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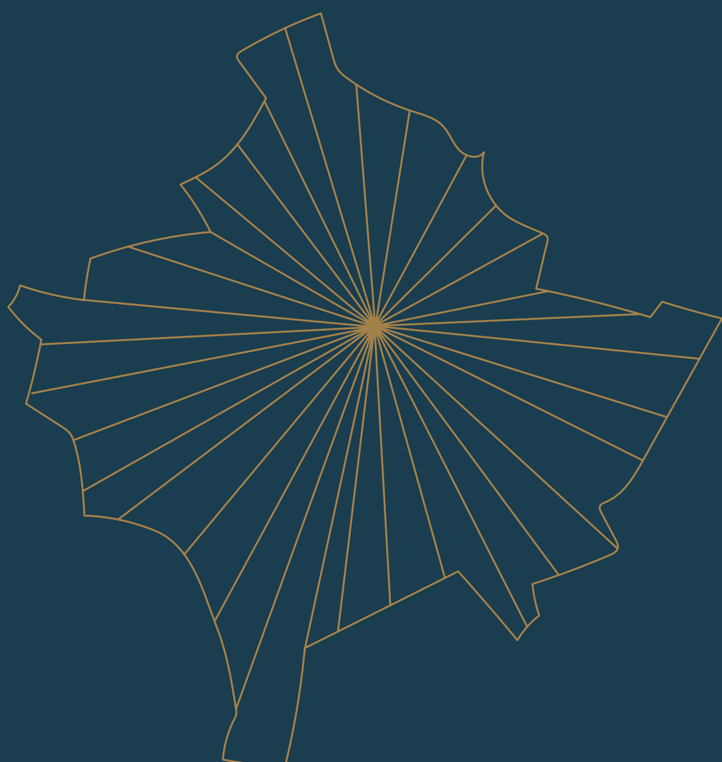
ACTIVATING SOURCES OF ECONOMIC GROWTH

Navigating Kosovo's economic path: governance, investment, and sustainable growth



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ACTIVATING SOURCES OF ECONOMIC GROWTH

Navigating Kosovo's economic path: governance, investment, and sustainable growth

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Contents

List of Abbreviations

ALMM	Active Labour Market Measures
CBK	Central Bank of Kosovo
EBRD	European Bank for Reconstruction and Development
ERA	European Research Area
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
IDA	International Development Agency
IMF	International Monetary Fond
KAS	Kosovo Agency of Statistics
KTA	Kosovo Tax Administration
MFPT	Ministry of Finance, Labour and Transfers
NACE	Nomenclature for the Classification of Sectors in the EU
NAO	National Audit Office
OECD	Organization for Economic Co-operation and Development
PIP	Public Investment Programme
S3	Smart Specialization Strategy
UNMIK	The Administration of the United Nations Mission in Kosovo
VAT	Value Added Tax
WB	Western Balkans
WB	World Bank
WIIW	Institute for International Economic Studies

1. INTRODUCTION AND EXECUTIVE SUMMARY

Kosovo's developmental path and economic growth have faced long-term specific obstacles. Until the end of the 1950s of the last century, similarly to the period of rule under the first Yugoslavia, it did not undergo any significant economic transformation in terms of industrialisation and infrastructure development.[1] Between 1960 and 1988, especially after the economic and constitutional reforms in Yugoslavia (1968-1974), Kosovo consolidated its large territorial and political autonomy, enjoying solid economic growth. This was reflected in the development of its physical and social infrastructure, industrialisation, and the improvement of the overall social fabric. However, at the time of the breakup of the former Yugoslavia, Kosovo's GDP per capita was less than one-third of the federation's average.[2] Since the early 1990s, its autonomous institutional independence was forcibly dismantled under the Milosevic regime. This period was marked by massive disinvestment, severe deindustrialisation, a halving of the national output, and devastating war consequences (Riinvest Institute 1998, 2000, 2014).[3]

The administration of the United Nations Mission in Kosovo (UNMIK) and the Kosovo Force (KFOR) played a crucial role in maintaining security and peace in Kosovo. Within five years, substantial international financial and technical support enabled the establishment and development of basic physical infrastructure, social services, and housing. This progress was further supported by targeted technical assistance focused on capacity building, market-oriented economic reforms, and institutional development. Legislation was drafted in line with the market economy principles and EU standards, ensuring Kosovo's alignment with these key benchmarks.

However, this progress did not translate equally into a robust economic growth trajectory, nor did it achieve the necessary standards in the quality of education and health services. Over time, Kosovo's institutions gradually expanded their competencies, particularly after declaring independence in 2008 and gaining full authority, especially in economic affairs, by 2011. Despite these advancements, the anticipated improvements in economic growth and societal development were not fully realised. Economic policies, particularly taxation, were not conducive to investment in the private sector or to attracting Foreign Direct Investment (FDI). Until 2016, customs tariffs and the Value Added Tax (VAT) (totalling 26 percent when combined) were collected at the border for capital goods and other inputs for manufacturing and services. This policy, combined with high interest rates, a modest contribution from privatisation with frozen proceeds (approximately 0.6 billion euros), frequent electricity cuts, and insufficient investment in new electricity generation capacities, created a business environment that was generally unfavourable for investment.

1 During that period, in other parts of former Yugoslavia, post-WWII reconstruction and investment were almost entirely supported by budgetary grants. In contrast, Kosovo's investment in infrastructure, industry, and other economic sectors was delayed and relied almost entirely on domestic bank loans, international bank loans, World Bank (WB) credits, and the Federal Fund for Credit Support to Less Developed Republics and Autonomous Provinces (which included Bosnia and Herzegovina, Kosovo, North Macedonia, and Montenegro). In the case of Kosovo, this reliance resulted in a substantial accumulation of domestic and foreign debt, which adversely impacted growth rates, particularly during the 1980s (Mustafa 1985; Riinvest Institute 1998).

2 The key industrial output of Kosovo, particularly in energy and basic metals, was restricted by export quotas and was forced to sell its products in the Yugoslav market at controlled, lower prices compared to world market prices. This significantly affected the ability of companies to invest and repay debts (Riinvest Institute, 1998).

3 The consequences of the war and the administration of Kosovo by the Government of Serbia during the 1990s are estimated to have caused losses amounting to approximately USD 22 billion (Riinvest Institute, 1998, 1999, 2000, 2006).

These challenges were further exacerbated by gaps in the implementation of the legal framework, including weak rule of law, inefficiencies in the judiciary system, poor contract enforcement, and inadequate measures to combat corruption. Additionally, economic governance and the quality of institutions were undermined by intense political conflicts, which hindered the ability to reach consensus on key national priorities and effectively implement evidence-based policies.

Despite all these challenges, Kosovo has managed to advance to the status of a High-Middle-Income Country (HMIC), driven by steady economic growth averaging 3 to 4 percent over the past two and a half decades. However, it continues to fall behind, remaining at around 65 to 70 percent of the Western Balkans Six (WB6) average in terms of GDP per capita. The country still faces significant challenges in achieving the necessary economic growth and building competitive capacities to address its persistent economic imbalances, including a high trade deficit, unemployment, and emigration. These issues remain significant obstacles to successfully converging with the European Union (EU) and reaching the development level of High-Income Countries (HIC).

This paper has been prepared to facilitate discussions at the fifth edition of the Riinvest International Conference, titled 'Activating Sources of Economic Growth,' organised to mark the 30th anniversary of the Riinvest Institute. It draws on evidence from Riinvest's own research, as well as publications from the World Bank, International Monetary Fund (IMF), European Bank for Reconstruction and Development (EBRD), and recent insights on industrial policies and the middle-income trap. On this occasion, we thank the Riinvest staff for their contribution to the preparation of reports and studies, as well as for the statistical section included in this report. We also thank our partners for their support of our research work. Our summary conclusion emphasises the critical need to enhance economic governance and raise ambitions for accelerating economic growth. This requires a shift toward a transformative economic growth model, with policies designed to overcome the middle-income trap and ensure sustainable, high-quality growth.

2. ECONOMIC GROWTH TRENDS AND MACROECONOMIC PICTURE

2.1 Global and regional context

The IMF's latest projections from April 2025 indicate that global growth will reach 2.8 percent this year and 3 percent next year, representing a cumulative downgrade of about 0.8 percentage points compared to the projections in January. Similarly, the McKinsey Global Survey reveals that top executives from the world's leading companies are expressing increased caution, identifying geopolitical instability as the primary risk, alongside the fact that more than half of the global population will vote in local elections this year and next (McKinsey and Company, 2024). This situation will inevitably impact the Western Balkans (WB6) as well. According to the latest IMF projections, growth expectations have been revised downward for Albania, Montenegro, and Serbia (Table 1).

In the World Bank's report on trends and forecasts for Central Eurasia (World Bank, 2024), economic growth projections for the Western Balkans for 2024 and 2025 are estimated at 3.3 percent and 3.5 percent, respectively. Similar projections are made for Turkey, an important economic partner for the region. Although inflation levels have declined, prices remain 20 percent higher than in the pre-COVID-19 period, with food prices being particularly affected, having increased by 50 percent. The World Bank also highlights several potential "headaches" that could hinder economic performance, including lower growth among key European trading partners, restrictive monetary policies, rising debt burdens, and the escalation of regional and global geopolitical tensions. These factors are expected to slow economic growth and undermine investor and consumer confidence.

