously addressed with a range of comprehensive industrial and trade policy measures in line with the open market. The economic situation in the country remains highly vulnerable to the impact of imported inflation caused by the crisis resulting from aggression in Ukraine, and potentially, most recently, due to the deterioration of the situation in the Middle East. This applies especially to the negative effects of import prices for energy and food. With a modified economic growth model, Kosovo could more easily adapt to these risks.

Given such a background, the government's projection that "in the medium-term (2024-2026), the Kosovo economy is expected to achieve real growth that exceeds the historical pre-pandemic average, fluctuating on average around 5.8% in real terms" (MFPT, 2023) seems overly optimistic and overstretched". However, as mentioned earlier, this is more than necessary, but from the published development documents based on the MTEF, it does not seem to be supported by an integrated and coherent system of related policies and measures.

1.2.1 The existing model of economic policies

The existing model of economic policies, mainly based on external factors such as remittances, loans, and external financial assistance for over two decades, has not been suitable or appropriately designed to boost domestic supply, especially export industries and high value-added services. Significant support with Fiscal Packages 1 and 2 in 2015 and 2016 was not further developed and improved as needed. As a result, the existing model of economic growth has almost exhausted its potential for transformative economic growth, or, in other words, it lacks development drivers and, furthermore, it maintains a situation that, in the theory and practice of development, is known as the development trap of middle-income countries (World Bank, 2009)[4]. KThis characterises the majority of countries with a similar level of development that do not successfully solve this issue. To get out of such a situation, it is suggested to invest in enhancing the competitiveness of the domestic supply of products and services, as well as investing in innovation and development research. Unfortunately, Kosovo lags far behind in this area. By following the same criteria as the ranking of the 142 countries in the World Economic Forum's Global Competitiveness Report (WEF) in Davos (where Kosovo is not yet included), it is calculated that, regarding innovation capacity, Kosovo is ranked 128th (ASHAK, 2023).

As previously emphasised, there is a necessity to overcome this situation through promoting and implementing a new model of economic growth based on active industrial policies, strengthening policies in favour of domestic competitive supply, knowledge acquisition, and new technologies (Riinvest, 2017). This would entail an improvement in industrial policies, especially benefiting the manufacturing and high-value-added services industries, as well as the so-called creative industries[5]. The new economic growth model should be based on policies that increase the supply of products and services for domestic and international markets. Important component is also responsible and effective public funds expenditure, particularly aimed at productive investments in education, healthcare, research, and development. With this, the conditions for long-term sustainable economic growth are created, especially when connected with the important commitments related to developing and approving the Smart Specialization Strategy (S3), the Green Agenda, and Digitalization. Within this reorientation, Kosovo should significantly increase public and private investments in research and development (R&D) far above the existing legal obligations (0.7% of the budget). It is not convincing to

4 Note: This is a situation where a country with middle-income per capita struggles to transition into the group of high-income countries due to rising costs and the decline in competitiveness. For a more detailed analysis, please refer to: Brenda Grith ibrary.worldbank.org/doi/epdf/10.1596/9780821387856_CH04).

5 Note: The sectors that were identified through the Entrepreneurial Discovery Process (EDP) of the S3 strategy, which includes Wood Processing Industry, ICT, Food Processing Industry, Energy (with a focus on Green Energy), and Creative Industry. Riinvest has been an active participant in the working groups for drafting the S3 strategy.

oppose this need by claiming limited absorption capacity[6]. The new growth model requires that at least investments in research and innovation to reach at least the regional average (0.5% of GDP) over a 2-3 year period. This can be exceeded in a more favourable environment that promotes incentives for research organisations in universities, faculties, and beyond[7]. The new economic growth model, based on policies that favour competitive supply, is the necessary path to keep up with the trend of closing the gap with the EU in terms of income and to curb the worrying trend of migration, especially of experts from various fields, well-educated individuals with capacities and potential for research and development.

An important part of transitioning to the new economic growth model is the necessary improvement of fiscal and budgetary policies, especially when it comes to investments in education and healthcare and investments in research and innovation. Related to this is also the overcoming of weaknesses and inefficiencies highlighted in executing the Public Investment Program (PIP). As further analysed, budget policies fail to achieve this for a long time. In one of its preliminary assessments, the IMF states, "deficiencies in the management of public investments have a significant impact on the quality of investments and worsen the situation (IMF, 2023). According to the IMF, this requires an improvement in the structure and absorptive capacity of public investments by overcoming various deficiencies in public investment management related to land expropriation, procurement, and execution contracts. The deficiencies in contract implementation especially increase investment costs and significantly reduce the expected effects of these projects in the operational phase. Furthermore, the WB finds that, in general, decisions regarding public expenditures are not aligned with strategic priorities, and "the budget process remains disconnected from performance (World Bank, 2023). Another problem is low efficiency and unfavourable effects of transfers and subsidies, including those in agriculture and public enterprises, where there is almost a lack of a necessary standard for evaluating projects in their approval stage, control, and ex-post evaluation of their effects.

1.2.2 Trade Balance and the External Sector

Table 3, provides a comprehensive overview of Kosovo's trade dynamics in recent years, including projections for 2023 and 2024. In recent years, exports of goods have shown steady growth year by year, except for the year 2023. During the period from January to August, there was a significant decrease compared to the previous year, increasing the trade deficit by 3.1% compared to the same period in 2022. According to the projections of the Vienna Institute for Economic Studies (wiiw) (wiiw, 2023), the amount of exports for 2023 and 2024 is expected to remain behind the amount of exports in 2022, while the projections for imports anticipate an increase. Both of these factors are expected to further deepen the trade deficit. In this way, the import-export coverage seems to decrease compared to 2022.

6 Note: During 2021 research organisations from Kosovo applied with more than 50 project at Horizon Europe Programme

7 Note: Opinions and suggestions regarding the National Science Program (NSP): As a part of the budget, in the next three years (as envisaged by the MTEF), the overall budget requirements for activities foreseen by the NSP are very modest. In 2023, this share is 0.32%, in 2024 it is 0.49%, and in 2025 it is 0.56%. As a share of GDP, budget requirements for activities foreseen by the NSP in 2023 are 0.11%, in 2024, 0.15%, and in 2025, 0.16% of GDP, in contrast to the regional average of around 0.5%.

Table 3. Trade Statistics (in million euros)

	2019	2020	2021	2022	January - August 2023	2023 projections	2024 projections
Export of goods	393	475	753	932	495	987	1,184
Import of goods	3,233	3,048	4,320	5,219	3,199	5,421	5,941
Trade deficit	-2,840	-2,573	-3,567	-4,287	-2,704	-4,434	-4,757
Import-to-export coverage ratio	12%	16%	17%	18%	15%	18%	20%

Source: Central Bank of Kosovo (CBK) 2019-2022

In the first eight months of 2023, Kosovo's imports increased slightly by 1.03% compared to the same period in 2022. A closer look at trading partners reveals that imports from CEFTA countries fell by 7.59%. On the other hand, imports from EU countries and other nations saw a positive increase of 2.35% and 3.47%, respectively. This year, Kosovo continued to maintain a significant level of imports from Germany (30%), which remains in the top position. Meanwhile, Italy takes the second position this year, accounting for 13% of the total imports.

Kosovo's exports, until August of this year, fell by approximately 7.93% compared to the same period in 2022. In 2023, the countries to which Kosovo exports the most by volume remain the same as in 2022: North Macedonia with around 37%, followed by Albania with 32% and Serbia with 14%. Exports to EU countries experienced a more significant decline by 10.97%. However, exports to Germany increased by seven percentage points in 2023. With other countries, exports make up approximately 27.8% of the total export value, compared to 31% in 2022, with the majority of them being covered by the United States and Switzerland.

Compared to 2022, the main categories that Kosovo exports remain the same. According to the structure, we observe that the products Kosovo exports the most in 2023 are various manufactured products, accounting for 18% of the total export value. This category includes furniture, beds, mattresses, bedsteads, pillows and similar stuffed layers; following plastics and plastic products at 12%, and basic metals (cast iron and steel products) at 11%.

On the other hand, the products imported in the highest value in 2023 are those related to mineral products (mineral fuels, mineral oils, and their distillation products, bituminous substances) at 13%. Next are the means of transport, their parts, and their complements at 10%; the third category is machinery and mechanical equipment at 7%. It is important, particularly with regard to the last category, to analyse the level of machinery imports for production to assess the potential for increasing production and investments. In the given Table, we can see the value of imported machinery, excluding household and transportation equipment. Such a level of equipment imports is indicative of the insufficient volume of investments in the production sector (Table 4).

Table 4. Machinery and equipment imports over the years (in million euros)

Year	Machinery and equipment	As % of total imports
2021	326.11	7.01 %
2022	292.27	5.22 %
January - September 2023	249.87	6.71 %

Source: Customs of Kosovo.

Furthermore, it is important to understand that the inputs used to produce exported goods are often imported in many cases. In such cases, the economic benefits depend on the added value in these goods destined for export. Judging by the product structure and trade deficit trends, it is evident that the low level of added value in exports constitutes one of the key issues. The Table below illustrates that despite still having insufficient exports, the contribution of the processing industry to exports is significant. Therefore, when eliminating raw materials as exports from Kosovo, the processing industry accounts for approximately 38% of the total export base. This demonstrates the potential of this sector and the need for meaningful support.

Table 5. Contribution of the processing industry to exports of Kosovar goods (in million euros)

Year	Export of processing industry [8]	As % of total exports
2019	156,229	**40.7 %**
2020	183,755	**38.7 %**
2021	261,209	**34.8 %**
2022	355,591	**38.6 %**

Source: Kosovo Agency of Statistics (KAS).

8 Note: In the calculation of the size of the processing industry in Kosovo, the following exports are included: oils, food, beverages, alcoholic beverages and tobacco, products of the chemical industry, plastics, rubber and articles thereof, leather and articles thereof, wood and articles of wood, paper and paper articles, textile and textile articles, footwear, stone articles, plaster, prod. ceramics and glass, machinery, mechanical and electrical equipment.

When evaluating export flows, it is important to consider the value-to-quantity ratio. Thus, it is observed that even though the value of exported goods was higher in 2022 compared to the previous year, the quantity of these goods has been lower compared to 2021. The differences are more apparent in the sections according to the integrated tariff, "livestock and animal origin products," as well as "Mineral Products" (Kosovo Customs). It is worth noting that the increase in the value of exports, but not the quantity, is partly attributed to the rise in prices over the past two years.

FDIs increased by 14% in the first half of 2023, primarily driven by Turkish investments. Other major partners of Kosovo, such as the EU and the USA, have reduced their incoming FDIs. In particular, the leading investing partners, Germany and Switzerland, reduced their FDI inflows to Kosovo by 7% and 4%, respectively, while FDIs from the USA almost halved. This foreign investor scepticism may partly be due to geopolitical tensions and political instability in the country, which have the potential to disrupt trade dynamics on several fronts.

Table 7. FDIs in Kosovo (in million euros) by economic activity, cumulative, and as a percentage of the total - (January 2019 - August 2023)

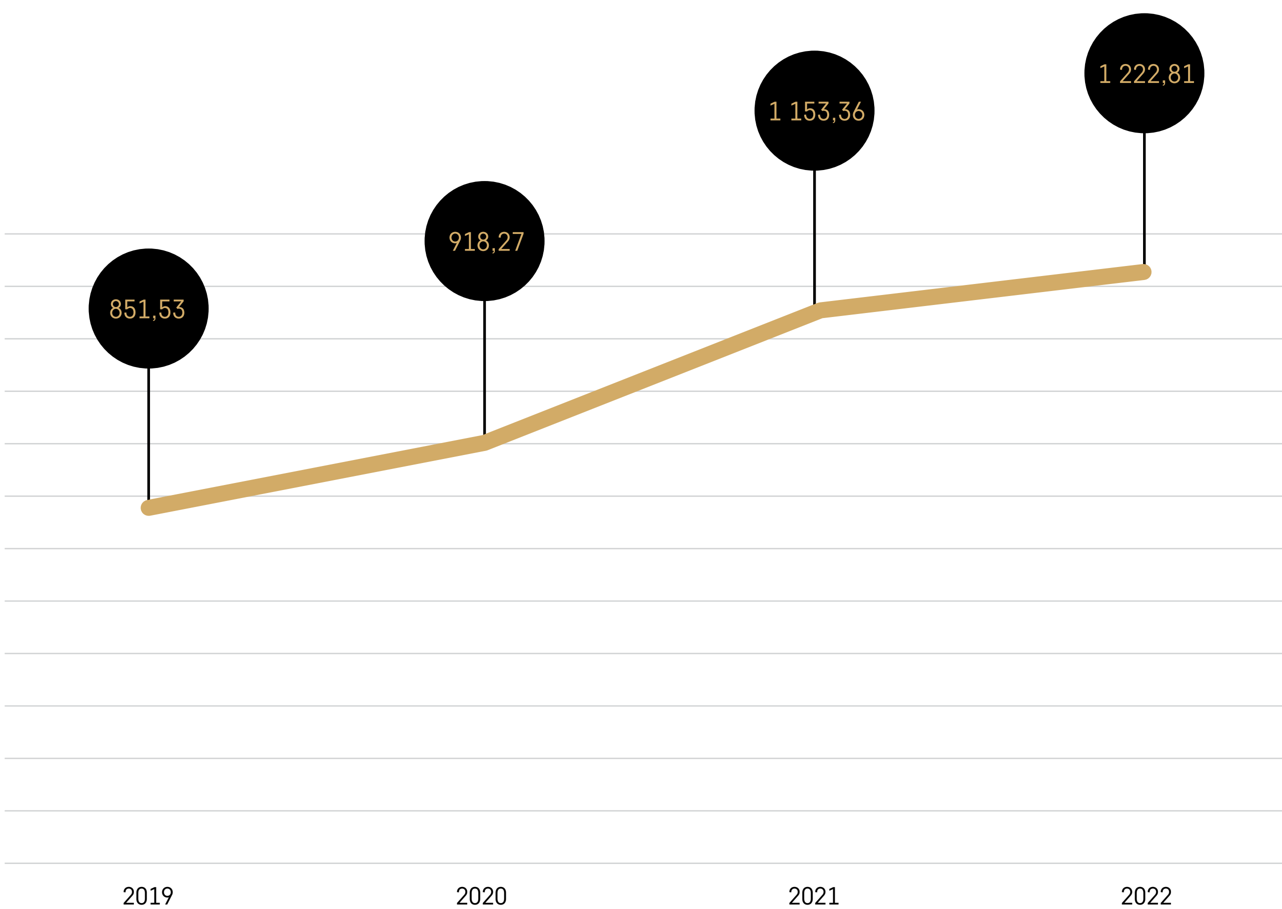
Economic activity	Total IJD 2019- Gusht 2023	Si % e totalit
Real estate activities	1646.7	72.6
Financial and insurance activities	283.2	12.5
Electricity, steam gas and air conditioning supply	76.6	3.4
Mining ores and quarries	51.3	2.3
Construction	43.6	1.8
Informatics and communication	39.9	1.8
Manufacturing	36.6	1.6
Unspecified	32.5	1.4
Professional, scientific and technical activities	28.8	1.3
Administrative and support activities	11.5	0.5
Total	**2267.0**	**100%**

Source: Central Bank of Kosovo

In addition to the level of foreign investments, a crucial issue is related to the sectors in which investments have been made. The Table above illustrates an unsatisfactory situation where the list is dominated by investments in real estate, which do not represent potential for economic multiplication impact. On the other hand, there is a concerning trend of decline in the manufacturing industry, which has the potential for economic growth. Therefore, apart from the volume of foreign investments, the focus should primarily be on attracting and channelling investments into sectors with development and expansion potential. So far, foreign investments in Kosovo do not seem to be in sectors that promote economic development, especially not in the industrial production sectors, as the key sector for the development of export potential.