According to the World Bank (2024), there remains significant room for improvement across the region, particularly in enhancing business dynamism, including the entry and exit of businesses. The competitive environment does not sufficiently encourage innovation, nor does it effectively support the creation and absorption of new knowledge and technologies. These challenges are further compounded by excessive state involvement in the economy and notable weaknesses in education and training systems, which collectively hinder progress in labour productivity. One of the World Bank's major concerns is the continued emigration of educated young populations, a persistent issue across all countries in the region. The solution lies in leveraging diaspora networks, maximising the benefits of remittances, and expanding opportunities in the local labour market. The new economic growth plan for the Western Balkans aims to further stimulate regional economic growth, complemented by deeper structural and democratic reforms.

Table 1. Economic Growth Projections in the Western Balkans (World Bank and wiiw)

	World Bank		wiiw		IMF
	2024	2025	2024	2025	2025
Albania	3.3	3.4	4.0	3.8	2.8
Bosnia and Herzegovina	2.8	3.2	2.6	2.9	3.8
Kosovo	3.8	3.9	4.1	3.8	4.0
Montenegro	3.4	3.5	3.5	3.7	3.2
North Macedonia	2.5	2.9	1.8	2.3	3.2
Serbia	3.8	4.2	3.7	3.7	3.5
Western Balkans	3.2	3.5	3.4	3.4	-

Source: World Bank: Retaining Growth Momentum, October 2024; IMF WEO, April 2025)

The Institute for International Economic Studies (wiiw): External-weakness-dampening-robust-consumer-driven-growth, October 2024)

2.2 Growth trends challenges

After experiencing slower growth in 2023, Kosovo's economy in 2024 and, as projected for 2025, has returned to the pre-COVID-19 trend of around 4 percent. Although falling short of government plans, the IMF and World Bank view Kosovo's economic growth trends more positively than last year, particularly in terms of macroeconomic stability and fiscal performance. However, contrary to expectations, inflationary pressures in Kosovo have been increasing. Inflation rose to nearly 3 percent in March, up from 2 percent, and the recent 16.1 percent increase in electricity prices (May 2025) is expected to further negatively impact the economic situation and social stability.

Moreover, the widening trade deficit remains a serious concern. Import growth, largely driven by increased consumption, has outpaced export growth, reaching 70.3 percent of GDP. Notably, the coverage of imports with exports of goods has deteriorated, declining from around 17.9 percent in 2022 to approximately 15 percent in both 2023 and 2024. These chronic imbalances in trade dynamics pose a persistent challenge to the country's economic resilience.

Judging by the perceptions of private company leaders in Kosovo regarding their business activities, 2023 was better than 2024, as only 28 percent of companies reported increased sales (55 percent reported no change, and 13 percent reported a decline). In 2024, only about one-third of companies experienced growth, while this percentage rose to 54 percent in terms of expectations for 2025.[4] From this perspective, the projected GDP growth rate of 5.6 percent in the 2025 budget documents may be challenged by difficulties in achieving real growth in exports (7 percent) and private investments (6.1 percent). Additionally, considering recent trends, the execution of approximately 800 million euros in planned capital investments appears to be overestimated.

It is also important to consider potential difficulties in consolidating government institutions following the national elections on February 9, which could influence business and household expectations, as well as the business cycle, further challenging the government's optimistic projected economic growth rate (Table 2).

A serious problem continues with the low level of labour market participation. According to the Kosovo Agency of Statistics, only 37 percent of the working-age population is employed. This means that out of every 100 working-age individuals (15–64 years old), only 37 are employed. This

4 Riinvest Survey September 2024. Technical details available in Riinvest (2024).

Table 2. Real GDP Growth of Kosovo in % and projections for 2024 and 2025

	2019	2020	2021	2022	2023	2024f	2025f
EBRD			10.7	4.3	3.3	4.0	4.0
IMF	4.8	-5.3	10.7	4.3	3.3	3.8	4.0
World Bank	4.8	-5.3	10.7	4.3	3.3	3.8	3.9
wiiw		-5.3	10.7	4.3	4.1	4.1	3.8
Government of Kosovo (Draft Law on the Budget of the Republic of Kosovo 2025)	4.8	-5.3	10.7	4.3	4.1	4.5	5.6

Source: Authors based on data from EBRD; IMF; WB; wiiw; Government of Kosovo

fact undermines the positive changes reflected in official statistics showing a drop in unemployment to around 10.9 percent. It seems that many working-age individuals are discouraged from entering the labour market through registration at employment offices due to the lack of active labour market instruments and policies (such as financial assistance for the unemployed) and the limited role of employment offices in mediating job placements. All of this is reflected in a reduction in the statistical unemployment rate. When adding the alarming trend of migration, particularly among unemployed youth, it becomes clear that this has heavily impacted the accuracy of statistical measurements and assessments of labour market dynamics. (More details will be presented in Section 4).

Considering the historical context characterised by a long, difficult, and specific transition, marked by severe consequences of war, brutal deindustrialisation, and a colonial position during the 1990s, this level of economic growth is insufficient. This specific historical reality created a significant gap, leaving Kosovo lagging behind other countries in the region and beyond, especially compared to the EU. Consequently, economic growth over these two and a half decades has been built on a critical and emergency-driven situation, which failed to establish the prerequisites for overcoming macroeconomic imbalances, particularly unemployment and the trade deficit. This model, based on external factors - remittances, foreign technical and financial assistance, and credit - has nearly lost its transformative power and potential to generate the growth Kosovo needs.[5] It has fallen short of enhancing its convergence with the EU-27 countries and of addressing macroeconomic imbalances in the overall economic configuration.

5 It has conserved an inadequate sectoral composition of GDP, hindering necessary changes during 2010 – 2023 (Annex A1).

Kosovo's existing economic growth model has been primarily consumption-driven for nearly 25 years. This trend is evident in recent years, as consumption remains the main contributor to economic growth. Over the past two years, with economic growth rates of 3.3 percent and 3.8 percent, the contribution of consumption has been 3.9 and 4.6 percentage points, respectively, while investments contributed 1 and 1.7 percentage points (Table 3). Assuming that imports and exports in Koso vo were balanced (i.e., net exports equalled zero), economic growth would have reached 4.9 percent (3.9 + 1) in 2023 and approximately 6.3 percent (4.6 + 1.7) in 2024. However, the negative trade balance reduces the growth rate. This means that to sustain this consumption, a significant portion of goods and services has been imported, resulting in a decrease from the potential 4.9 percent to 3.3 per- cent in 2023 and 6.3. to 3.8 percent in 2024. This demonstrates that Kosovo has insufficient contributions from investments and exports to generate higher economic growth. In this model, increased consumption drives higher imports of consumer goods, thereby lowering the economic growth rate and creating an unsustainable cycle in the economy. These remain key problems to be addressed through systematic, holistic policies and other measures.

Table 3. Contributors to economic growth in Kosovo in 2023 and 2024

Description	2023	2024
Real Economic Growth (%)	3.3	3.8
Contribution to Growth		
Consumption	3.9	4.6
Investment	1.0	1.7
Net export (export-import)	-1.6	-2.5

Authors based on data from the World Bank (2024)

2.3 Foreign trade and external sector

In parallel with economic growth, trade balance has deteriorated, with the deficit increasing since 2019 by 65 percent reaching 31.4 % of GDP (Table 4). Especially worrisome is deficit trade balance of goods, which increased by 74.4 percent during the same period.[6] However, it is evident that diversification of the exports in terms of products exceeding one million euros annually from 32 (2015) to 114 (2023).[7] There is also a positive trend in exports of services where positive balance nearly doubled during the period between 2019 and 2024.[8] This positive trend has its deficiencies when it comes to the structure of export services, as about three-quarters of its value is related to so-called diaspora tourism, respectively to their travels and consumption during their stay. The second largest contributor is computer, information, and telecommunications services. This is a positive indicator of the potential of this sector. According to the latest ICT barometer, 39 percent of these companies focus exclusively on international markets (STIKK, 2022). Meanwhile, data from the Kosovo Tax Administration shows that Kosovo exported around 60 million euros worth of ICT services to the United States, 44.4 million euros to Switzerland, and 38.4 million euros to Germany last year.

6 Annex A2

7 Annex A3

8 Annex A4

● **Table 4.** Foreign trade balance (million Euro)

	PBB	Mallra	Shërbime	Totali	Deficiti/PBB (%)
2019	6.989	-2,840	926	-1,914	-27%
2020	6,679	-2,573	392	-2,182	-33%
2021	7,499	-3,576	1,035	-2,532	-34%
2022	8,299	-4287	1,276	-2,911	-35%
2023	9,680	-4,589	1,629	-2.962	-31%
2024	10,035	-4926	1,791	-3,153	-31%

Authors based on CBK, Statistical Monthly Bulletin, 2025

Looking at the balance of payments (Table 5), it can be observed that remittances over the last five years have maintained their share of GDP between 13.5 and 14.5 percent, demonstrating their importance and impact on the income structure of household economies and in boosting consumption, especially during the summer.

FDI has recorded an increase in both its volume and share of GDP over the last two years. However, they primarily originate from the diaspora and are dominated by the real estate sector. This does not translate adequately into long-term economic development due to the high share of imported inputs and, consequently, a lower multiplier effect. Other sectors with a significant share include financial and insurance activities (16 percent) and the energy sector (8 percent). Attracting investments in the manufacturing sector, as the key sector for developing export potential and high-value-added products and services, remains a challenge.

Despite the increase in foreign direct investments in Kosovo in 2024, the deterioration of the financial account balance may be linked to the impact of portfolio investments and other investments, which have contributed to the net outflow of capital. Consequently, these trends in external accounts reflect the increase in the deficit in the balance of payments, which remains a significant concern.

Table 5. Foreign trade statistics over the years

	Migrant remittances		**Foreign direct investments**		**Current account**		**Financial account balance**		**Balance of payments**	
	In millions of euros	As part of GDP (in %)	In millions of euros	As part of GDP (in %)	In millions of euros	As part of GDP (in %)	In millions of euros	As part of GDP (in %)	In millions of euros	As part of GDP (in %)
2019	851.5	12.1	254.6	3.6	-408.3	-5.8	-161.1	-2.3	-399.5	-5.7
2020	980	14.5	345.7	5.1	-454.7	-6.7	-562.1	-8.3	-472.2	-7.0
2021	1153.4	14.5	420.7	5.3	-632.5	-7.9	-365.0	-4.6	-694.7	-8.7
2022	1222.8	13.7	732.0	8.2	-878.7	-9.9	-661.6	-7.4	-917.1	-10.3
2023	1335.8	13.8	840.1	8.7	-729.4	-7.5	-415.5	-4.3	-666.5	-6.9
2023 (January - June)	627.4	14.9	371.1	8.8	-538	-12.7	-255.7	-6.1	-491.6	-11.6
2024 (January - June)	630.1	13.9	419.1	9.3	-691.8	-15.3	-496.6	-11.0	-667.9	-14.8

Source: CBK and KAS

2.4 Financial Sector

The financial sector in Kosovo has continued its positive development trends this year in terms of stability, resilience, and growth. It remains well-capitalized, profitable, and liquid. Key return indicators, such as Return on Assets (ROA) and Return on Equity (ROE) in the banking sector, which stand at 2.6 percent and 19.2 percent, respectively, reflect solid and sustainable returns over the years.

Liquidity stands at around 31 percent (liquid assets to short-term liabilities), while the loan-to-deposit ratio is 84.7 percent, non-performing loans are only 2 percent, and capitalization is around 15.5 percent, indicating a strong performance within the banking sector.

Credit growth in the economy continues its upward trend, with loans increasing by 15 percent annually. Household loans have seen a more significant rise compared to corporate loans, with growth rates of 20 percent and 11 percent, respectively. Deposits also grew by 11 percent, though this is slower than the previous year.

In terms of structure, household loans now account for 40 percent of the total, reflecting a two-percentage-point increase. Corporate loans, however, maintain a similar structure, mirroring the composition of the economy. For example, loans in agriculture make up 2 percent, while industry, energy, and construction account for 34 percent, and services dominate with 64 percent, maintaining a consistent trend. There is no significant contribution to investments in sectors that demonstrate export potential.

Regarding loan maturity, the structure has remained unchanged in recent years: loans with a maturity of up to one year account for 10 percent, loans with a maturity of 1–5 years make up 35 percent, and loans with a maturity of over 5 years account for 55 percent.

Private sector credit as a percentage of GDP, at nearly 50 percent, is above the average for the Western Balkans, with Kosovo performing better than most countries in the region. After a period of rising interest rates globally, driven by inflation and tightening monetary conditions, these trends do not appear to have fully reflected in the banking sector in Kosovo. Interest rates on loans have slightly decreased, while deposit rates have increased, narrowing the interest margin from 4.1 percentage points to 3.2 percentage points this year.

2.5 Government sector and budgetary policies

Fiscal and budgetary policy in the case of Kosovo is the main instrument of the government for implementing its economic policies, aiming to maintain fiscal stability and encourage economic growth. An analysis of revenues and expenditures for 2024 and projections for 2025 shows that, as in the previous period, policies have resulted in macro-fiscal stability. However, they have also been accompanied by an unfavorable expenditure structure, particularly in terms of spending on infrastructure and mechanisms that accelerate economic growth. This is further associated with insufficient financing in education, healthcare, scientific research, innovation, and critical inefficiency in implementing projects related to capital investments.

Value Added Tax (VAT), still collected primarily at the borders (about two-thirds), and excise duties remain the main sources of budget revenues (74 percent). Direct taxes are still modest, accounting for about 17 percent of total revenues, expected to reach €356 million this year, up from €292 million in 2024, with the largest increase coming from concessionary fees due to the growing number of passengers at Pristina International Airport.

While tax rates are relatively low, there is also an insufficient domestic tax collection base. Furthermore, Kosovo is the only country in the region where dividends are not taxed at all. Capital gains, especially from real estate transactions, are almost untaxed due to administrative limitations (World Bank, 2023).[9]

Total expenditures for 2025 are projected to be €3.6 billion, an increase of 8.8 percent compared to 2024, raising their share of GDP to 32.7 percent. Current expenditures for salaries, subsidies, and goods are projected at 72 percent of total expenditures, while capital goods projections remain at the same level as in 2024, around 26 percent of expenditures. However, actual spending on capital goods in recent years has been only 60-68 percent of projections, reflecting deficiencies in project preparation, project management, and procurement.

The allocation of funds does not adequately follow declared national priorities, especially regarding funds dedicated to healthcare, education, research, and innovation. This level of healthcare funding is noticeably lower not only compared to European Union (EU) and OECD countries but also in comparison to regional countries, except for Albania (around 3 percent of GDP). Government expenditures on healthcare in Bosnia and Herzegovina reach 6.5 percent of GDP, in Montenegro 6.5 percent, in Serbia 6.3 percent, and in North Macedonia 4.7 percent (Riinvest Institute, 2024).

Expenditures for education and science in 2025, including grants for municipalities, are expected to be €388 million, or 3.5 percent of GDP, which is below the EU average of 4.7 percent.

Funds dedicated to labor market policies (€33 million) and support for businesses and industries (€39 million) are insufficient to address urgent needs. The same applies to funds dedicated to the environment (€60 million) and energy (€59 million), which together constitute only around 4 percent of the sectoral budget.

Overall, the atypical structure of budget expenditures, which is more oriented towards current expenditures than investments, slows down job creation, hinders productivity growth, and limits the potential for sustainable economic growth. The budget structure is clearly skewed toward transfers and subsidies at the expense of capital investments and salaries.

Related to this is the need to overcome weaknesses and inefficiencies highlighted in executing the Public Investment Program (PIP). As further analyzed, budget policies have long failed to achieve this. 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, overcoming various deficiencies in public investment management related to land expropriation, procurement, and contract execution.

9 Budget revenues as a share of GDP in Kosovo reached 29.9 percent, while expenditures stood at 30.1 percent, slightly higher than in Albania but significantly lower than in Bosnia and Herzegovina, Montenegro, and Serbia, where both categories exceed 40 percent (World Bank, Regular Spring Report 2025).

Deficiencies in contract implementation particularly increase investment costs and significantly reduce the expected effects of these projects in the operational phase. Furthermore, the World Bank (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 the low efficiency and unfavorable effects of transfers and subsidies, including those in agriculture and public enterprises, where there is almost a complete lack of a necessary standard for evaluating projects at the approval stage, control, and ex-post evaluation of their effects.

2.6 Public Debt

The overall portfolio of Kosovo's public debt, amounting to approximately 17 percent of GDP, remains at sustainable levels and within the fiscal rules established by the Law on Public Debt and State Guarantees, which stipulates that public debt should not exceed 40 percent of GDP.

Domestic debt primarily consists of treasury bond issuances. According to government projections, by the end of 2024, this component of public debt is expected to reach €1.07 billion, representing 53.7 percent of the total debt. 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 related to the purchase of goods and services, as well as transfers (NAO, 2023), rather than financing capital investments.

External debt at the end of 2024 is expected to be around €921 million, reflecting a 33 percent increase compared to the previous year. This external debt is owed to international financial organisations, primarily the International Development Agency (World Bank) 36 percent, the European Bank for Reconstruction and Development (EBRD) 13 percent, the European Union (EU) 14 percent, and the International Monetary Fund (IMF) 11 percent. External debt is dedicated to financing projects in sectors such as education, agriculture, land registry, energy, healthcare, wastewater treatment, central heating, and road and railway rehabilitation (MFLT, 2023).

In 2023, the Assembly ratified eight loan/financial agreements to finance projects in the sectors of environment, energy, transport, digitalisation of public administration, as well as public finance reforms and economic growth. However, the situation regarding the dynamics of implementing projects linked to contracted debts is concerning. According to the National Auditor's Office (NAO, 2023), delays in credit agreements and the slow withdrawal of available funds have been a common obstacle over the years. This reflects poor planning, delays in the expropriation process, and overall deficiencies in governmental capacity to effectively and promptly utilise borrowed funds.