High income from remittances is a major category within secondary income, the value of which amounted to 753.9 million euros by July 2023, representing an increase of 84 million euros or 12% compared to the same period in 2022. The positive effects are evident, especially during the summer season when a significant number of expats visit Kosovo, leading to increased sales for businesses. Additionally, remittances are almost entirely used to finance consumption and the trade deficit, which has not helped competitiveness. This financing model has kept the Kosovo economy on a limited path for competitive growth and can be changed through policies that redirect remittances towards more productive practices. Given the significant role of remittances in stimulating the service sector, policies aimed at channelling them, supporting investments in education and entrepreneurship research and innovation, and fostering a favourable environment for economic diversification can further enhance the contribution of the service sector to the economy.

Figure 1. . DRemittances over the years (in million euros)



Source: Central Bank of Kosovo

Table 7. Export and import of services over the years (in million euros)

	2019	2020	2021	2022	January - June 2023
Export of services	1,675	995	1,906	2,503	1,089
Import of services	749	603	871	1,127	536

Source: Central Bank of Kosovo

Kosovo is considered to be the most open economy for trade in services in the Western Balkans region. Compared to OECD economies, it is also one of the most attractive in terms of the lack of restrictions on service providers (OECD, 2021). A greater opening of trade in services can enhance the efficiency and productivity of domestic firms. According to the Economic Bulletin for the first quarter, the positive growth of service exports significantly contributed to the country's overall economic growth. Particularly in 2022, there was a 30.5% increase in service exports compared to the previous year. Furthermore, according to wiiw forecasts, a growing trend is expected for this year as well. The key sectors of the economy that supported this growth were the ICT, construction, and wholesale and retail trade.

The sector has been significantly contributing to service exports for years and has strong potential for further growth. Despite having some comparative advantages in fostering an export-oriented ICT industry, the market is still relatively small and underdeveloped due to low levels of digitalisation. This is primarily because of insufficient qualified workers, weak collaboration between the sector and relevant educational institutions, and a lack of access to finance, especially for start-up businesses.

To conclude, the drop in Kosovo's goods exports for 2023 and 2024 can also be attributed to the global situation, which deserves thorough analysis and addressing through appropriate policies. Nevertheless, to tackle these challenges, Kosovo should focus on economic diversification and promoting sectors with growth potential. This should begin with the identification of sectors with growth trends and potential, followed by the design of economic policies that stimulate the development of these sectors and promote investments, especially from the private sector. In this regard, it is essential to note that while goods exports may present challenges in its growth, the services sector offers significant potential and opportunities. Although the services sector already has an overall positive balance, there is still room for further growth. Policymakers should consider encouraging innovation, improving financial inclusion, and supporting enterprises. These steps will help enhance the country's competitiveness and develop a more sustainable and diversified economy.

1.2.3. Financial Sector

The financial sector in Kosovo, dominated by commercial banks, continues to exhibit stability and sustainability trends. In terms of its structural composition, the dominance of banks with foreign capital (comprising approximately 85% of the banking market), possessing the necessary technology and knowledge for modern banking, and proactive supervision by the CBK, has been a determining factor for success in the sector. Last year, a bank with local capital and two non-banking financial institutions were added to the banking sector. Despite advancements in digitalisation, the number of branches and employees in the sector has continued to grow. Since the onset of the pandemic, e-banking and point-of-sale payments have doubled in terms of transaction numbers and amounts.

The financial sector remains well-capitalised, profitable, and liquid. For example, a Return on Assets (ROA) and Return on Equity (ROE) of 2.6% and 21%, respectively, in the banking sector indicate a solid performance. A liquidity ratio of 33% (liquid assets compared to short-term liabilities), a loan-to-deposit ratio of 81%, non-performing loans of only 2%, and a capitalisation of around 15% demonstrate exceptional banking sector performance. Other financial sectors have also shown good performance. For instance, insurance companies have improved their performance, especially in terms of capitalisation. Microfinance institutions have continued to expand lending, primarily to households, with a share of less than 10% of the total loans in the financial sector.

Lending in the various economic sectors continues to follow organic trends. Loans have seen an annual growth of nearly 14%, in nominal terms, which inflation neutralises in real terms. Deposits have also shown an increase of 11.3%. In terms of structure, loans for household economies account for 37%. On the other hand, loans for businesses maintain a similar structure, reflecting the overall economic structure. For instance, loans in the agriculture sector have a 2% share, industry, energy, and construction have 36%[9], and services have 62%, a nearly consistent trend. Regarding maturity, the structure of loans has remained relatively unchanged in recent years, with loans with a maturity of up to one year accounting for 15%, those with a maturity of 1-5 years at 45%, and those with a maturity of over 5 years at 40%. However, when compared to a decade ago, the share of long-term loans (over 5 years) has doubled, while short-term loans (up to 1 year) have decreased significantly. Loans in the private sector in relation to GDP, at nearly 50%, remains at relatively low levels when compared to the Eurozone. However, this indicator falls within the average for the WB region, where Kosovo outperforms Albania and Serbia.

After a long period of favourable trends, the interest rates, partially determined by global monetary conditions and the performance of the country's financial sector, seem to have interrupted this trend. It can be expected that lending conditions will become more challenging, where the prospects of global monetary (and fiscal) developments give such an indication. Interest rates have experienced a slight increase in loans and deposits, but the interest rate margin remains almost the same compared to the previous year. Rising prices and liquidity needs may increase the demand for loans. Potential tightening of lending conditions, credit interest rates, as well as a return to government bonds, are expected to exert pressure for growth. Thus, it may hinder access to finance, with negative implications for consumption and investment. Since the pandemic, the stock of variable interest rate loans has doubled, reaching 30%. Consequently, movements in international market interest rates such as Euribor will have implications for the financial market in Kosovo.

The exposure of the financial sector to the external sector remains high. Net external assets have almost reached €4 billion, or 45% of GDP, with the Pension Savings Trust participating with ½ of the value, followed by the CBK and commercial banks. Commercial banks are the main contributors to the annual growth of net external assets by 13%, followed by the Pension Savings Trust (PST), where the position of CBK remains almost unchanged. On the other hand, the financial sector's demands (mainly the PST and commercial banks) on the central government have decreased by around €150 million.

The relatively high exposure of the financial sector to international markets (although well-diversified) reflecting risks in many dimensions implies the necessity to strengthen the principle of security established in the investment policies of financial institutions (e.g., CBK and the PST). Thus, by subordinating the principle of asset return to a significant degree, for at least the short term. For example, an increase in the PTS's asset exposure in the form of government bonds and deposits in the financial market in Kosovo may be desirable.

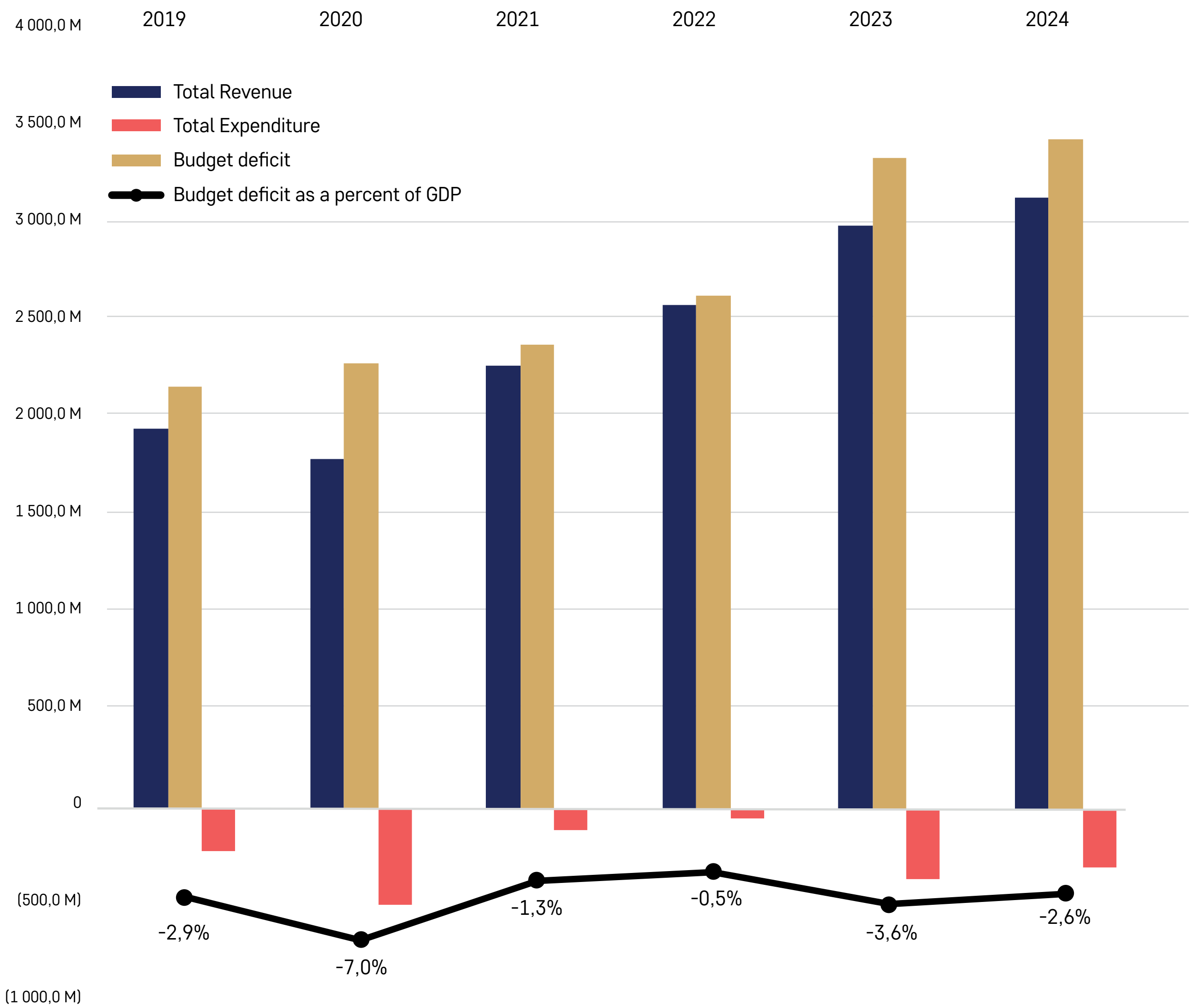
1.2.4. Government expenditure – Budget

BKosovo's budget remains one of the main instruments for economic policy through which the government supports the development of various sectors. Based on the Government of Kosovo projections, budget revenues and expenditures for 2023 and 2024 are expected to follow a similar growth trend as in previous years. Revenues for 2023 are projected to reach around 2.8 billion euros, approximately 390 million more than in 2022 [10]. This increase in budget revenues primarily comes from the growth in value-added tax (VAT) revenues, which are also a result of rising prices in international markets and the formalisation of the economy. On the other hand, budget expenditures for 2023 are expected to be around 3.2 billion euros, 680 million euros more compared to 2022. The budget deficit is expected to be -3.6% of GDP. The structure of revenues and expenditures for 2024 is expected to be roughly the same as the previous year, with revenues projected to reach 3.02 billion euros, and expenditures at 3.3 billion euros with the budget deficit -2.6 % (MFLT, 2023).

9 Note: Within this category, bank loans in the industrial sector have reached a value of approximately €580 million, with an annual increase of 13%, without changing the structure of the banking sector's lending in this category over a multi-year period. In relation to the loan stock, credits in the industrial sector represent about 13.3%.