3. INVESTMENT - DYNAMICS, STRUCTURE AND EFFICIENCY

The dynamics and quality of economic growth and overall economic and social development are determined primarily by the volume and quality of investment activity. Volume refers to the depth or weight of gross investments in GDP (investments as a share of GDP), expressed as a percentage. Countries with a higher percentage of investments relative to GDP aim for a higher growth rate and are usually at a lower stage of development. However, economic growth depends not only on the volume of investments but also on their quality - that is, the efficiency of investments and their marginal contribution to GDP growth. Efficiency depends on the quality of the preparatory process for investment decisions, cost-benefit assessments, the implementation of approved projects, and the successful exploitation during their operational period.

Kosovo has the highest average share of Gross Capital Formation (33.6 percent) in the Western Balkans for the period 2014–2023. However, this high share has not translated into high rates of economic growth, raising questions about the efficiency of these investments and their impact on productivity.[10]

Overall investments include private sector investments, government and public enterprise investments, and foreign investments, including contributions from the diaspora. An overview of these investments in 2023 is presented in Table 6.

Table 6. Investments in Kosovo in 2023 (in million Euros)

	A		B	
	2023	Proportion (%)	2023	Proportion (%)
1. Government investments	554	24	554	18
2. Investments of Publicly-Owned Enterprises	85	4	85	3
3. Private sector investments	817*	36	1600**	52
4. FDI	840	37	840	27
5. Total and structure (in %)	**2296**	**100**	**3079**	**100**

Source: 1 – Government of Kosovo; 2 – Unit for Monitoring Public Enterprises; 3 – *Tax Administration of Kosovo (TAK), **Riinvest Institute Survey; 4 – Central Bank of Kosovo (CBK)

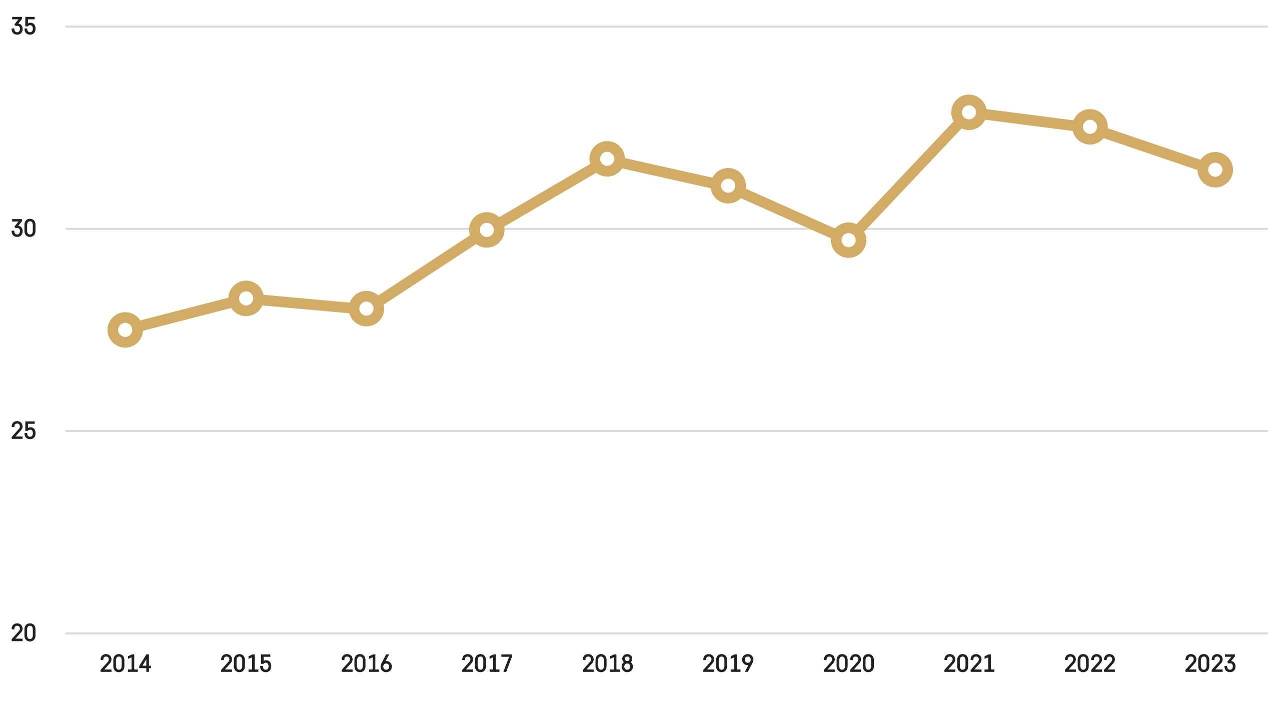
10 North Macedonia (32.0 percent) also exhibits a high level of investments, while Montenegro (27.6 percent) shows significant variations, mainly due to large infrastructure projects. Bosnia and Herzegovina (24.4 percent) and Albania (23.6 percent) maintain relatively stable levels, where- as Serbia (22.0 percent) has the lowest level of investments as a share of GDP.

According to these data, the level of investments in Kosovo is estimated to be around 2.3 billion euros. This calculation is based on administrative data reported by relevant institutions. If, for the level of private sector investments, we use data from the Riinvest Institute extrapolated to include the entire population, the level of investments reaches approximately 3.1 billion euros. Although this figure is closer to the estimated level of gross investments in Kosovo as calculated by the Kosovo Agency of Statistics, the IMF, the World Bank, the Central Bank, and the Government, there is still a discrepancy. This highlights the importance of improving statistical information, particularly regarding private sector investments.

3.1 Efficiency of investments and economic growth

Over the past decade, the share of Gross Fixed Capital Formation (GFCF) in Kosovo's GDP has shown a gradual increase, rising from 28 percent in 2014 to 33 percent in 2021 before stabilizing around 31 percent in the following years (Figure 1). This trend indicates that Kosovo has allocated an increasingly larger portion of its economic resources to investments in fixed capital, which are essential for long-term economic growth and infrastructure development.

Figure 1. Gross Fixed Capital Formation as a Percentage of GDP in Kosovo



Source: KAS, 2024

However, despite the increase in the share of GFCF, Kosovo's overall economic growth rate has remained relatively low, with an average of 4 percent. This suggests that, although more resources are being directed towards investments, the productivity or efficiency of these investments has not improved proportionally, indicating that there are structural challenges or inefficiencies in translating investments into faster growth.

To assess capital productivity in Kosovo, we have used the Incremental Capital-Output Ratio (ICOR)[11], which links investment levels to changes in GDP for the period from 2015 to 2023. The aim is to capture medium-term changes in the ICOR and examine the relationship between capital levels and production growth. In this context, ICOR is influenced by several factors, including the rate of technological progress, the development of professional and managerial skills, and the quality of organizational structures within the economy.

Unlike a narrow focus on new investments, ICOR not only considers the income generated from new investments but also takes into account the productivity of existing assets. This is because the change in GDP (the denominator in this case) reflects the productivity of the entire capital stock. Since existing assets are often larger than the capital added each year, ICOR reflects the efficiency of the entire capital stock and not just the most recent investments. For example, a decline in capacity utilisation can lead to an increase in ICOR, even if new investments are productive. This means that ICOR in Kosovo may increase not only to inefficiencies in new investments but also because of challenges in fully utilising existing assets.

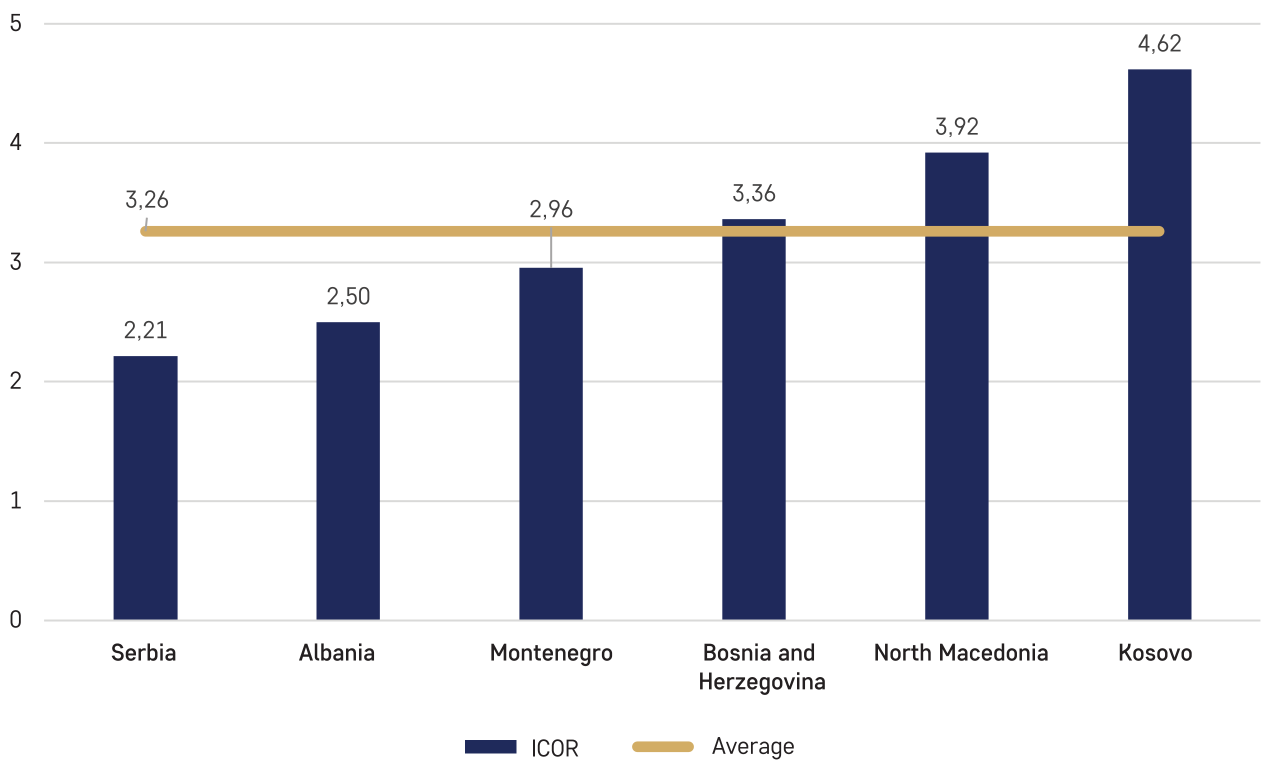
In fact, data from a survey conducted for this study shows that the average capacity utilisation by businesses is around 61 percent. This suggests that many companies are not fully utilizing their existing capacity, which leads to lower investment- efficiency and, consequently, a higher ICOR. This implies that more fixed capital is used to achieve a certain level of output, namely GDP. Low-capacity utilization may result from challenges such as insufficient demand, lack of qualified resources, or unfavorable market conditions, indicating that improving capacity utilization could help lower ICOR and increase capital efficiency in the country.

To gain a better understanding of Kosovo's ICOR, it has been placed in a regional perspective by comparing it with other countries in the Western Balkans (Figure 2). The ICOR values highlight significant differences in capital efficiency across the region. Kosovo stands out with the highest ICOR of 4.62, indicating that it requires significantly larger capital investments to generate economic growth compared to its neighbours. On the other hand, Serbia has the lowest ICOR at 2.21, suggesting relatively high efficiency in converting investments into economic output. Albania and Montenegro also show average efficiency, with ICOR values of 2.50 and 2.96, respectively. Bosnia and Herzegovina (3.36) and North Macedonia (3.92) have higher ICORs, but remain more efficient than Kosovo.

These figures imply that Kosovo faces structural challenges in capital productivity, which could hinder its economic growth compared to other Western Balkan countries. Addressing these inefficiencies may involve measures to improve capacity utilisation, enhance the technical structure of investments, improve workforce skills, and overall productivity to bring Kosovo's capital efficiency closer to regional standards.

11 ICOR (Incremental Capital-Output Ratio) for the period from i (2015) to j (2023) is defined as the ratio of the sum of investments during the period from i-1 to j-1 (expressed in terms of GFCF) to the output (expressed in terms of GDP) during the period j, minus the output in period i. ICOR=(Σ_2014^2022 GFCF)/(ΣGDPΣ_2023-ΣGDPΣ_2015)

Figure 2. ICOR in the Western Balkan Countries



Source: Authors based on data published by EUROSTAT, 2024.

Furthermore, the technical structure of private investments in Kosovo during the period from 2023 to 2025, based on survey results, illustrates several reasons explaining the high ICOR.[12] In 2023, a large portion of investments was concentrated on less productive assets, with 58.4 percent allocated to new buildings and 29.7 percent to land, while only a small portion was directed towards machinery and equipment (4 percent) and research and development (0.16 percent). This distribution indicates that capital was directed towards assets that, although important for business expansion, do not immediately increase productivity, leading to a higher ICOR. Here, the central government and local authorities can fulfill part of their responsibilities by facilitating infrastructure development (energy, water, roads, telecommunications) and providing suitable business locations. This would help reduce the current burden on the private sector, which currently bears a significant cost for these investments.

Our survey data show promising expectations among respondents regarding a shift towards more productive investments in the coming years. Specifically, the share of investments in machinery and equipment is expected to increase significantly, from 4 percent in 2023 to 22.6 percent by 2025. If this focus on more productive assets is realized, it could contribute to improving capital efficiency and overall economic growth in Kosovo.

The technical structure of investments also reveals that spending on research and development (R&D) remains very low, with only 0.16 percent allocated in 2023 and a slight increase to 0.38 percent planned for 2025. Although mod-

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est, this increase is a positive sign, suggesting an increasing awareness of the importance of R&D to foster innovation and long-term competitiveness. If this trend continues, even small increases in R&D could contribute to improved productivity and a reduction in the Incremental Capital-Output Ratio (ICOR) in the future, as innovation could encourage more efficient use of capital in various sectors. Overall, although ICOR is an informative indicator, its interpretation for Kosovo also requires an analysis of sectoral composition, which provides a better understanding of capital productivity. Based on the survey data, data from the Tax Administration of Kosovo (TAK) on the sectoral distribution of investments, and data from the Kosovo Agency of Statistics (ASK) regarding each sector's contribution to GDP, we have calculated the ICOR for each sector based on the NACE (one-digit) classification.

The data suggest that there are significant differences in the level of ICOR across different sectors in Kosovo. Sectors with low ICOR and low investment-to-turnover ratios, such as the financial sector and education, are highly efficient, requiring minimal investment to generate significant output and income. On the other hand, sectors with high ICOR, such as construction and energy, require large capital investments that are not efficiently translated into production due to high infrastructure costs, long payback periods, and operational challenges. Sectors with moderate ICOR, such as manufacturing and accommodation, require investment diversification and higher capacity utilisation.

Sectoral data on investments, contributions to GDP, and turnover by sector (Table 17) in Kosovo show an economy largely supported by wholesale and retail trade and construction.[13] Trade represents 31.23% of investments, 14% of GDP, and 53% of turnover, reflecting a strong consumer market but creating a dangerous dependence on consumer demand. Construction accounts for 17.13% of investments but contributes only 8% to GDP due to its capital-intensive nature and delayed economic impact. This reliance on trade and construction makes the economy vulnerable to sectoral shocks and limits long-term diversification. Meanwhile, the manufacturing sector, which represents 15.43% of investments, 13% of GDP, and 14% of turnover, is crucial for addressing Kosovo's structural dependency and imbalances. This can be achieved by increasing capacity utilisation and directing the investment structure towards more effective elements such as machinery and equipment, digitalisation, research and development (R&D), and training. Focusing on these areas would help the manufacturing industry increase productivity and reduce Kosovo's high dependence on imports, contributing to a more sustainable and competitive economy.

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4. HUMAN CAPITAL AND MIGRATION

4.1 Labour market dynamics in Kosovo

Kosovo's labour market continues to face significant structural challenges, including persistently low participation rates, high unemployment—particularly among youth and women—and a pronounced skills mismatch (Table 7). These issues are further exacerbated by substantial emigration, which depletes the domestic workforce and undermines economic development.

Table 6. Key labour market indicators (% of working-age population)

	2016	2017	2018	2019	2020	2021	2022	2023
Labor force participation rate (15-64 years)	38.7	42.8	40.9	40.5	38.3	39.3	38.6	40.7
Rate of the economically inactive population as a share of the working age population (15-64 years)	61.3	57.2	59.1	59.5	61.7	60.7	61.4	59.3
Employment to population ratio - employment rate (15-64 years old)	28.0	29.8	28.8	30.1	28.4	31.1	33.8	36.3
Unemployment rate (15-64 years old)	27.5	30.5	29.6	25.7	25.9	20.7	12.6	10.9
Youth labor force (age 15-24) rate	21.2	23.7	22.4	25.9	22.4	21.6	19.6	22.1
Youth employment-to-population ratio - youth employment rate (15-24 years old)	10.1	11.2	10.0	13.1	11.4	13.4	15.4	18.3
Youth unemployment rate (15-24 years old)	52.4	52.7	55.4	49.4	49.1	38.0	21.4	17.3
Participation of NEET youth in the youth population (15-24 years)	30.1	27.4	30.1	32.7	33.6	32.1	33.0	33.4
Participation of non-sustainable employment in total employment (15-64 years)	22.9	23.1	19.6	18.8	17.0	12.7	13.3	15.3

Source: Kosovo Agency of Statistics: Labour Market indicators

As of 2023, the labour force participation rate for individuals aged 15–64 stood at 40.7 percent, reflecting a marginal improvement from 38.6 percent in 2022 (KAS, 2025). However, this figure remains significantly below the averages observed in other Western Balkan countries and the European Union, where participation rates are approximately 69 percent and 75 percent, respectively (IMF, 2025).

The employment-to-population ratio for the same age group was recorded at 36.3 percent in 2023, up from 33.8 percent in 2022 (KAS, 2025). Despite this upward trend, the overall employment rate remains low, indicating that a substantial portion of the working-age population is either unemployed or not actively seeking employment.