10 Note: Based on the treasury's nine-month financial report, the budget revenues for 2023 are 75% of the annual projected plan. Revenues collected by Kosovo Customs have reached a gross value of 1,202.42 million euros, or 72% of the budget plan for 2023. Meanwhile, revenues collected by the Tax Administration of Kosovo have reached a gross value of 644.18 million euros, or 72 % of the budget plan for 2023. For more details refer: https://mf.rks-gov.net/desk/inc/media/1675633B-7E7D-4FEA-9803-7DFDD4CE5FE0.pdf

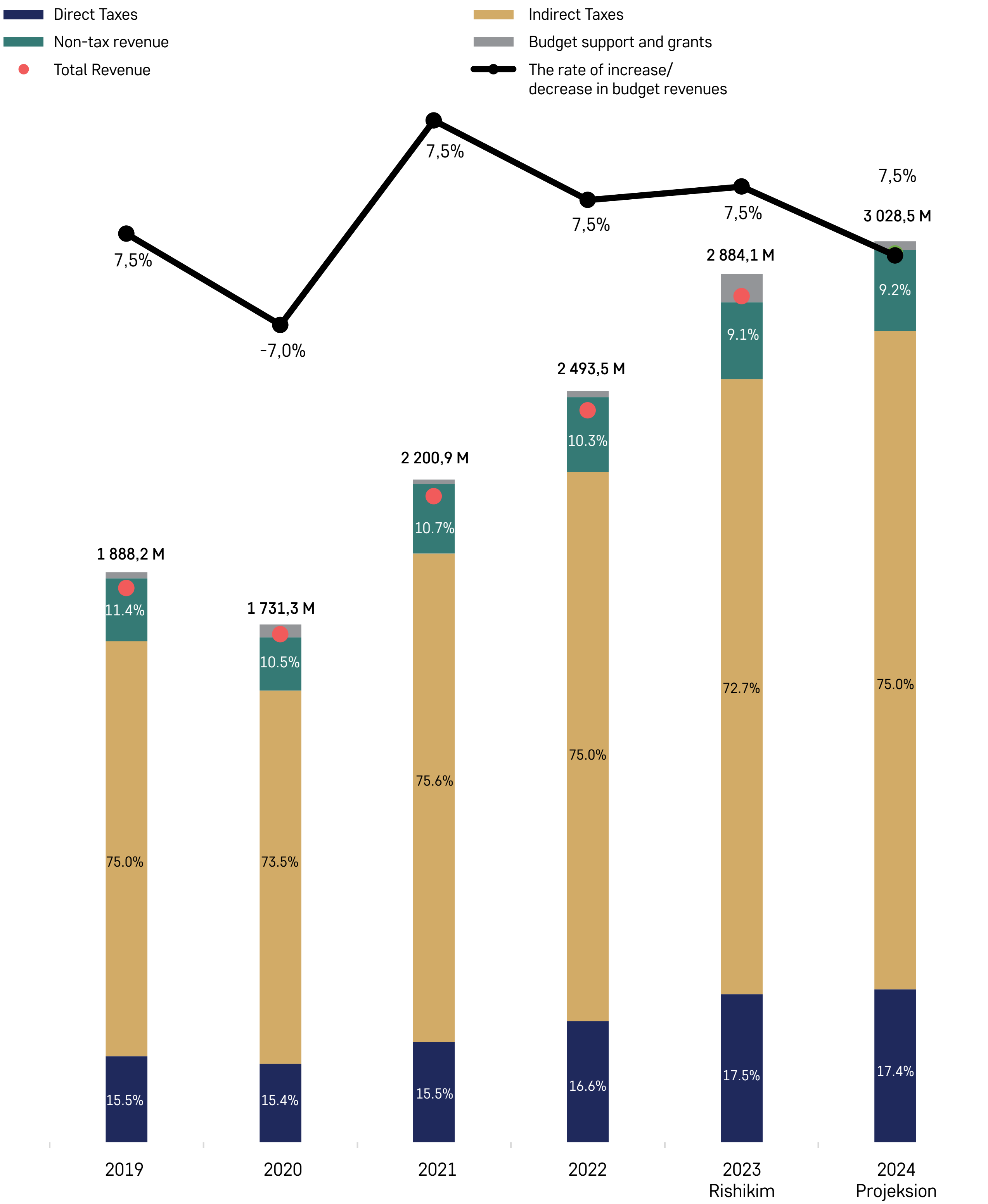
Figure 2. Budget revenues and expenditures



Source: MFLT: Medium-Term Expenditure Framework 2024 – 2026 and The Draft-law on budget allocations for the budget of the Republic of Kosovo for 2024.

The main source of revenues, approximately 75%, comes from indirect taxes, namely by collecting VAT. Compared to previous years, there has been a one-time increase in VAT collection in the country, driven by the rise in excise taxes on imported goods, which is influenced by the increase in the value of imported goods due to rising prices in international markets. On the other hand, revenue from direct taxes have also increased compared to the previous year due to the reduced informality trend in recent years and the inflation increase. Specifically, in 2023, there will be a significant increase in the category of grants and subsidies, totalling 97.5 million euros, which consists of EU grants to support the energy sector and public finance management (MFLT, 2023). Non-tax revenues remain relatively consistent in the structure compared to previous years, covering approximately 9% of the total revenues.

● **Figure 3.** Budget revenues structure



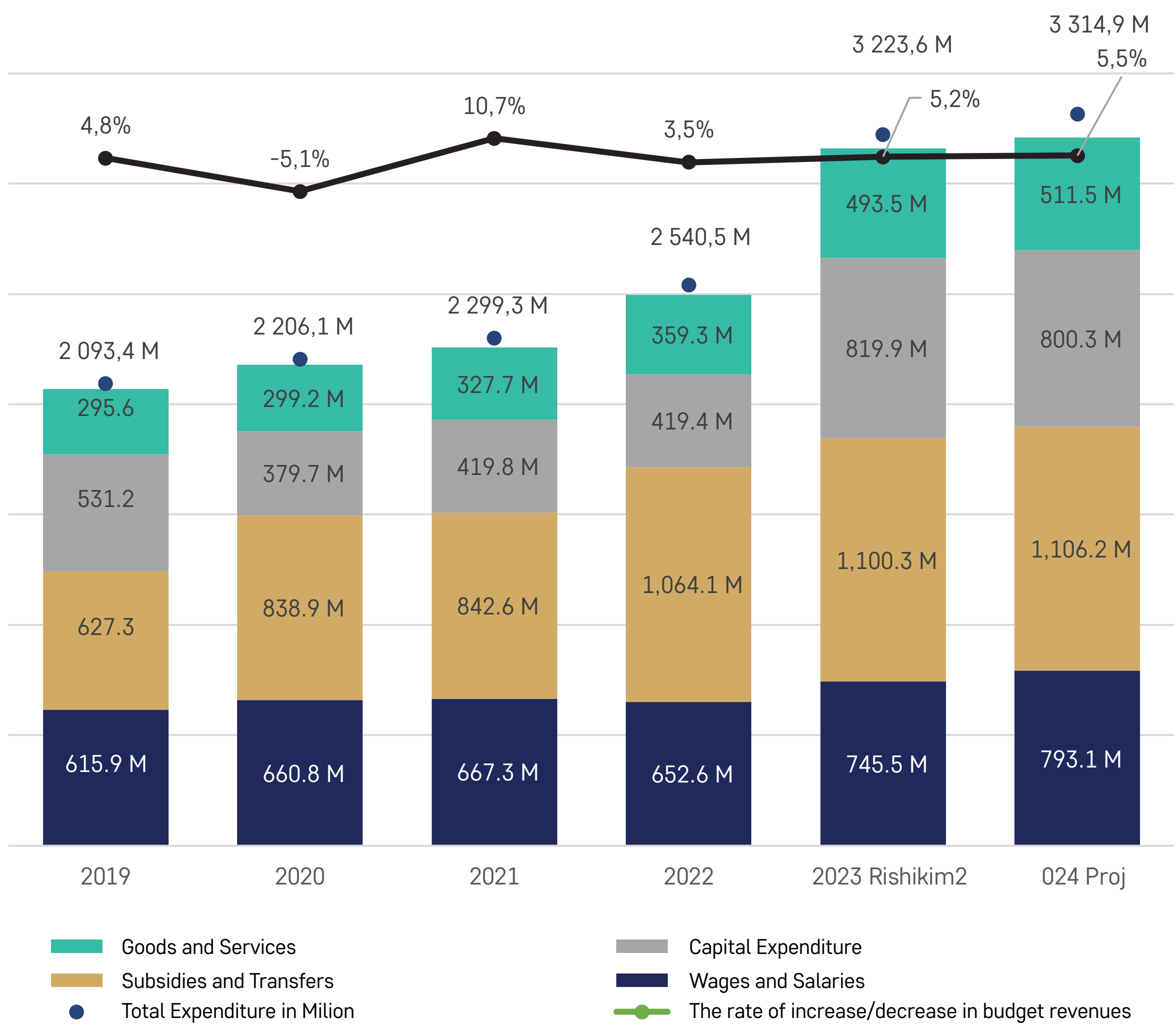
Source: MFLT: Medium-Term Expenditure Framework 2024 – 2026 and The Draft-law on budget allocations for the budget of the Republic of Kosovo for 2024.

1.2.4.1. Structure of Budget Expenditures

For the nine-month period (January - September 2023), approximately 55% of the budget has been spent, totalling 1.82 billion euros (MFLT, 2023). Expenditures for salaries and wages category are planned to reach 745.5 million euros in 2023, representing an 11% increase compared to 2022. This increase comes as a result of the coefficient increase in the new salary law for public officials. Meanwhile, expenditures for subsidies and transfers are expected to exceed 1 billion in the coming years. This substantial increase, especially in comparison to 2021, reflects a gradual reorientation of public policies towards social support in line with the government's recent initiatives.

The high share of current expenditures in the overall budget indicates a disproportion in the budget's allocation structure. Although in this year there is a 16.4% increase in capital expenditures compared to the previous year, the implementation of capital projects is at very low levels. According to the treasury's nine-month financial report, capital expenditures reached the amount of 263.7 million euros, which represents an execution rate of approximately 29% compared to the total budgeted amount for this category. Despite the government's justifications that capital projects are facing difficulties due to the non-functioning of the Procurement Review Body (PRB), property disputes, cancellation of fixed-price contracts by economic operators due to inflation, these are issues within the government's competence and should be addressed in a timely manner.

Figure 4. Structure of budget expenditures



Source: MFLT: Medium-Term Expenditure Framework 2024 – 2026 and The Draft-law on budget allocations for the budget of the Republic of Kosovo for 2024.

The allocation of public funds to specific sectors reflects the government's policy priorities. To draw conclusions, this should be analysed over a longer, medium-term period. The Table below illustrates these movements since 2019, covering a 5-year period. In this aspect, priority is given to the defence sector, general governance, social protection, and law and order.

However, the growth dynamics of expenditures in economic sectors, and such as education, and healthcare, and their share in the budget allocations, are noticeably insufficient. Despite the stated priorities, the support for these areas seems insufficient in terms of budgetary resources and not in favour of the country's economic development, namely faster economic growth. Approximately 30% of the budget, or 731 million euros, will be spent on social protection. The healthcare and education sectors remain underfunded with much slower growth dynamics. Although the healthcare sector will have a 49% increase in the budget compared to 2019, it remains significantly lower, at around 3.5% of GDP[11] much lower than regional and EU countries.

Table 8. The framework for sectoral expenditures at the central level (in million euros)

	2019	2024 projections	The percentage of increase/ decrease 2024/2019
Public General Governance	209.70	369.8	76%
Defence sector	58.60	152.1	160%
Law, order and public safety	203.90	314.5	54%
Economic Affairs	445.80	360.5	-19%
Environment	55.30	74.9	35%
Housing and Community Affairs	10.50	6.8	-35%
Healthcare	169.70	252.2	49%
Recreation, Culture, and Religion	64.20	77.4	21%
Education	110.80	132.9	20%
Social Protection	466.60	731.7	57%

Source: Medium-Term Expenditure Framework 2020 – 2022; Medium-Term Expenditure Framework 2024 – 2026

11 Note: According to Eurostat data, the European Union's average for public healthcare expenditure is 8.8%, while in countries in the region; Bosnia and Herzegovina is at 6.9%, Serbia at 5.7%, and Albania at 3.4%.

The increase in budget revenues necessarily follows the increase in expenditures across various categories. Based on table 8, an inappropriate structure can be observed. There is a significant over-allocation of funds in the subsidies and transfers category in account of capital investments. The budget for salaries and wages has seen an increase of 185 million euros or approximately 24.5% of the total budget from 2019 to 2024. This increase is mainly to accommodate the increase of salaries in public sector. The most significant increase in expenditures is in the category of subsidies and transfers, from around 600 million euros in 2019 to 1.1 billion euros in 2024, representing about 32.4% of the total expenditures. Concerning capital investment expenditures, they have remained nearly the same value from 2019 to 2024, projected to be 859 million euros compared to 788 million euros, an 8.9% increase within the five-year period. When this is coupled with the weak implementation of capital investments, it is evident in this area serious interventions are needed.

Table 9. The sectoral expenditure framework by expenditure categories.

	2019	2024 projections	The percentage of increase/decrease 2024/2019	The participation of categories in total expenditures.
Salaries and Wages	619,9	805,4	29,9%	24,5%
Goods and Services	307	518,9	69,0%	15,8%
Utilities	29,4	36,4	24,1%	1,1%
Subsidies and Transfers	600	1.062,3	77,1%	32,4%
Capital Expenditures	788,8	859,2	8,9%	26,2%

Source: MFLT: Medium-Term Expenditure Framework 2024 – 2026 and The Draft-law on budget allocations for the budget of the Republic of Kosovo for 2024.

1.2.4.2. State Debt Analysis

The overall portfolio of Kosovo's state debt is still at sustainable levels and within the framework of fiscal rules and the law on state debt and state guarantees, which stipulates that public debt should not exceed 40% of GDP (Assembly of Kosovo, 2022). Kosovo's debt structure at the end of 2022 consists of 63% domestic debt and 37% external debt, along with two state guarantees, which in total make up 20% of GDP or 1.7 billion euros.