Unemployment rates have shown a declining trend, with the overall rate decreasing to 10.9 percent in 2023 from 12.6 percent in 2022 KAS, 2025). Youth unemployment (ages 15–24) also saw a reduction, falling to 17.3 percent in 2023 from 21.4 percent in the previous year (KAS, 2025). However, these improvements are tempered by the fact that many individuals, particularly women and youth, remain outside the labour force, often due to discouragement or lack of suitable opportunities.

A notable characteristic of Kosovo's labour market is the significant gender gap in participation. Female labour force participation is among the lowest globally, with rates below 20 percent, making it the lowest in Europe (IMF, 2025). This disparity is attributed to various factors, including traditional gender roles, family responsibilities, and limited access to affordable childcare, daycare, and elderly care services. Addressing these barriers is crucial for enhancing women's economic participation and overall labour market efficiency (Riinvest, 2017).

Youth in Kosovo face considerable employment challenges. Despite a decrease in youth unemployment rates, the proportion of young people not in employment, education, or training (NEET) remains high, at 33.4 percent in 2023 (KAS, 2025). This indicates that a significant segment of the youth population is disengaged from both the labour market and educational institutions, posing long-term risks to human capital development and economic growth.

Employers in Kosovo frequently report difficulties in finding workers with the necessary skills, highlighting a persistent mismatch between the education system's outputs and labour market needs. This skills gap is particularly evident in sectors such as construction, manufacturing, and information technology (Riinvest, 2023). Efforts to align vocational education and training with industry requirements are essential to address this issue and improve employment outcomes. , Also, businesses face challenges in retaining their workforce due to the rising propensity for migration.

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.

In an attempt to analyse the difficulties that companies face due to migration and the factors that drive emigration from Kosovo, Riinvest (2023) investigated (i) determinants of companies losing staff due to migration, and (ii) determinants of youth propensity to emigrate. Results suggest that companies in larger cities are 8 percentage points less likely to experience staff losses. The construction sector is most affected, with a 18 percentage point higher likelihood of employee departures compared to manufacturing. Exporting companies are less affected, with a 12 percentage point lower likelihood of staff losses. Company size does not significantly impact employee retention, but companies operating for over 10 years show greater stability, being 6 percentage points less likely to lose staff. Firms with strong HR practices and better working conditions are also less prone to staff losses (14 and 16 percentage points lower, respectively). These findings emphasize the importance of improving working conditions and adopting sound HR practices to mitigate staff turnover.

Similarly, an analysis of Riinvest data highlights several factors driving youth emigration in Kosovo. Unemployed individuals are 18 percentage points more likely to emigrate compared to those employed. Males and unmarried individuals are 19 and 7 percentage points more likely to leave, respectively. Participation in Active Labour Market Measure (ALMM) programs reduces the likelihood of emigration by 9 percentage points. Rural residents are 11 percentage points more likely to emigrate compared to their urban counterparts. Education level does not significantly affect emigration likelihood, indicating a high overall tendency to migrate. Policymakers should focus on job creation and improving ALMM programs while addressing broader factors like education, healthcare, and working conditions.

4.2 Demographic trends and their economic implications

KKosovo is experiencing profound demographic changes that are reshaping its long-term economic prospects. The country has transitioned from a period of population growth to one of gradual decline, driven by a combination of low fertility rates, substantial emigration, and an ageing population. According to the 2023–2024 census, Kosovo's resident population stands at approximately 1.59 million, down from around 1.73–1.78 million in 2011. This decline of roughly 8–11 percent in just over a decade is a significant shift for a country historically characterised by a young and growing population.

The primary factors behind this demographic decline are continued emigration and falling birth rates. Kosovo has one of the highest emigration rates in the Western Balkans. The cumulative impact of this outflow has resulted in a large diaspora, estimated at around 900,000 people, equivalent to over half of the resident population. While remittances provide crucial economic support to many households, they also underscore the loss of human capital.

Internally, Kosovo's population distribution is shifting from rural and mountainous areas toward urban centres, particularly Prishtina. This urban migration is driven by better access to education, healthcare, and employment opportunities in cities. However, it has also led to depopulation in rural regions, with adverse effects on agricultural output, village sustainability, and the viability of rural schools and healthcare facilities. The 2023–2024 census further reveals that several peripheral municipalities experienced population declines, while urban centres, particularly Prishtina, continued to grow.

Youth emigration is a particularly pressing concern. Despite Kosovo having one of the youngest populations in Europe, a substantial share of its youth express a desire to migrate. This is driven by a combination of limited local opportunities, higher wages abroad, and the allure of better living conditions. Fertility rates in Kosovo have also fallen dramatically over recent decades. In the early 2000s, the total fertility rate was above 2.5 children per woman, but it has since dropped to around 1.5–1.6, aligning with the European Union average of 1.46 in 2022. This sharp decline in birth rates has fundamentally altered the country's demographic structure, leading to a significant slowdown in natural population growth. Key factors behind this decline include urbanisation, higher educational attainment among women, changing social norms, and economic uncertainties that have led families to have fewer children.

As a result of these trends, Kosovo's population is gradually ageing. The average age of the population rose from around 30 years in 2011 to 34.8 years in 2024, while the share of people aged 65 and over has increased. Although Kosovo remains one of the youngest countries in Europe, with only about 10 percent of its population aged 65 and over (compared to 20 percent in Serbia or Bosnia), the country's aging process is accelerating. However, despite this demographic transition, Kosovo still has a window of opportunity to leverage its demographic dividend, where a relatively young working-age population can drive economic growth if appropriately mobilized.

The economic implications of these demographic changes are significant. A shrinking and ageing population tends to dampen long-term economic growth by reducing the labour supply and increasing the dependency burden on working-age individuals. Fewer young workers entering the labour force means lower potential output unless productivity per worker rises significantly. High emigration further reduces the domestic labour pool, while the ongoing "brain drain" threatens the quality of human capital available within the country. Sectors such as information technology, engineering, and healthcare are particularly affected by the loss of skilled workers.

To mitigate the negative effects of these demographic trends, Kosovo must focus on policies that enhance youth retention, improve labour force participation, especially among women, and strengthen social services for an ageing population. These measures are critical for maintaining a sustainable and resilient economy in the face of demographic decline.

5. NEW MODEL OF ECONOMIC GROWTH TO ADDRESS MIDDLE INCOME TRAP

As we emphasised in the study report "A New Model for Sustainable Economic Growth", prepared for the Annual Economic Forum 2023 (Riinvest Institute, 2023), economic growth in Kosovo has hovered around 3–4 percent for nearly two decades. This leads to the conclusion that Kosovo, like many other countries, is facing difficulties associated with the so-called Middle-Income Trap. As noted, Kosovo, with a GDP per capita of USD 6,643, is now among 55 countries categorised as High Middle-Income Countries. There are approximately 108 countries with a middle-income level struggling with unfavourable economic growth trends and, being "trapped," are unable to transition into the club of developed economies.

This phenomenon has become a pressing and problematic issue because it can prolong a state of unsatisfactory development for an extended period. Although not all these countries experience the same intensity of challenges, they face similar obstacles in employing qualitative factors, implementing necessary structural reforms, and improving governance quality to achieve the status of High-Income Countries. Kosovo should learn from their experiences, particularly from those countries that have already navigated this challenging development path.

Historically, differential growth experiences and disparities between countries and regions have led to significant differences in economic development levels worldwide. On the other hand, there are countries where growth dynamics have contributed to narrowing and even closing such gaps. Acemoglu (2012) and Garicano and Rossi-Hansberg (2006), in their model featuring organisations ("organising growth"), suggest a framework in which productivity growth results from the interplay between the accumulation of knowledge and advancements in information and communication technology (ICT).

While entrepreneurship is often a key input for economic growth, the slowdown in middle-income economies (MIEs) is largely attributed to the fact that productivity becomes stagnant (stuck in the middle) and that "efficiency deteriorates," eventually overwhelming technological progress over time. As a result, the "net" contribution of productivity becomes negative (Acemoglu, 2012; Eichengreen et al., 2012; Yanrui Wu, 2013).[14] The causes presented in this literature are generic, emphasising factors such as the quality of legal institutions, demographic challenges, lack of social infrastructure, poor macroeconomic policies, and insufficient policies promoting technological progress.

The New Brazilian Developmental School contributes to the literature on growth and structural change with the diagnosis that economies such as Brazil and Argentina suffer from chronic real exchange rate overvaluation. This issue arises from a combination of Dutch disease and a growth strategy reliant on external savings. Their recommended strategy consists of adopting an export-led growth regime, where the promotion of the manufacturing sector drives the acceleration of capital accumulation and the adoption of modern production techniques (Luiz Carlos Bresser-Pereira et al., 2020). They rightly conclude that "Relying on domestic autonomous demand, such as government spending, means that growth will sooner or later be interrupted by a crisis in the balance of payments."

14 Yanrui Wu (2013) calculated that during the period 1961–2019, the contribution of Total Factor Productivity (TFP) growth to GDP growth was positive, amounting to 34.83 percent in the case of High-Income Countries (HICs) and 7.33 percent for Middle-Income Countries (MICs) that graduated to higher income levels. In contrast, the contribution was negative for Low-Income Countries (LICs), at -4.21 percent, and for Middle-Income Countries (MICs) trapped in the middle-income category, at -1.65 percent.