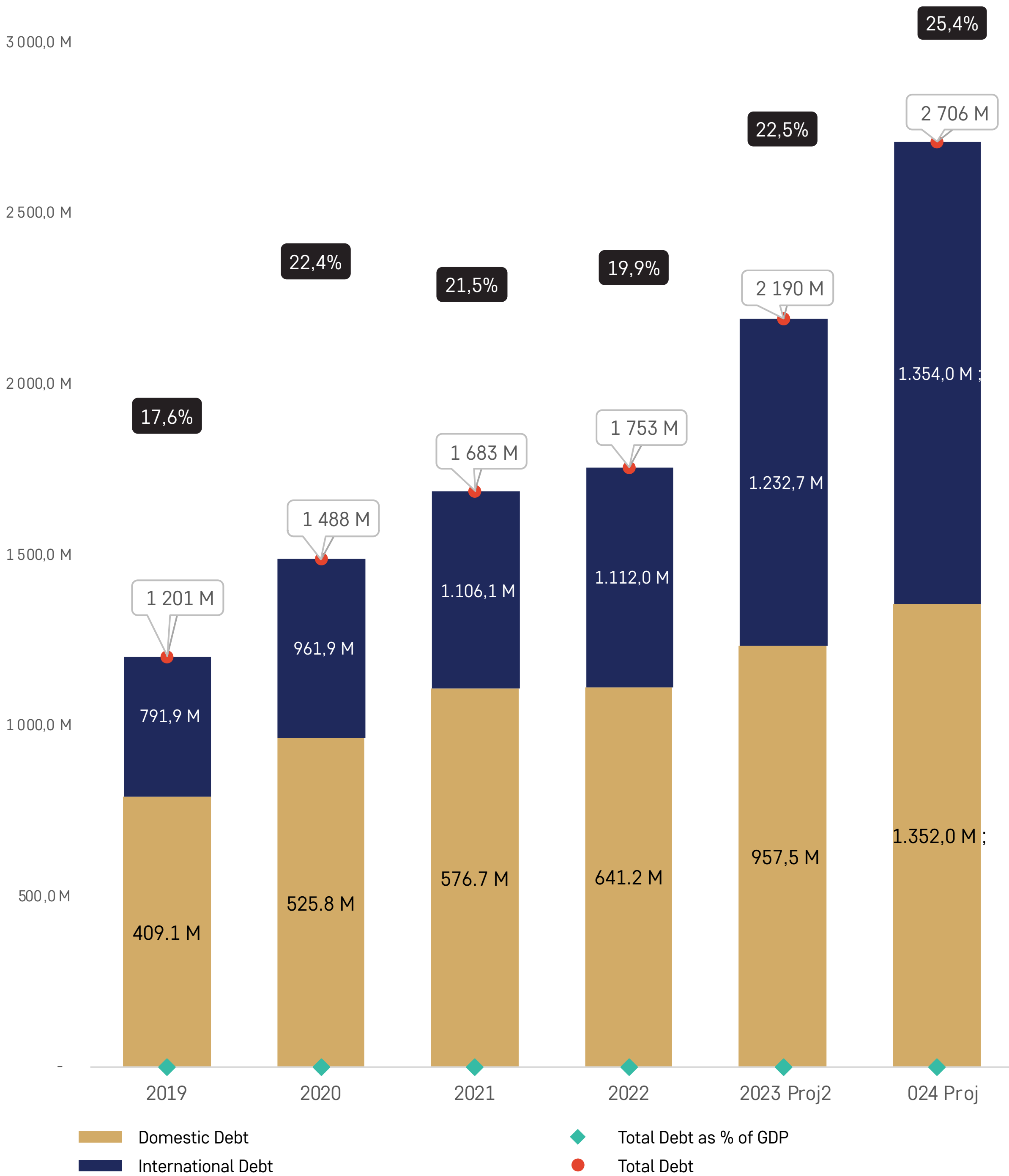
The domestic debt primarily consists of Issuance of Treasury Bonds, Government Bonds, and securities. According to government projections, by the end of 2024, this component of public debt will reach the amount of 1.3 billion euros or 56.3 percent of the total debt. It concerns the debt owed to local financial institutions, where approximately 49 percent of the debt is held by pension funds; 25 percent in commercial banks; 19 percent in public institutions; 4 percent in insurance companies; and 2 percent in other entities. Additionally, the government plans to continue preparing for the issuance of government bonds in the foreign market – Eurobonds. While it is positive that more than half of the total debt is domestic, it is concerning that this debt is being used to cover the budget deficit in the allocation of goods and services and transfers (MFPT, 2023) rather than financing capital investments. The government should pay greater attention to domestic debt dynamics, structure, and destinations, as otherwise, contrary to the current trend; it may challenge the country's budget stability in the medium to long term. Therefore, it would be beneficial for the dynamics of bonds and the interest paid on bonds with a maturity of more than two years to be more closely linked to the dynamics of GDP growth and the primary revenue sources of the country's budget (Riinvest, 2019).

The external debt at the end of 2022 amounted to 641 million euros, marking an 11 percent increase compared to the previous year. This debt is primarily held by international financial organisations, with the International Development Agency (World Bank) holding 34.08 percent, the EBRD with 15.9 percent, the EU with 15.6 percent, and the IMF with 8 percent. The external debt has been borrowed to finance projects in education, agriculture, cadastre, energy, healthcare, sewage treatment, central heating, road rehabilitation, and railways (MFPT, 2023). However, the situation regarding the implementation dynamics of projects related to contracted debts is concerning. According to the annual audit report for external debt, seven (7) projects/loans[12] totalling 177 million euros ratified for utilisation between 2017 and 2022 were not disbursed at all. Furthermore, for loans ratified during 2014 - 2020, which had maturity dates between 2021 and 2023, the utilisation rate by the end of 2022 was only 74 out of 174 million euros[13]. This situation is quite concerning and raises the need for transparency and accountability, primarily from the government and the agencies responsible for implementing projects funded by these loans (Riinvest, 2019). Entering into loan agreements and delays in disbursing available funds are a result of poor planning, land expropriation processes, and the government's lack of capacity to utilise the borrowed funds in a timely and effective manner. As a result of these shortcomings, the government is continuously paying commitment fees for these unused loans. Despite all these concerns about the utilisation of state debt, from 2023 onwards, the dynamics of state debt growth will be highly pronounced. Based on the State Debt Program (MFLT, 2023), by the end of 2024, the debt will reach 2.7 billion euros or 25.4% of GDP. This significant increase in debt requires increased attention from the government and other stakeholders regarding Kosovo's absorptive capacity to transform this debt into economic growth and social welfare, contributing to the quality of life and sustainable growth in the medium and long term, as well as macroeconomic and fiscal stability.

12 Note: Ratified loans with no disbursement of funds by the end of 2022 include: (i) Sewage Treatment Project in Pristina; (ii) Development of sewage project in Gjilan; (iii) Energy efficiency measures project in the municipalities of Prishtina, Gjakova, and Gjilan; (iv) Kosovo's response to the COVID-19 pandemic for SMEs; (v) Sewage treatment plant project in Mitrovica; (vi) Development of sewage project in Mitrovica, (vii) Promoting and Leveraging Opportunities for Water Security Project.

13 Note: Ratified loans that had delays in the disbursement of funds until the end of 2022 are: M2 Milloshevë-Mitrovica Highway Expansion Project, (ii) Prishtina-Mitrovica Highway Project (iii) Regional Road Rehabilitation Project, (iv) Additional Financing for the Agriculture and Rural Development Project, Land Administration and Geospatial Infrastructure Project, (vi) Competitiveness and Export Readiness Project, (vii) Kosovo's Digital Economy Project, (viii) Rehabilitation of the 10th Railway Line Project.

Figure 5. The structure of Kosovo's state debt



Source: State Debt Program 2024 – 2026

BUSINESS ENVIRONMENT

2

This chapter provides a concise overview of the challenges within the business environment over the years and explores the critical role that a business environment plays in the development of the private sector in Kosovo. It focuses on its impact on economic growth, job creation, innovation, and competition.

The private sector in general and small and medium enterprises (SMEs) in particular play a very important role in the socio-economic well-being of the country as they generate the largest number of new jobs and represent the backbone of the economy. According to the data of the Statistics Agency of Kosovo (ASK), currently SMEs together with micro businesses make up about 99% of all businesses in the country. The development and growth of the private sector not only helps in economic advancement and poverty reduction, but also contributes to creating employment opportunities and raising the quality of life. However, this contribution of the private sector cannot be envisaged without a friendly business environment. A friendly business environment is essential for fostering private sector development and fostering economic growth. When businesses operate in a stable and supportive environment, they are more likely to invest in expansion, increase production, and enter new markets. In addition to stimulating economic activity and contributing to overall economic growth, such a business environment directly affects job creation. Furthermore, innovation is a key driver of economic growth, and a supportive business environment plays a key role in fostering innovation within the private sector.

Despite the many challenges that the private sector in Kosovo has systematically faced during the last two decades, there were institutional efforts to improve the business environment in the country. Data from various reports and analyses in recent years show an improvement in the sentiment of businesses in Kosovo regarding the general economic situation in the country (Balkan Barometer, 2022. However, the lack of political stability, challenges with the rule of law, unfair competition, and many other factors have undermined the development potential in Kosovo. Also, the potential to attract foreign investment remains limited mainly due failures in addressing structural issues, including political interference in the economy, the level of corruption, energy insecurity, high level of informality, as well as lack of enforcement of contracts.

This chapter summarizes the challenges of the business environment over the years and explores the critical role that a business environment plays in the development of the private sector in Kosovo, with a focus on its impact on economic growth, job creation, innovation and competitiveness.

2.1 Business environment barriers over time

The impact of business barriers on private sector development and economic prosperity is undoubtedly profound. These obstacles, ranging from complex regulatory frameworks, political stability, competition, to capital-related constraints, create an environment where entrepreneurial efforts are significantly hindered and organic growth of businesses is hindered. Large bureaucracies and stringent compliance requirements not only imply excessive costs for enterprises, but also act as barriers stifling innovation. Moreover, financial burdens, manifested through limited access to capital, worsen the condition of emerging businesses, hindering their ability to invest, expand and contribute substantially to the economic structure. Therefore, improving the business climate - including legal, financial, regulatory and institutional aspects - through strengthening the rule of law and favorable policies for the private sector, is a very important step towards sustainable economic growth.

Against this background, Riinvest Institute has systematically evaluated the business environment through research activities and surveys with businesses in Kosovo. The main purpose of such activities has been to provide a comprehensive overview of the attitudes and practices of businesses on a range of topics related to barriers to doing business in Kosovo. In the following table are summarized the results from regular Riinvest surveys since 2000 for a multitude of indicators and obstacles encountered by businesses in Kosovo. Table 10 reflects the perception of businesses for 25 different indicators and their intensity over the years. The colors in the table reflect the impact on doing business from the perspective of businesses for each barrier, where green means low intensity barriers and red the opposite.[14]

14 Note: The intensity of each indicator (barrier) is measured through an intensity scale from 0-100, where 0 means that the issue or certain indicator is not considered an obstacle, while a value of 100 intensity points represents a very big obstacle in doing business.

Table 10. Doing business barriers (2000-2023)

Year	2000	2001	2002	2003	2004	2005	2007	2011	2012	2013	2017	2023
Tax Rates	60.5	65.9	66.9	74.7	71.1	75.5	74.7	47.3	62.1	76.1	57.3	63.7
Administrative burdens	41.1	51.6	55.8	64.1	64.3	66.5	65.5	-	-	-	54.3	63.5
Legal and judicial system	89.2	80.7	73.9	61.5	64.1	66.5	60.8	60.5	68.2	77.7	52.8	55.4
Access to finance	69.5	61.4	63.3	61.9	59.9	55.5	59.8	55.0	60.5	65.3	50.7	58.0
Cost of financing	-	-	-	-	-	-	56.6	56.2	66.7	85.0	56.5	63.5
Company's limited potentials	48.8	48.7	51.2	46.7	50.4	42.0	46.0	-	-	-	45.9	57.5
Management skills	29.6	30.0	28.3	29.9	29.2	26.6	28.9	-	-	-	36.9	53.7
Provision of raw materials and equipment	50.4	48.7	44.3	44.1	45.7	41.6	38.9	-	-	-	41.8	59.2
Small market (low demand)	41.4	50.1	55.0	63.3	60.5	55.4	57.0	-	-	69.8	61.3	65.7
Access information	59.1	57.0	50.5	50.6	52.3	51.3	53.4	-	43.0	-	37.1	55.3
Collection of debts	47.1	51.1	55.6	64.6	63.2	63.0	60.3	-	68.0	60.6	47.9	59.7
Corruption	-	52.5	54.0	77.9	74.0	81.0	76.5	63.6	77.7	82.3	58.9	59.8
Electricity supply	-	61.4	-	-	-	-	86.3	61.7	51.7	43.0	51.2	57.2
Transportation	-	76.3	65.5	66.7	69.6	74.5	77.7	35.9	39.3	44.7	35.7	51.2
Telecommunications	-	79.4	-	-	-	-	77.7	29.9	36.1	36.2	32.0	47.6
Security and political stability	-	-	74.4	78.5	80.7	77.4	65.3	43.8	67.5	65.7	52.2	57.6
Inefficient tax administration	-	-	-	-	-	-	-	46.5	60.3	53.3	53.8	62.8
Customs	79.5	79.3	80.3	83.5	81	77.5	-	45.1	53.9	-	47.0	60.6
Licensing procedures	-	-	-	-	-	-	-	36.1	43.7	49.1	43.8	-
Crime and theft	-	-	-	-	-	-	71.3	75.2	72.4	73.0	57.3	61.0
Payment of ransom	-	-	-	-	-	-	-	-	67.7	47.4	47.3	-
Unfair competition	80.7	79.8	79.9	77.9	82.9	82.8	76.5	59.5	83.4	81.3	-	-
Skills and education of workers	-	-	-	-	-	-	-	-	-	-	38.7	55.1
Migration	-	-	-	-	-	-	-	-	-	-	-	75.2
Tax evasion and informality	-	-	-	-	-	-	-	-	-	-	57.0	63.5

Source: Riinvest Institute, Business Surveys (2011 – 2023)

2.2 Legal and fiscal regulations

In the 2000s, tax-related barriers and issues related to the legal and judicial system were perceived as significant obstacles. This period coincides with the recovery phase of Kosovo after the war period. A poorly consolidated judicial system together with the complex tax regulations of the time may have contributed to the concerns of businesses. This group of barriers includes issues related to the fiscal system (tax rates, tax administration), the perception related to customs, as well as laws and the judicial system in general. It is worth noting that the perception of businesses regarding these types of barriers has improved relatively little over the years. Kosovo's declaration of independence and international recognition of sovereignty led to reforms and increased stability, partially addressing some of the concerns related to the legal framework but also fiscal reforms. According to the data based on business sentiment, there have been improvements after 2017, albeit with some fluctuations. These years correspond to Kosovo's efforts to further improve its legal and judicial system. Governments have focused on strengthening the rule of law and ensuring a more predictable legal environment, positively influencing the perception of these barriers.

2.3 Investments and financial barriers

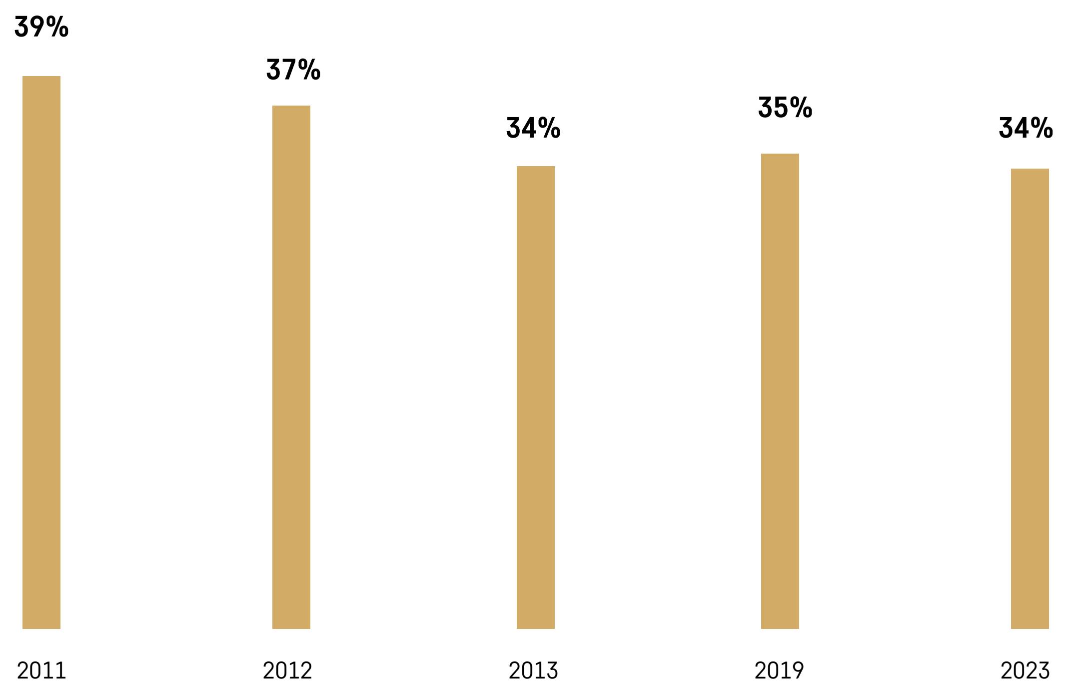
Although access to credit in Kosovo has consistently been present as an obstacle, albeit with moderate intensity, in recent years there has been an improvement. From 2000 to 2007, access to finance appeared to be gradually improving, reflecting the efforts of the banking sector to create a more favorable financial environment. Meanwhile, the cost of financing as an obstacle estimated by the perception of businesses, has been accompanied by some negligible fluctuations. Despite the fact that lending to the private sector has grown significantly over the last decade (mainly from the foreign-owned banking sector), and regardless of the drop in interest rates and non-performing loans, businesses still face restrictions in access to finance. This is especially true for micro-enterprises that cannot meet the banks' rigorous credit requirements. For example, over 90% of loans in Kosovo require collateral, the value of which exceeds regional values (World Bank, 2020). In addition to access and cost of financing, in this context it is essential to consider two other factors that significantly affect the business environment in Kosovo, administrative burdens and debt collection. Based on the primary data with businesses from the Riinvest Institute (Table 10), these two types of obstacles, as can be seen from the value of the intensity points, have not shown dramatic changes over the years; the small fluctuations in the intensity, albeit not significant, of these obstacles show that they remain constant challenges faced by businesses in Kosovo. It is worth noting that last year the Government of Kosovo approved the Program for the Prevention of Administrative Burden (2020-2027) – an inter-institutional initiative which aims to reduce the administrative burden for citizens, businesses and society (ZKM, 2022). As part of this program, Kosovo has launched a basic assessment of all administrative burdens for businesses, identifying 11 laws, 26 by-laws and 2 government decisions that should be amended or repealed to improve the business environment for SMEs (ZKM, 2022). The obstacles faced by local businesses can also be reflected in the lack of interest in foreign direct investment (FDI) in Kosovo.

2.4 Informal economy and corruption

Informality, fiscal evasion, and corruption unfortunately still remain pressing challenges for the development of the private sector in Kosovo. Chronologically, based on Riinvest data, the barriers related to informality and corruption in Kosovo show fluctuating trends. Corruption is a big obstacle for businesses as it negatively affects operating costs and also prevents healthy market competition. Despite institutional efforts to mitigate corruption, unfortunately we cannot say that Kosovo has managed to address the endemic level of corruption. The Prosecution and Judicial Council of Kosovo regularly updates the strategic plans defining the objectives for the judicial and prosecutorial system. Last year, the Judicial Council approved a strategic plan for the efficient resolution of cases of corruption and organized crime, a communication strategy for 2022-2024 as well as the Strategic Plan for Access to Justice for 2022-2025. However, their implementation cannot be said to be effectively monitored. In recent years, as the data from the various studies of Riinvest Institute suggest (the last two rounds of surveys with businesses in table 1), a limited progress is observed; however, continuous efforts and a more proactive approach of all relevant stakeholders are needed for an effective functioning of the entire justice system.

A challenge for businesses in Kosovo is also informality - estimated at around 30% of GDP (European Commission, 2021). Currently, to address this phenomenon, the previous government had approved the National Strategy of the Republic of Kosovo for the Prevention and Combating of the Informal Economy, Money Laundering, Financing of Terrorism and Financial Crimes (2019-2023). This strategy focuses on increasing incentives for voluntary compliance for businesses and improving the inspection capacities of the administration. Until now, it has been possible to partially fulfill what was intended, where out of 71 activities 62% of them have been implemented (Government of Kosovo, 2023). A business environment characterized by high informality prevents new formal and innovative firms from growing and creating new jobs in the market. This phenomenon also sends disturbing signals to foreign investors, who may hesitate to invest in Kosovo. Also, data from various studies of Riinvest Institute (2011-2023) have evaluated the level of non-declaration of income for tax purposes. As can be seen in Figure 6, from 2011 there is a slight decrease of the turnover that is not declared by businesses for tax reasons; the level of undeclared turnover in 2011 was 39 percent while in 2022 (data collected in 2023 for fiscal year 2022) this percentage was lower by 5 percentage points.

Figure 6. The level of tax evasion in Kosovo



Source: Riinvest Institute, Business Surveys (2011 – 2023)

2.5 Labor market and barriers related to business

In Kosovo, despite the optimism of businesses for growth in the medium term, the difficulty in finding new employees with the necessary skills has systematically been among the most serious challenges of businesses (Riinvest, 2021). In the recent Business Environment and Enterprise Performance Survey (BEEPS 2018-2020), around 45% of firms identified inadequate worker education as a major barrier. This suggests that unemployment and the persistently high level of unemployment has a structural character. The VET system in Kosovo is organized according to specialized profiles, however these profiles in most cases do not match the needs of the labor market. However, in recent years, significant efforts have been made to improve the education system through reforms such as the creation of new curriculum framework that include work-based learning, or even career guidance in higher education institutions. As for the obstacles related to the potential of businesses, the historical data shows fluctuating trends. While management were not seen as an obstacle, from the data of the latest Riinvest survey (2023) it is observed that the skills and adequate education of workers is perceived by businesses as a barrier with average intensity (Table 10). Since the largest number of registered businesses in Kosovo are micro, small and medium, often the owners of these businesses do not invest in the development of their personnel or do not hire workers with sufficient skills and experience to occupy positions leading.

A worrying issue that businesses are facing in recent years is the recent migration trend. This concern is reflected in the latest Riinvest survey (2023) where migration was assessed by businesses as the barrier with the highest intensity (Table 10). This concern comes mainly because visa liberalization with Kosovo is expected to come into effect in January 2024, which is expected to have implications in the labor market in Kosovo.

2.6 Administrative barriers and infrastructure

The administrative obstacles assessed through the data from the surveys with the businesses over the years are not seen as obstacles in doing business. The data in the different rounds of surveys with businesses (2011-2017) show that licensing procedures are not seen as major obstacles by businesses (Table 10). However, obtaining licenses in Kosovo takes much longer than in other developed economies. For example, obtaining a building permit in Kosovo takes an average of 273 days (compared to the OECD average of 152 days) and requires 18 procedures (the OECD average is 13) (OECD, 2021). These difficulties can potentially prevent new businesses from entering the market. A clear, transparent and efficient licensing system is essential to foster entrepreneurship and attract investment. Moreover, among the institutional barriers that have a more problematic political character in recent times are the ongoing tensions in the north of the country. After failing to ease ten-

Energy Sector and Business Environment

Although domestic energy production meets a significant portion of the demand, energy imports are necessary during peak consumption periods. Renewable energy capacities have experienced modest growth, including hydro, wind, and solar energy, but the dominance of coal in energy generation has overshadowed these advancements. These developments impact business stability and costs. The lack of flexibility in the energy system, caused by the concentration of generation in very old thermal power plants, is also accompanied by supply deficiencies. These dynamics lead to frequent interruptions for businesses, affecting their operation stability and financial planning; they also discourage potential investors, making it more challenging for existing businesses to thrive. What needs to be done immediately is to diversify the energy supply sources, including exploring the possibility of gas supply. Building a more sustainable infrastructure is essential. Although there have been improvements in energy supply reliability indicators in 2022, fundamental issues in the energy sector persist, creating a challenging and uncertain business environment regarding stable electricity supply.

sions in this part of the country, the European Union decided to undertake temporary measures, suspending high-level meetings and bilateral visits, as well as suspending funding from EU funds. These are factors that reduce the confidence of local businesses and also foreign investors. As for the obstacles related to the infrastructure, there is a significant improvement in the perception of businesses after 2011; transport and telecommunication services are generally not seen as obstacles in doing business in Kosovo. After 2008, major investments were made in road infrastructure and telecommunications in Kosovo. Examples of infrastructure investments include building new highways, improving existing road infrastructure, and modernizing electricity infrastructure. These efforts are focused on improving the access and quality of public services for citizens and on developing a favourable environment for businesses (EBRD, 2013). However, the recent energy crisis in Europe has also affected Kosovo which is expected to face energy supply issues during the winter season. This uncertainty is also reflected in businesses since according to the data of the latest business survey of Riinvest Institute (2023), electricity supply is seen as a relatively high-intensity obstacle for business development (table 10).

Finally, it should be emphasized that among the institutional barriers, which have taken on a more problematic political character in recent times, are the ongoing tensions in the northern part of the country. Concerning these tensions and the EU negotiation process, the European Union decided to take temporary measures, suspending high-level meetings and bilateral visits, as well as halting funding from IPA funds. These are factors that decrease the confidence of local businesses and foreign investors alike. Regarding infrastructure-related challenges, there is a noticeable improvement in the perception of businesses since 2011; transportation and telecommunication services, in general, are no longer seen as obstacles to conducting business in Kosovo.

LABOUR MARKET

3

3.1 Introduction

Kosovo is currently grappling with several labour market challenges, including, among others, high unemployment (especially for youth and women), low participation rate, a shortage of skilled workers, and workforce depletion due to significant migration. This Chapter aims to provide an overview of Kosovo's labour market challenges faced by the private sector.

Skill mismatch represents a significant barrier, closely linked to the inability of vocational education and training (VET) schools and higher education institutions (HEIs) to provide the private sector with the skilled workforce it requires. This has a detrimental impact on the competitiveness of the economy. Within the education system, there is a persistent challenge related to inadequate institutional capacity to link job seekers with employment opportunities, facilitate effective training, and establish mechanisms to ensure the delivery of high-quality education and training (European Commission, 2022). Over half of businesses report that their employees lack adequate and relevant skills, as recognized also by the policymakers (Government of Kosovo, 2022). Filling job vacancies remains a challenge, particularly for high- and medium-skilled positions (Krasniqi and Hashi, 2021). Riinvest (2019) reveals that a third of businesses face hiring difficulties in selected occupations, which are also confirmed in this study, as explained in the subsequent section.

The intensity of migration of skilled and educated employees, including youth, remains a challenge in Kosovo, similar to other WB6 countries (Icoski, 2022; Leitner, 2021; Mara and Vidovic, 2020; World Bank and wiiw, 2019). WB6 are ranked among the counties with the most affected by brain drain at the global scale (Icoski, 2022). The highest share of overqualified migrants is from WB6 compared to foreign-born population in OECD countries (OECD, 2022). Mara and Landesman (2022), in their projection from 2020 to 2030, show that a shortages and surplus of labour force based on different skill groups will emerge in WB6. Kosovo is expected to have labour shortages of both low and highly educated people, and excess on medium educated employees. The labour force migration is expected to become an increasingly pressing issue, particularly with Kosovo citizens expected to enjoy visa-free travel in the Schengen Area by 2024. Visa liberalization was found to be a significant contributing factor to the rise of emigration, including the high share of youth (Lavrič, 2020).

Analyzing the propensity to migrate and firm reaction in relation to migration has important policy and managerial implications. In doing so, we have also investigated two models: (i) the determinants that drive emigration from Kosovo, with a particular emphasis on the youth demographic (BOX 3); and (ii) the attributes of companies that have lost staff due to migration (BOX 4). The results of these models and those from the descriptive analysis provide insightful policy recommendations.

3.2 General overview of the labour market in Kosovo

Labour market indicators pose an ongoing challenge for policymakers and government officials. While there have been some improvements in these indicators, there is still ample scope for implementing more sophisticated policies and mechanisms to enhance them further. The labour market struggles with persistent issues, including high unemployment rates, especially among youth and women, and high levels of inactivity, which are prominent concerns. When compounded by factors like skill mismatches and substantial migration rates, these challenges underscore the pressing need for more immediate and comprehensive policy interventions to address these issues and promote socio-economic well-being.

Table 11. Key labour market indicators (% of working-age population)

	2015	2016	2017	2018	2019	2020	2021	2022
Labour force participation	37.6	38.7	42.8	40.9	40.5	38.3	39.3	38.6
Inactivity	62.4	61.3	57.2	59.1	59.5	61.7	60.7	61.4
Employed/total population	25.2	28.0	29.8	28.8	30.1	28.4	31.1	33.8
Unemployment rate	32.9	27.5	30.5	29.6	25.7	25.9	20.7	12.6
Youth unemployment rate (15-24)	57.7	52.4	52.7	55.4	49.4	49.1	38.0	21.4
Unstable employment (15-64)	22.8	22.9	23.1	19.6	18.8	17.0	12.7	13.3
Long-term Unemployment[15]	74.5	65.5	65.5	58.4	63.6	71.7	70.8	65.1

Source: Kosovo Agency of Statistics: Labour Market indicators

The challenge of labour force participation persists in Kosovo, with an average rate of 39.6 percent recorded over the period spanning from 2015 to 2022. Encouragingly, youth unemployment has been decreasing from 57.7 percent in 2015 to 21.4 percent in 2022. Similarly, there has been a decline in unstable employment over the past two years compared to 2015. While the unemployment rate has decreased (to 12.6 percent in 2022), the employment rate as a percentage of the population remains low (33.8 percent). It appears that the decline in the labour force participation rate had an impact on lower unemployment figures, also partly influenced by migration. These statistics are particularly concerning for young people and women.

Similarly, long-term unemployment has seen a modest reduction, although it remains notably high. The number of job seekers during the three quarters of 2023 has increased compared to 2022, with the highest percentage of job seekers being among women compared to men. For both genders, the most significant proportion of job seekers falls within the age group of 25-39.[16] It is worth emphasizing that long-term unemployment may not solely result from a lack of available job opportunities but may also be linked to the significant presence of informal employment in Kosovo, partly induced by the distortions that pose social protection schemes.

3.3 Labour demand and difficulties filling positions

Riinvest's survey finds that 33.8 percent of businesses have hired new employees over the last three years. Also, in the following three years, companies expect to increase the number of employees in occupations such as: craft and

15 Note: Unemployment longer than 1 year or the Duration of unemployment for more than a year of total unemployed refers to people who have been unemployed for more than 12 months.