On the other hand, Agenor (2016) identifies a wide range of obstacles facing Middle-Income Countries (MICs), including diminishing returns to physical capital, exhaustion of cheap labour and imitation gains, insufficient quality of human capital, inadequate contract enforcement and intellectual property protection, distorted incentives and misallocation of talent, lack of access to advanced infrastructure, and lack of access to finance, especially in the form of venture capital. The principal stylised fact of this theory is that technological progress must be maintained through innovation.

A recent World Bank (WB) publication (2025) focuses on the development challenges facing Middle-Income Countries (MICs) in Europe and Central Asia (ECA), specifically addressing the obstacles that prevent them from overcoming the Middle-Income Trap.[15] VOnly a few Europe and Central Asia (ECA) countries have reached high-income status, primarily due to slow progress in implementing structural reforms at home and the deterioration of the global economic environment. The report adopts a pessimistic outlook, stating that "it is unlikely that any of the ECA MICs will cross the high-income threshold in the next few years." The authors of the study argue that relying solely on traditional policies focused on supporting small and medium enterprises (SMEs) is insufficient. Such policies often prove misguided because they lead to an excess of SMEs without significantly promoting cumulative growth in jobs and output. Another common challenge for these countries is the shortage and misallocation of talent, which limits firms' ability to invest, adopt new technologies, attract capital and expertise from abroad, and innovate.

A key driver for the success of Middle-Income Countries (MICs) in Europe in overcoming the Middle-Income Trap over the past three decades has been their process of integration into the European Union (EU). The EU convergence machine—through institutional change, trade, investment, and the flow of capital and managerial expertise from richer to poorer countries—has helped all EU member states successfully escape the Middle-Income Trap.

In September 2024, the World Bank published a special report titled "Middle-Income Trap," addressing the challenges of economic growth in these countries from various perspectives. As a synthesis of its recommendations, the report suggests a pathway for these countries based on the so-called "3Is": Investment, Infusion, and Innovation.

The first "I" (Investment) focuses on increasing investments in physical capital (machinery, equipment, and infrastructure) and expanding investments in human capital, including quality education, training, and healthcare. Economic and investment policies should aim to create and implement strategies that encourage the attraction of both private and public investments, particularly foreign investments, which bring an "infusion" of ideas, models, and new technologies into the domestic economy. There are serious issues to address in this sense to increase the effectiveness and efficiency of investment through a number of improvements to their sectoral structure, their technical structure and improvements in the overall project management cycle. This is true especially when it comes to public funds investment by governmental institutions and public enterprises at the central and local levels.

The second "I" (ii) relates to infusion, where countries focus on imitating, adopting, and disseminating new technologies and business models characteristic of developed economies. This entails equipping domestic industries to become suppliers of products and services on a global scale. Successful structural reforms that support the sustainability of achievements and positive changes in the external competitive environment are crucial for this phase. In this regard, Kosovo remains at an early stage.

The third "I" relates to innovation, where local capacities are developed to add value even to global technologies, becoming "creators of global knowledge." This is characteristic of upper-middle-income countries and represents a significant challenge in supporting the sustainability of existing firms in the global market. This phase requires advanced institutional maturity and capacity to reduce risks for successful and innovative businesses through incentive schemes, as well as to promote investments in research and development (R&D).

15 Since 1990, 27 countries across the globe have reached high-income status; of these, 10 are in the Europe and Euro-Central Asia (ECA) region and have joined the European Union. Another 20 ECA countries have become more prosperous since the 1990s. However, these middle-income countries (MICs) have found that their prospects for growing to high income have become troubled. This partly reflects the slowing pace of progress on structural reforms at home. The challenges are also partly linked to the deteriorating global environment

Experience shows that moving to this phase requires a commitment to higher developmental ambitions and effective reforms. This demands serious efforts from policymakers to successfully link the macroeconomic growth structure with its determinants at the microeconomic level, such as incentives, policies, organisations, and enablers of the economic growth process. In this context, Kosovo must begin to address these issues much more seriously.

Given that Kosovo has now entered the group of High-Middle-Income Countries, it must simultaneously address all three "I's." This inevitably poses significant tasks for macroeconomic management at the national level and for local businesses to enhance their competitive capabilities. Kosovo's approach to this challenge can benefit from the EU's "Economic and Investment Plan for the Western Balkans," which could support the first "I" (Investment) and the second "I" (Infusion) by boosting investments. Structural reforms remain critical for this, particularly in the development of the energy sector, ensuring a reliable water supply, advancing human capital, and the connectivity agenda with regional and pan-European physical and digital infrastructure corridors. This must be achieved in parallel with commitments and obligations related to the Green Agenda, including its goal of "Net Zero CO2 Emissions" and decarbonisation.

Recent research suggests that regional cooperation plays only a facilitative and supportive role but lacks transformative power for the Western Balkan economies without EU integration (Mustafa and Hashani, 2024). Since 1990, only 34 middle-income countries have transitioned into the group of high-income countries. Of these, more than one-third achieved this milestone through the process of EU integration.[16] The others include Southeast Asian countries, such as Taiwan and South Korea, which have focused their development policies on high-value-added products and services for export while significantly increasing investments in education, new technologies, and innovations to bridge the gap with advanced global technologies.[17]

In general, governments in Kosovo have paid little attention to these vital developmental issues. Chronically, they have lacked the ambition to make qualitative changes to Kosovo's economic reality. Kosovo, as a whole, requires a new developmental vision. A development ambition is needed, free from the inertia and routine of current policies, which have been primarily characterized by antagonistic confrontations among political actors on almost every issue. It is essential to concentrate energies on development that propels the country towards advanced economies.

Kosovo cannot escape this trap without, first, increasing investments in sectors with export potential and, second, investing in knowledge, new technologies, research, development, and innovation. This would result in increased exports and a rise in the competitive domestic supply of products and services. The data presented earlier reflect a worrisome situation.

Such a development does not favour export growth or facilitate the transition from the first "I" to the second and third "I" on the pathway that middle-income countries must follow toward becoming developed economies. Therefore, alongside changes related to the volume and technical structure of investments (real estate, facilities, equipment), changes in sectoral investment policies are necessary. What is particularly concerning relates to investments in the fields of scientific research and development, education, innovation, and healthcare. In addition to insufficient funding, the research and innovation sector still faces a poorly developed and insufficiently operationalised legal framework for implementation. The institutional structure remains incomplete, hindering the effective implementation of research and innovation policies and programmes. The National Research Program 2023–2028 has remained unimplemented and non-operational over the past two years. Within the Ministry of Education, Science, Technology, and Innovation, institutions such as the Agency/Fund for Research, which should be responsible for implementing this programme, have not yet been established. A positive development is the draft Law on Innovation and Entrepreneurship, which foresees the creation of the Innovation Fund. However, this document remains in draft form, pending approval since December 2023. Kosovo still has modest participation in the European

16 A model commonly referred to as the "European convergence machine" (World Bank, 2024).

17 According to the World Bank: World Development Report Concept Note

Research Area (ERA), including Horizon Europe [18], the EU's largest research programme. Additionally, Kosovo has not yet become part of the EU Innovation Scoreboard, leaving it without a statistical information system for tracking innovation development and other important components of scientific and research production. Table 8 illustrates extremely low funding (as a percentage of GDP) for research, innovation, education, and healthcare—key components for building human capital that would enhance absorptive capacities, drive development dynamics, and promote the implementation of a new economic growth model in Kosovo.

Tabela 5. Investimet ne K&I, Arsim dhe Shëndetësi viti 2023 si % e PVB

	Kosova	Ballkani Perëndimor	BE
Research and innovation	0.1 - 0,2[13]	0.50	1.7
Education	3.5	4.6	4.7
Health	5.8	8.5	10.2

Source: Riinvest, 2024

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mprovement in industrial policies, particularly benefiting the manufacturing, high-value-added services, and so-called creative industries, is essential. The new economic growth model should be based on policies that increase the supply of products and services for domestic and international markets. An important component is responsible and effective public funds expenditure, particularly aimed at productive investments in education, healthcare, research, and development. This approach would create the conditions for long-term sustainable economic growth, especially when connected with significant commitments related to the development and approval of 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). The existing model of economic policies, primarily based on external factors such as remittances, loans, and external financial assistance for over two decades, has proven unsuitable and inadequately designed to boost domestic supply, particularly in export industries and high-value-added services. Although there were significant improvements with Fiscal Packages 1 and 2 in 2015 and 2016, these measures were not further developed and enhanced as needed.

The new growth model requires that investments in research and innovation reach at least the regional average (0.5 percent of GDP) over a 2–3 year period, maintaining a further trend toward approaching EU standards. This target can be exceeded in a more favourable environment that promotes incentives for research organisations in universities, faculties, and beyond.[20] 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, particularly 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, particularly in investments in education and healthcare, as well as investments in research and innovation.