16 Note for more see the link: https://askdata.rks-gov.net/pxweb/sq/ASKdata/

related trade workers. The demand for other professions, professionals, elementary workers, and managers is below average, and the new jobs that are expected to be created include sales workers, waiters and bartenders, building and related trades workers, and labourers in mining, construction, manufacturing, and transport. These account for almost half of the new jobs. However, the challenge besides the increase in demand is the lack of supply as the propensity to migrate grows (discussed further in this Chapter). Therefore, based on the current trends, businesses will face challenges in keeping their employees.

The survey data suggest that managers (ISCO 01), account for over 13 percent of the total workforce among the surveyed businesses, and 44 percent of companies have an employee with such an occupation.

The second group with the highest percentage is Elementary Occupations (ISCO 09) with 11.7 percent. Within this occupation, Cleaners and Helpers and Food preparation assistants (fast food preparers and kitchen assistants) share the highest percentage of employees with 5.9 and 4.6 respectively. Craft and Related Trades Workers[17] (ISCO 07) account one third share of employees with its five sub-occupations. Services and Sales workers (ISCO 05) are the third occupation with 3.8 percent of the share of employees and 5.8 percent are employed in this occupation. The highest percentage from sub-occupations that businesses employ are waiters with 16.7 percent, followed by bartenders with 11.1 percent and Cooks with 9.6 percent. Other occupations with lowers share of employees are: Technicians and Associate Professionals (ISCO 03) and Clerical Support Workers (ISCO 04), Skilled Agricultural, Forestry and Fishery Workers (ISCO 06), Plant and Machine Operators and Assemblers (ISCO 08), and Professionals (ISCO 02).

17 The occupations that include in this occupation are: Vehicle mechanics and repairers (auto mechanic) 1.8 percent, Garment and similar workers 1.6 percent, Bakers, pastry and cake makers, Tailors, seamstresses, joy-makers, and hatters.

Table 12. Main occupational groups: Prevalence, expected increase and typical wages

Occupation ISCO 8	Firms employing such occupations	Share of employees	Typical wage (EUR) Mode	Min	Max	The number of employees increased in last three years	No of employees on this occupation	Expected increase in the next three years
1. Managers	**44.0%**	**13.0%**	**564**	**483.2**	**641.4**	**1.10**	**1.18s**	**22.8%**
2. Professionals	**10.2%**	**4.0%**	**606**	**646.7**	**599.0**	**1.37**	**1.55**	**81.2%**
2.2.6.2 Pharmacists	2.3%	1.3%	376	280.9	531.1	1.88	2.30	67.7%
3. Technicians and Associate Professionals	**0.7%**	**0.4%**	**388**	**300.0**	**500.0**	**0.60**	**2.29**	**50.0%**
4. Clerical Support Workers	**0.8%**	**0.4%**	**325**	**300.0**	**363.3**	**0.80**	**2.13**	**81.3%**
4.2 Customer Services Clerks	6.5%	3.7%	383	319.5	421.7	1.46	2.28	49.0%
4.4 Clerks and other administrative support workers	0.9%	0.4%	389	225.0	323.3	1.38	1.89	11.1%
5. Services and Sales Workers	**5.8%**	**3.8%**	**360**	**328.9**	**370.0**	**1.96**	**2.62**	**24.7%**
5.1.2 Chefs	9.6%	6.2%	507	489.8	570.5	1.63	2.56	23.0%
5.1.3.1. Waiters	16.7%	12.0%	388	367.5	436.3	1.21	2.88	23.3%
5.1.3.2 Bartenders	11.1%	5.4%	391	387.2	436.4	0.91	1.95	14.0%
5.1.4.1 Hairdressers	5.1%	3.3%	340	267.5	405.7	1.57	2.59	63.8%
5.1.4.2. Cosmetologists and similar workers	4.3%	2.4%	356	389.1	455.7	1.17	2.21	45.3%
5.2 Sales staff	22.8%	13.0%	399	295.9	417.1	1.07	2.28	33.4%
6. Skilled Agricultural, Forestry and Fishery Workers	**0.1%**	**0.1%**	**450**			**1.00**	**4.00**	**0.0%**
7. Craft and Related Trades Workers	**7.6%**	**5.2%**	**380**	**328.3**	**466.4**	**1.45**	**2.71**	**73.8%**
7.2.3.1 Vehicle mechanics and repairers (auto mechanic)	1.8%	1.1%	423	332.0	458.6	1.17	2.39	35.3%
7.3 Garment and similar workers	1.6%	0.8%	271	238.1	305.0	1.29	2.06	76.4%
7.5.1.2. Furrtarët, gatuesit e pastave dhe ëmbëlsirave	2.4%	2.2%	379	306.4	467.8	1.00	3.58	78.2%
7.5.3.1 Tailors, seamstresses, furriers and hatters	2.4%	1.5%	339	265.0	391.0	1.82	2.42	109.7%
8. Plant and Machine Operators and Assemblers	**2.6%**	**1.6%**	**519**	**452.9**	**562.4**	**2.00**	**2.50**	**40.8%**
8.3.2.2 Car, taxi and van drivers (nations)	3.3%	2.0%	415	371.4	472.0	1.46	2.39	30.9%
9. Elementary Occupations	**11.1%**	**11.7%**	**345**	**282.4**	**361.2**	**2.02**	**4.20**	**52.4%**
9.1 Cleaners and helpers	5.9%	2.3%	344	290.7	372.6	1.21	1.56	19.7%
9.4 Food preparation assistants (fast food preparers and kitchen assistants)	4.6%	2.3%	323	268.6	349.3	0.89	2.02	20.6%
9.4 Food preparation assistants (fast food preparers and kitchen assistants)								

Source: Authors' Calculations Based on Survey Data

The lowest net salary among occupations is 225 euros for Clerks and other administrative support workers, while the highest salary is for Managers at 641.4 euros. The highest increase on the number of employees regarding the occupations was in Services and Sales Workers (1.96 percent) and Craft and Related Trades Workers (1.45 percent), while regarding sub-occupations, Pharmacists had an increase on employees by 1.88 percent. In terms of expected increase in the next three years, the highest increase is expected in Services and Sales Workers (6.31 percent) and Craft and Related Trades Workers (4.71 percent).

Table 14 below presents the most common 'typical' level(s) of education reported by companies for workers of different occupational groups. Secondary education – mostly general secondary education – is the most common level of education across the sample. The highest degree based on occupations is for Management occupations where 55.4 percent of workforce among the surveyed businesses have bachelor's degree. While for Professionals 46.2 percent have bachelor's degree whereas 26.5 percent have Master degree, and 5.1 percent have PhD, whereas, 39.2 percent of Clerical Support Workers, have Bachelor degree.

Table 13. The level of education based on occupation

	The level of education based on occupations							
ISCO	I have no education	Primary	Secondary	University Bachelor	Master	PhD	I do not know	Total
1. Managers	0%	0.8%	33.1%	55.4%	9.7%	0.3%	0.8%	100.0%
2. Professionals	0%	0.9%	20.5%	46.2%	26.5%	5.1%	0.9%	100.0%
3. Technicians and Associate Professionals	0%	0%	85.7%	14.3%	0%	0%	0%	100.0%
4. Clerical Support Workers	1.3%	1.3%	55.7%	39.2%	2.5%	0%	0%	100.0%
5. Services and Sales Workers	0.2%	2.9%	76.5%	17.1%	0.9%	0%	2.5%	100.0%
6. Skilled Agricultural, Forestry and Fishery Workers.	—	—	—	—	—	—	—	—
7. Craft and Related Trades Workers	0.8%	4.6%	84.0%	7.6%	0%	0%	3.1%	100.0%
8. Plant and Mahine Operators and Assemblers	0%	0%	86.3%	13.7%	0%	0%	0%	100.0%
9. Elementary Occupations	0.5%	4.4%	83.5%	5.5%	0.5%	0%	5.5%	100.0%
Total	0.3%	2.4%	62.8%	27.2%	4.8%	0.4%	2.1%	100.0%

Source: Authors' Calculations Based on Survey Data

Our survey results suggest that the occupations businesses (Table 14) find very difficult to find employees are Professionals with 59.5 percent, Managers with 27.4 percent, and Craft and Related Trades Workers with 23.4 percent. The possible explanation of these results is that businesses need more employees and find it difficult to fill open vacancies in these occupations.

Table 14. The difficulty on hiring employees

ISCO	Very easy	Easy	Difficult	Very difficult	Total
1. Managers	32.7%	17.3%	22.6%	27.4%	100.0%
2. Professionals	25.2%	7.2%	8.1%	59.5%	100.0%
3. Technicians and Associate Professionals	50.0%	25.0%	0%	25.0%	100.0%
4. Clerical Support Workers	15.4%	39.7%	35.9%	9.0%	100.0%
5. Services and Sales Workers	23.4%	35.2%	26.8%	14.6%	100.0%
6. Skilled Agricultural, Forestry and Fishery Workers.	—	—	—	—	—
7. Craft and Related Trades Workers	12.4%	22.6%	41.6%	23.4%	100.0%
8. Plant and Machine Operators and Assemblers	31.3%	29.2%	18.8%	20.8%	100.0%
9. Elementary occupations	15.2%	31.6%	35.1%	18.1%	100.0%
Total	22.9%	28.4%	27.2%	21.5%	100.0%

Source: Authors' Calculations Based on Survey Data

Survey results also show that the reason why is difficult and very difficult to find employees is related to the lack of experience, the lack of skills and demand for higher salaries (Table 15). The lack of experience, according to the survey, is in occupations such as Craft and Related Trades Workers (50 per cent), Managers (22.2 percent) and the lowest percent percentage regards to the demands on skills are Elementary Occupations. While in terms of difficulty on finding skilled employees, the occupations with the highest performance are Technicians and Associate Professionals (50 percent) and Craft and Related Trades Workers (47.7 percent). The demand regarding high salaries is on occupations such as Professionals (34.1 percent) and Plant and Machine Operators and Assemblers (27.8 percent). The lowest percentage regards to these occupations on demand for salary are Craft and Related Trades Workers (7 percent) and Technicians and professional collaborations with no demand on salary. These findings also show another interesting aspect on these occupations, where for example businesses find difficulties regarding to finding experienced and skilled employees on Craft and Related Trades Workers and the demand of employees from this occupation regarding the salary is low.

Table 15. The reason why is challenging to hire employees based on occupations

	If was difficult (3-4), what was the reason? (select up to 2)							
ISCO	1. The candidates lacked experience	2. Candidates lacked the required education	3. Candidates lacked the required skills	4. Suitable candidates demanded high salaries	5. Suitable candidates prefer to work in the public sector	6. There were no interested candidates	Other	Total
1. Managers	22.2%	7.8%	26.7%	20.0%	11.1%	8.9%	3.3%	100.0%
2. Professionals	13.6%	13.6%	20.5%	34.1%	6.8%	4.5%	6.8%	100.0%
3. Technicians and Associate Professionals	50.0%	0%	50.0%	0%	0%	0%	0%	100.0%
4. Clerical Support Workers	9.5%	16.7%	38.1%	21.4%	0%	11.9%	2.4%	100.0%
5. Services and Sales Workers	14.1%	7.3%	39.6%	15.3%	1.3%	22.0%	0.3%	100.0%
6. Skilled Agricultural, Forestry and Fishery Workers.	—	—	—	—	—	—	—	—
7. Craft and Related Trades Workers	12.8%	20.9%	47.7%	7.0%	1.2%	8.1%	2.3%	100.0%
8. Plant and Machine Operators and Assemblers	11.1%	5.6%	22.2%	27.8%	5.6%	22.2%	5.6%	100.0%
9. Elementary occupations	8.2%	15.5%	38.2%	9.1%	0%	28.2%	0.9%	100.0%
Total	13.8%	11.2%	37.0%	15.7%	2.7%	17.9%	1.7%	100.0%

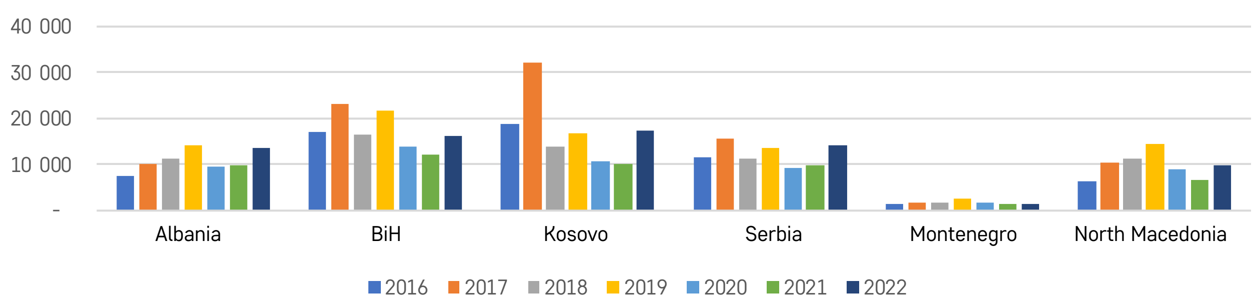
Source: Authors' Calculations Based on Survey Data

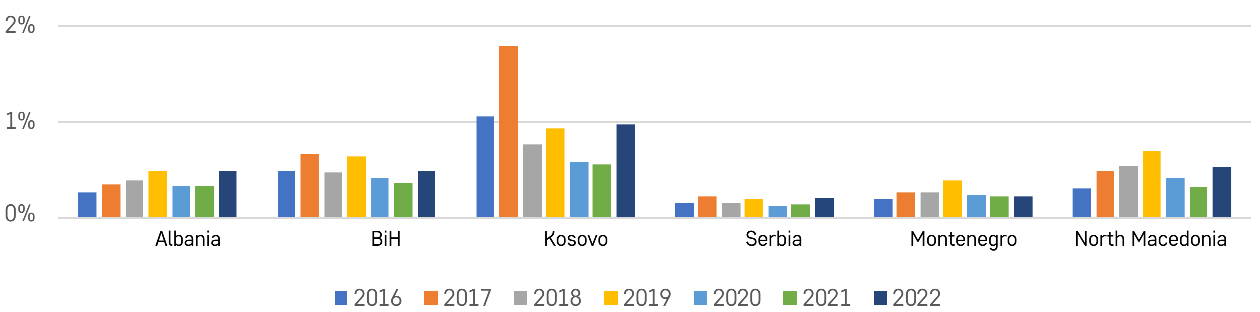
3.4 Difficulties in retaining employees

The shortage in workforce due to migration and skilled workforce presents a challenge for private sector to fill job vacancies. According to (Mara and Landesman, 2022) the imbalances on labour market present an issue regards to filling job vacancies in Western Balkan countries. This study shows that the availability of labour and skills and skilled and educated workers are two main barriers that businesses face to expand and continue their operations (RCC, 2020). For instance, Riinvest (2019) study shows that one of the main barriers businesses have is the labour supply due to workforce migration. This study shows that the high percentage of labour migration in two waves of migration since 2013 has been listed as one of main barriers for businesses. The continuous migration of skilled and educated labour force will have consequences on human capital development on the ability of country to compete and grow (World Bank and wiiw, 2018).

This was confirmed by the data collected for the purpose of this report. The migration of employees remains the primary issue that businesses face. Survey results suggest that 17.59 percent of firms reported that their employees informed them they would migrate in the next year. In general, businesses expect 32.72 percent of employees to migrate next year. In an effort to mitigate this problem, in the last three years, 79 percent of businesses have increased their salaries, and the salary growth was 22.23 percent. Over two-thirds of businesses (37 percent) plan to keep increasing the salaries across the board. Almost a quarter of businesses (24.5 percent) plan to improve working conditions, 20.6 percent plan to hire women, and 10.4 percent plan to invest in new technologies for work automation. However, Riinvest (2022) study finds that businesses lag significantly behind in digitalization compared to European companies; hence, the adoption can be challenging. Only a small fraction of companies is expected to provide training to their staff in an attempt to lower the incentives to leave. Providing skills is important in creating opportunities and may be an important source to stop migration-brain drain and improve the standard of living (Addarii et al., 2022).

Figure 7. Number and percentage of citizens that migrated 2016-2022





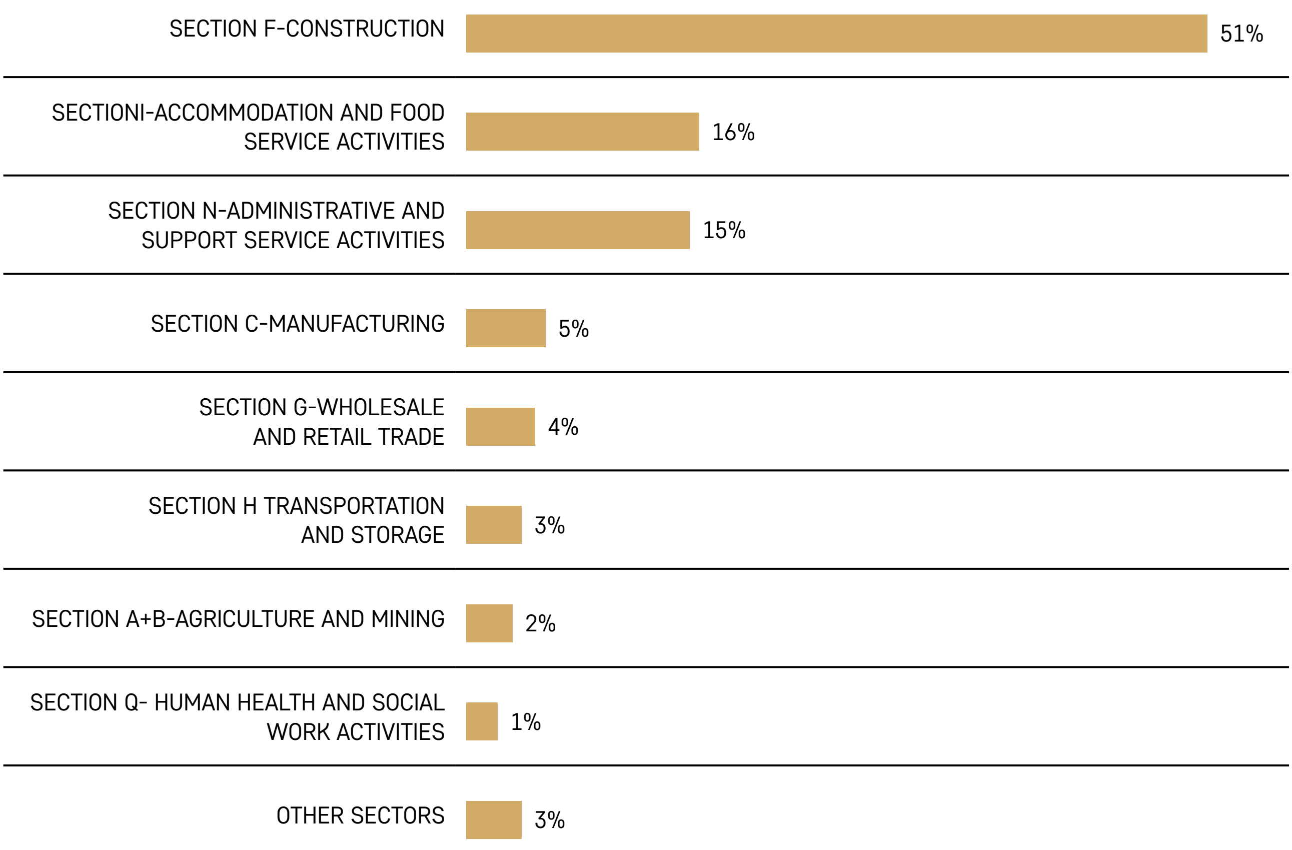
Source: German Federal Employment Agency

Starting from 2016, approximately 1 percent of Kosovo's population has been migrating annually to Germany, which translates to nearly 120,000 individuals of working age.[18,19] During the same timeframe, other Western Balkan countries have seen a workforce outflow to Germany at approximately 0.4 percent of their respective populations (Figure 7).

Working permits for Kosovars have been predominantly issued in the Construction sector, accounting for over 50 percent of the permits. Within this sector, more than 70 percent of workers are engaged in preparatory construction work and installations, while the remaining individuals are split between building activities (21 percent) and civil engineers (8 percent).

The second-largest sector employing Kosovar workers is the Accommodation and Food Service Activities sector (NACE Section 1), comprising over 16 percent of the workforce. Within this sector, nearly 95 percent of individuals work in gastronomy, with the remainder involved in accommodation services. Approximately 15 percent of workers are employed in Administrative and Support Service Activities, with roughly 89 percent specializing in building maintenance, gardening, and landscaping. Workers in healthcare sector represent only around 1 percent of the workers that have been issued working visa permits. However, this represents a significant high number relative to the labour supply in this group. Moreover, the social cost and time to prepare a health professional is significantly higher than other occupations, making it more difficult to replace them in the short term.

Figure 8. Migration based on occupations



Source: Authors' Calculations Based on Survey Data

18 Note: German Federal Employment Agency Data, 2023.

19 Note:The increase of migration from the year 2015 is also related to the migration policies in Germany (e.g., Western Balkan Regulation §26.2.) which has eased the process of migration from WB6.

The ongoing trends in the migration of Kosovo citizens, which are also likely to persist into the future, are anticipated to exert considerable pressure on the domestic labour supply. These migration patterns, characterized by a significant number of Kosovo residents seeking opportunities abroad, are poised to present substantial challenges to the availability of skilled and unskilled workers within the country. As Kosovo citizens continue exploring employment prospects and seeking better livelihoods beyond their national borders, the local labour market may experience a talent shortage across various sectors and industries. This phenomenon affects the quantity of available labour and raises concerns about the potential skills gap and workforce imbalances that could hinder economic growth and development. Therefore, addressing these migration trends and their impact on domestic labour supply is of paramount importance for Kosovo's future economic sustainability and competitiveness.

2. Determinants of companies that have lost staff due to migrationt

We investigated the determinants of companies that have lost staff due to the migration of the workforce. Utilizing available data from Riinvest, we employed probit regressions to explore this issue. Our analysis encompassed various attributes of companies under investigation.

The results reveal that companies operating in larger cities, specifically the seven major cities in Kosovo, are 8 percentage points less likely to suffer staff losses due to emigration. Among various sectors, the construction sector appears to be the most susceptible to staff migration. In comparison to the manufacturing sector (used as the reference category), construction companies are 18 percentage points more likely to experience employee departures. Conversely, exporting companies exhibit a 12 percentage point lower likelihood of losing staff due to migration. Interestingly, the company's size does not seem to significantly influence employee propensity to leave. Companies with a tenure of more than 10 years demonstrate greater stability, being 6 percentage points less likely to experience staff losses due to migration. As anticipated, companies implementing effective HR practices are 14 percentage points less likely to face staff departures, while those offering better working conditions also show a reduced likelihood of staff loss by 16 percentage points.

Addressing this trend requires a concerted effort to ensure favourable working conditions and incentivize companies to adopt sound HR practices. Once again, a comprehensive approach is necessary to enhance the overall environment, encompassing improvements to the education system, healthcare system, and overall working conditions.

3. Determinants of youth propensity to emigrate

We investigated the determinants that drive emigration from Kosovo, with a particular emphasis on the youth demographic. Utilizing available data from Riinvest, we employed probit regressions to explore this issue. Our analysis encompassed various socio-demographic characteristics of survey respondents.

The findings indicate that individuals who are unemployed are 18 percentage points more likely to emigrate compared to their employed counterparts. Additionally, gender and marital status exhibit a significant influence on the propensity to leave the country. Specifically, males and unmarried individuals are respectively 19 and 7 percentage points more inclined to emigrate. Furthermore, individuals who have participated in Active Labour Market Measure (ALMM) programs are 9 percentage points less likely to emigrate. Individuals from rural areas are 11 percentage points more prone to emigrate in comparison to their urban counterparts. Surprisingly, the study did not uncover a significant impact of education on emigration, possibly due to the high overall propensity to emigrate regardless of education level.

Addressing this trend necessitates a focus on job creation and optimizing the utilization of ALMM schemes. Policymakers should prioritize efforts to mitigate push factors and reduce the propensity to emigrate. Notably, unemployment appears to be just one of several significant push factors. Addressing this issue requires comprehensive enhancements, including improvements to the education system, healthcare system, and overall working conditions.

Another distortion in the labour market stems from the prevalence of social protection schemes. These schemes accounted for almost 20 percent of the state budget in 2022 or equivalent to 7 percent of Kosovo's GDP. Permanent benefits may have potential implications in the labour market. Most of the beneficiaries of social schemes are not allowed to work and claim benefits at the same time. Social schemes, particularly the Social Assistance Scheme (Category 2) and the Veteran pensions scheme, should be revised to avoid disincentivising the supply of labour and formal employment by having unemployment as an eligibility criterion. Moreover, some specific pension schemes such as Trepça and family pensions paid to citizens below the age of 65 are more like permanent unemployment benefits. Such benefits could discourage employment and even encourage exiting the labour market since they are directly linked with employment status. In order to make better use of the current social protection schemes as well as improve its sustainability, the system needs to be reformed. Allowing beneficiaries to claim the benefit and work for some time could potentially improve beneficiaries' welfare and make them permanently independent from the social schemes. Survey results indicate that social schemes influence employees' decisions to enter the labour force in various ways. Most businesses (57.1 percent) reported that social schemes impact employees' interest in joining the labour force, and 38.5 percent of employees who benefit from social schemes work in the informal sector.

Additionally, employee poaching is another problem that businesses face. Survey results suggest that 14.5 percent of employees who have been trained by the businesses have left the company and are currently working for their competitors. This was mainly due to the inability to enforce contracts. Furthermore, 25.1 percent of businesses reported that employees voluntarily left their jobs in the last three years, while 9.9 percent were laid off. Of those that have left the job, 44 percent did so due to migration. Only around 10 percent have left the job due to low wages. The rest were personal reasons, finding a new job, and changing occupations.

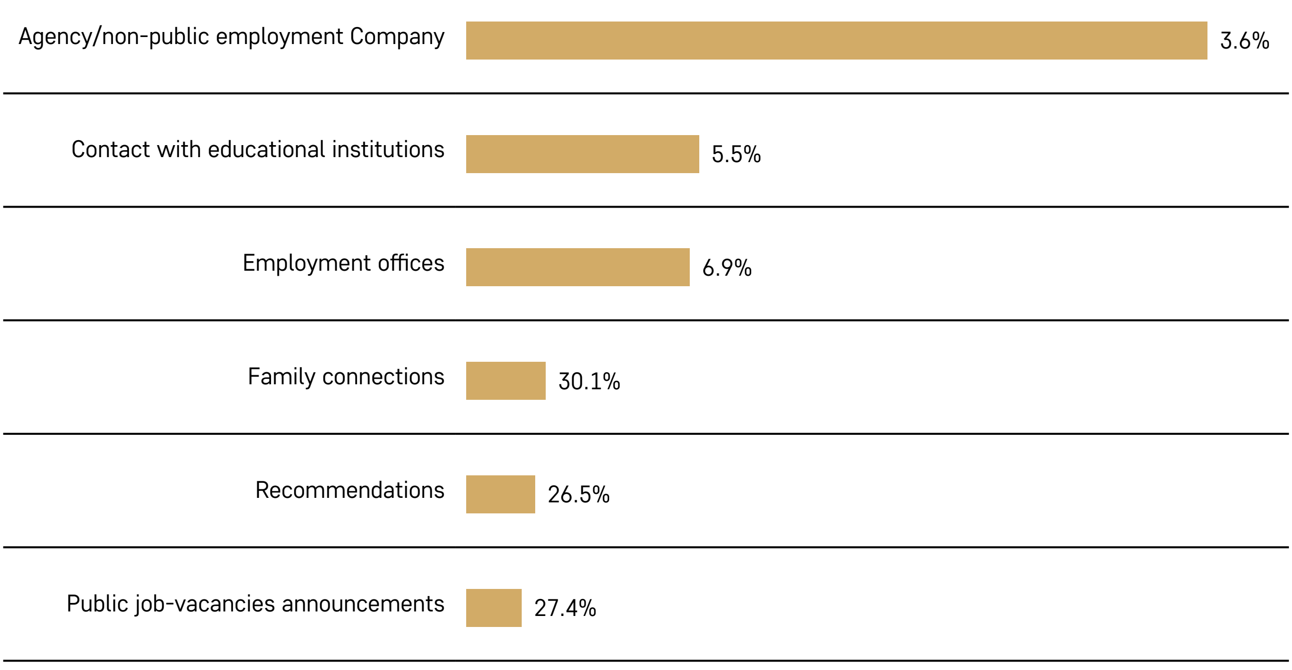
Furthermore, when considering the likelihood of employees leaving their jobs on a scale from 1 (high probability) to 3 (low probability), the results indicate the following trends based on qualification levels and income sources. It appears that employees with a lower level of education exhibit a lower probability of leaving (probability score of 2.11), while those with higher qualifications are more likely to consider leaving (probability score of 1.76). Additionally, employees relying on alternative income sources, such as remittances and social benefits, also have a relatively lower probability of leaving their current employment (probability score of 1.54).

3.5 Recruitment process and HR practices

Regarding channels used to hire employees, over the past three years, businesses have hired employees through various methods, including publicly announced job vacancies (27.4 percent), recommendations (26.5 percent), and family connections (30.1 percent) (Figure 9). Companies that have declared to have hired through employment offices operate in the construction sector, retail and wholesale sector, and gastronomy sector. Companies in Kosovo continue to hire mainly through recommendations and family connections.

The ones who have hired through public announcements have stated that they have published the vacancy announcement in social media, followed by publication of announcement in company premises, job portals, and employment offices. Social media networks continue to be an important tool for announcing vacancies. This is a result of the high use of internet among youngsters in Kosovo and the high use of social media networks. As a result, companies use those networks to announce new vacancies as they know that they might receive the desired audience. Job portals are also important as they are published online and job seekers check those websites.

Figure 9. Forms of employment by businesses



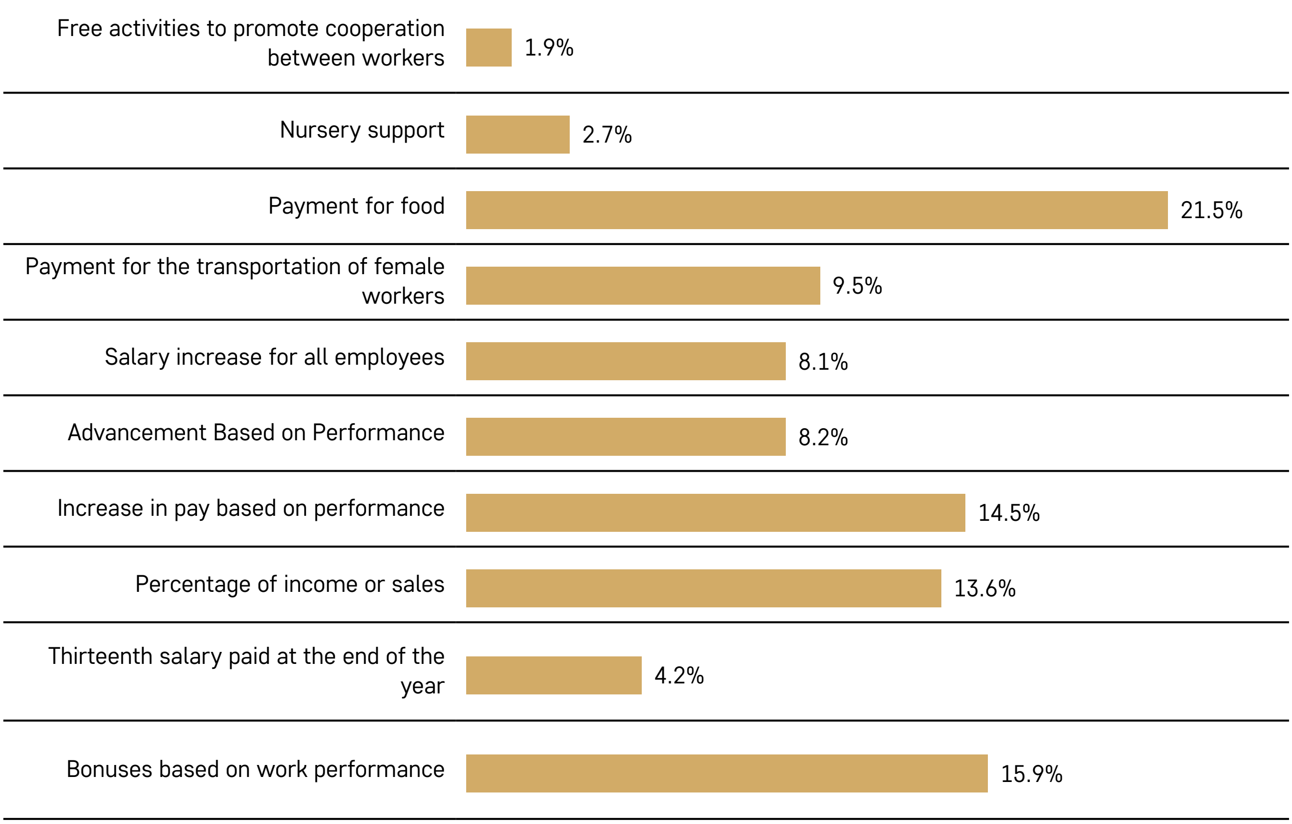
Source: Authors' Calculations Based on Survey Data

Survey results indicate that over two thirds of businesses implement several good human resource practices; however, only 20.4 percent have a designated employee responsible for human resources. This indicates that companies in Kosovo do not have a department that would be responsible for managing human resources. Instead, the owner who is usually the manager ends up with HR management responsibilities. This is not ideal, as the owners can not do everything on their own. A specific HR office or officer is needed in the company to deal with HR-related issues.

On the other hand, over two-thirds of companies stated that their firm regularly forecasts personnel requirements. This is a positive sign as it shows that companies are aware of personnel resources that they need in the future and can plan accordingly. Further, over two-thirds of companies stated that supervisors frequently give employees feedback on their performance. It is very important for employees to get feedback as they will understand that their supervisor is observing their work and they can improve their performance. Less than half of companies stated that they use a system for evaluating employee performance. This is also a good practice however; companies need to make sure that the system is transparent and that employees feel that they are evaluated equally.

Businesses utilize different types of incentives, including payment for food (21.5 percent), performance-based bonuses (15.9 percent), annual salary increases based on performance (14.5 percent), and a percentage of income based on sales (13.6 percent) (Figure 11). Only a fraction of companies offer child- and day-care support for their employees. This is particularly important for hiring women who, as previous studies suggest, are hindered by this obstacle (Riinvest, 2017). Around 10 percent of companies have offered support for employees' transportation, while over 8 percent of companies increase their sales annually across the board.

Figure 10. Business practices for employee motivation

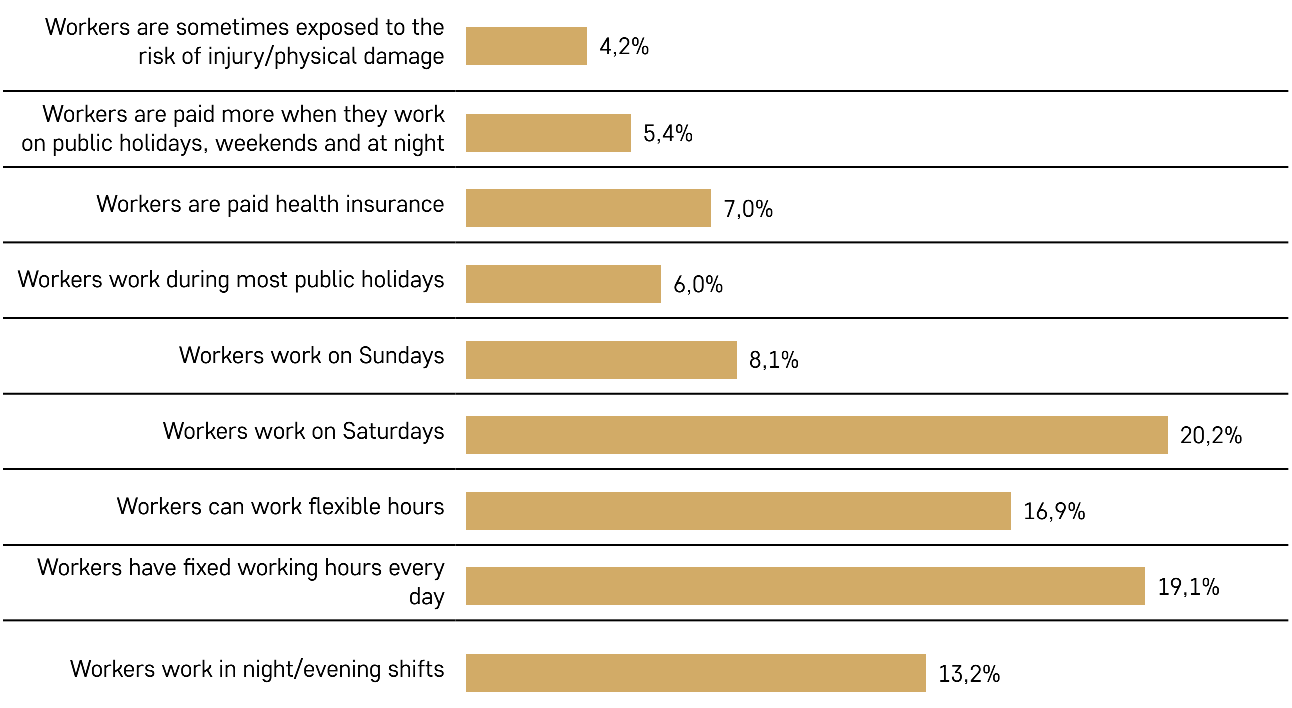


Source: Authors' Calculations Based on Survey Data

3.6 Working conditions

Businesses reported that employees work 6.1 days a week and 7.85 hours a day. The survey also reveals that a significant proportion of employees work on Saturdays, and around 9 percent work on Sundays, while 13.2 percent work night shifts. Around 6 percent of employees work regularly on national holidays. Regarding working arrangements, 19.1 percent have fixed working hours every day, and only 16.9 percent have flexible working hours. Only around 5 percent of companies stated that they pay their employees higher when working on national holidays, weekends, and night shifts. Roughly 4 percent of companies stated that their employees can sometimes be exposed to safety risk and majority of these companies operate in the construction sector. Construction sector employees work in less unfavourable working conditions. They are put at health and safety risks during work and do not have health insurance. Many of them work in irregular working schedule and do not have paid leave. Of companies that operate in other sectors, employees work in slightly better working conditions, having more regular working hours, are not exposed to health and safety risks during work, and might even have paid health insurance and paid annual leave (Figure 11).

Figure 11. Applicable practice in businesses



Source: Authors' Calculations Based on Survey Data

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Anex 1

Description of economic activities	Participation by percentage of economic activities in GDP during the years 2010-2022												
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Agriculture, hunting, forestry and fishing	9.5%	8.1%	7.4%	8.4%	8.3%	7.7%	8.2%	7.4%	6.5%	7.2%	7.4%	6.9%	7.4%
Extracting industry	2.5%	2.5%	2.4%	2.1%	2.0%	2.0%	2.2%	2.2%	2.2%	2.0%	2.0%	1.9%	1.5%
Manufacturing industry	13.8%	13.1%	13.3%	13.5%	13.5%	13.3%	13.1%	12.8%	13.1%	12.9%	13.4%	12.9%	13.2%
(Electricity, gas supply) + (Water supply)	3.1%	3.4%	3.4%	3.6%	3.7%	4.1%	4.2%	4.4%	4.2%	4.0%	4.5%	4.2%	4.3%
Electricity, gas supply	2.5%	2.7%	2.7%	2.9%	2.9%	3.4%	3.5%	3.6%	3.5%	3.4%	3.9%	3.6%	3.8%
Water supply	0.7%	0.7%	0.8%	0.7%	0.8%	0.7%	0.7%	0.8%	0.7%	0.7%	0.6%	0.6%	0.6%
Construction	7.7%	8.4%	8.5%	8.0%	7.3%	7.6%	7.3%	8.1%	8.4%	8.2%	7.7%	8.5%	8.5%
Wholesale and retail trade;repair of motor vehicles and motorcycles	13.0%	12.6%	12.7%	12.4%	12.2%	12.3%	12.3%	12.5%	12.5%	12.8%	12.8%	13.6%	14.3%
Transpotation and storage	4.0%	3.9%	4.1%	4.2%	4.5%	4.6%	4.4%	4.5%	4.5%	4.4%	3.9%	4.3%	4.4%
Accommodation and food service activities	1.1%	1.2%	1.3%	1.5%	1.6%	1.6%	1.6%	1.8%	1.9%	2.1%	1.6%	2.1%	2.1%
(Information and communiaction) + (Financial and insurance activities)	5.4%	5.4%	5.7%	5.9%	6.0%	5.6%	4.8%	4.9%	5.4%	5.7%	6.1%	5.6%	5.9%

Description of economic activities	Participation by percentage of economic activities in GDP during the years 2010-2022												
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Information and communiaction	1.5%	1.6%	1.6%	1.7%	1.8%	1.8%	1.8%	1.8%	1.9%	1.9%	2.0%	1.9%	2.0%
Financial and insurance activities	3.8%	3.8%	4.1%	4.3%	4.2%	3.8%	3.0%	3.1%	3.6%	3.9%	4.1%	3.7%	3.9%
(Real estate activities) + (Proffesional, scientific and technical activities) + (Administrative and support service activities) + (Public administration and defence ; compulsory social security)	16.1%	15.6%	16.1%	16.2%	15.9%	15.6%	15.2%	15.0%	15.1%	15.0%	16.2%	14.0%	13.1%
Real estate activities	8.8%	7.9%	8.0%	8.0%	7.8%	7.5%	7.3%	7.2%	7.1%	7.0%	7.3%	6.4%	6.1%
Proffesional, scientific and technical activities	1.5%	1.5%	1.6%	1.5%	1.5%	1.6%	1.6%	1.5%	1.5%	1.4%	1.6%	1.4%	1.4%
Administrative and support service activities	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%
Public administration and defence ; compulsory social security	5.1%	5.5%	5.7%	5.9%	5.9%	5.9%	5.7%	5.6%	5.8%	5.9%	6.6%	5.5%	5.0%
Education	3.6%	3.9%	3.9%	3.8%	4.1%	4.1%	4.0%	3.9%	3.8%	3.7%	3.8%	3.4%	3.1%
Human health and social work activities	1.8%	1.8%	1.9%	1.9%	2.0%	2.1%	2.1%	2.0%	2.2%	2.2%	2.7%	2.3%	2.1%
(Arts,entertainment and recreation) + (Other service activities)	0.9%	0.9%	0.9%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.6%	0.6%	0.5%	0.5%
Arts,entertainment and recreation	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.2%	0.2%	0.2%	0.2%
Other service activities	0.5%	0.4%	0.5%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.3%	0.3%

Burimi: ASK, 2023

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