18 During 2021 research organisations from Kosovo applied with more than 50 project at Horizon Europe Programme.

19 There is no official statistical data for Kosovo on Research and Innovation (R&I) spending. Riinvest Institute's estimates are based on survey data and the Kosovo budget (Riinvest, 2024)

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

6. INSTITUTIONS AND ECONOMIC GOVERNANCE

Kosovo's institutional performance presents a mixed picture. On one hand, the country has made strides in establishing a market-oriented regulatory framework; on the other hand, gaps in rule of law, public administration capacity, and corruption control continue to pose challenges. This section analyses the quality of Kosovo's economic governance – including its regulatory environment, rule of law, administrative efficiency, and public investment management – and compares key indicators with Western Balkan peers. It also examines how institutional quality affects Kosovo's ability to attract investment, implement reforms, and maintain policy continuity.

Regulatory Environment and Business Climate

Kosovo has undertaken significant reforms to improve its business climate over the past decade, simplifying business registration and digitising many government services. In fact, Kosovo was previously recognized as a top reformer in the World Bank's Doing Business reports, reflecting streamlined regulations for starting a business and paying taxes. In recent assessments, Kosovo performs reasonably well on certain competitiveness indicators relative to its neighbours. For example, the OECD's Competitiveness Outlook 2024 finds Kosovo outperforms the Western Balkan average in five of fifteen policy dimensions, and is a regional leader in areas like trade policy and management of state-owned enterprises (OECD 2024). The country's relatively low tax rates and use of the euro currency provide a stable macroeconomic backdrop for investors (Riinvest, 2024). However, businesses still face a number of institutional barriers. Investors often report that inconsistent implementation of laws, cumbersome bureaucracy, and a sizeable informal economy undermine the otherwise formal regulatory framework (Riinvest, 2023, 2024).

Comparisons with regional peers highlight Kosovo's need to further strengthen its business-enabling institutions. In the latest World Bank Worldwide Governance Indicators (WGI), Kosovo scores lower than most Western Balkan countries on Regulatory Quality and Government Effectiveness, indicating that policy implementation and public services lag behind EU standards (World Bank, 2022). Survey evidence underscores these concerns: over 50% of firms in Kosovo identify problems like complex administrative procedures and the slow issuance of permits as obstacles to growth (EBRD, 2023). To address such issues, Kosovo launched a new Commercial Court in 2023 dedicated to handling business disputes, aiming to reduce backlogs and build investor trust in the judiciary (Riinvest, 2023). This is a positive step, as unpredictable contract enforcement had been a deterrent to investment. Still, ongoing challenges remain in the legal system, including frequent delays of court hearings and inconsistent application of sanctions. Overall, while Kosovo's regulatory environment has improved on paper, the effectiveness of institutions in practice needs to catch up to fully reassure investors. Persistent "cost-of-doing-business" problems – from bureaucratic red tape to policy unpredictability – continue to rank among the largest obstacles cited by local and foreign businesses (OECD, 2024).

Rule of Law and Control of Corruption

Governance indicators related to rule of law and corruption reveal that Kosovo, like several Western Balkan states, still has substantial room for improvement. According to the World Justice Project's Rule of Law Index 2024, Kosovo's overall rule-of-law ranking slipped slightly, with the country now 58th of 142 countries globally (WJP, 2024). Regionally, however, Kosovo ranks 3rd among 15 Eastern Europe & Central Asia countries on this index – behind only

Georgia and Montenegro – reflecting relatively stronger performance in certain sub-dimensions. Notably, Kosovo scores well on Order and Security (ranked 31st globally) and on Constraints on Government Powers, suggesting a stable security situation and institutional checks and balances. Yet in areas crucial for economic governance such as Regulatory Enforcement and Civil Justice, Kosovo lags behind – ranked 82nd and 89th globally, respectively (WPJ, 2024). Weak contract enforcement and civil court inefficiencies undermine the business climate, as disputes take a long time to resolve despite recent judicial reforms.

Corruption remains a pressing concern. Transparency International's latest Corruption Perceptions Index (CPI) scores Kosovo at 41/100, which is on par with regional peers but below the global average. In 2023, Kosovo was ranked around 83rd out of 180 countries on the CPI, similar to North Macedonia and slightly ahead of Albania (Transparency International, 2023). This score indicates that despite some anti-corruption efforts, corruption is still perceived as widespread, echoing citizen and business surveys. Indeed, opinion polls consistently show that a majority of Kosovars believe corruption is prevalent in the public sector (UNDP, 2024). Within the Western Balkans, Kosovo's corruption score is middling – better than Bosnia and Serbia (which score in the 30s) but still trailing Montenegro (46) and far below EU countries (Transparency International, 2024) . There have been some recent improvements: for instance, Kosovo made progress in adjudicating corruption cases in 2022, resulting in a greater number of final convictions (European Commission, 2023). Legislative steps have also been taken, such as transforming the Anti-Corruption Agency into a stronger Agency for the Prevention of Corruption (per 2022 reforms) (Freedom House, 2023).

Public Administration and Investment Governance

The effectiveness of public administration and the management of public resources directly affect Kosovo's growth prospects. Assessments of Kosovo's public sector governance show mixed progress. According to the OECD/SIGMA Monitoring Report 2024, Kosovo is performing above the Western Balkan average in several areas of public administration reform – notably policy development, public financial management, service delivery, and accountability (OECD, 2024). This suggests that Kosovo has made strides in adopting modern public finance practices (e.g. internal audit and control systems) and improving service delivery through digitalization. In fact, Kosovo stands out regionally for certain administrative strengths: citizens' trust in the civil service is reported to be 25 percent higher than the Western Balkan average, indicating some favourable perceptions of recent reforms (OECD, 2024). However, the same review highlights persistent challenges in all areas of public administration. Policy implementation is often weak – many strategies and laws are drafted but not fully carried out. By the end of 2023, less than half of Kosovo's planned public administration reform activities had been implemented, and only 26 percent of intended reform objectives were achieved (OECD, 2024). This implementation gap points to limited administrative capacity and frequent delays. The government still has not developed adequate capacities for employing evidence-based policies in drafting development policies and strategies, as well as in managing their implementation through accurate corrective measures and mechanisms.

A critical concern is the management of public investments. The European Commission notes "weaknesses in public investment management" in Kosovo, as well as poor financial oversight of publicly-owned enterprises (European Commission, 2024). Execution of the capital budget has been consistently low. Over the past five years, Kosovo struggled to implement its planned infrastructure projects, with capital expenditures often underspent due to procurement bottlenecks and institutional inefficiencies (Riinvest, 2024). Similarly, Riinvest (2023, 2024) finds that public capital investment levels in Kosovo have actually declined to their lowest point of the last decade, even as pressing needs in roads, education, and health infrastructure remain unmet. This reallocation towards recurrent spending may have political expediency, but it crowds out productive investment in infrastructure and human capital, thereby constraining long-run growth. The institutional capacity to prepare and execute complex projects is still limited – as evidenced by procurement delays and the high number of stalled projects – which in turn discourages foreign investors looking for reliable public partners.

Public procurement illustrates both the progress and remaining weaknesses in economic governance. Kosovo has made procurement more transparent by moving to e-procurement and disclosing tenders publicly. Yet, accountability mechanisms are lagging. The Procurement Review Body (PRB) – tasked with handling bid complaints – suffers from slow procedures, and businesses often view the procurement appeals process as more of an impediment than a solution.

In summary, Kosovo has built the foundations of a market economy with laws and institutions akin to those of its neighbours, but the effectiveness of these institutions is the determining factor. Improving economic governance – by ensuring laws are evenly enforced, corruption is curtailed, public services are efficient, and budgets are invested wisely – is vital for accelerating Kosovo's growth and development trajectory.

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8. ANNEXES

Aneks A1. Struktura e PVB sipas veprimtarive

Participation of Economic Activities in GDP as a Percentage from 2010 to 2023

Description of Economic Activities	2010	2015	2019	2023
Agriculture, Forestry, and Fishing	9.5	7.7	7.2	7.8
Mining and Quarrying	2.5	2	2	1.7
Manufacturing	13.8	13.3	12.9	12.8
(Electricity and Gas Supply) + Water Supply	**3.1**	**4.1**	**4**	**3.7**
Electricity and Gas Supply	2.5	3.4	3.4	3.1
Water Supply	0.7	0.7	0.7	0.6
Construction	7.7	7.6	8.2	8.2
Wholesale and Retail Trade; Vehicle and Motorcycle Repair	13	12.3	12.8	14.2
Transportation and Storage	4	4.6	4.4	4.5
Hotels and Restaurants	1.1	1.6	2.1	2.1
(Information and Communication) + (Financial and Insurance Activities)	**5.4**	**5.6**	**5.7**	**6.3**
Information and Communication	1.5	1.8	1.9	2
Financial and Insurance Activities	3.8	3.8	3.9	4.3
(Real Estate Activities) + (Professional, Scientific, and Technical Activities) + (Administrative and Support Activities) + (Public Administration and Defence; Social Security)	**16.1**	**15.6**	**15**	**13**
Real Estate Activities	8.8	7.5	7	5.9
Professional, Scientific, and Technical Activities	1.5	1.6	1.4	1.4
Administrative and Support Activities	0.7	0.7	0.7	0.7
Public Administration and Defence; Social Security	5.1	5.9	5.9	5
Education	3.6	4.1	3.7	3.2
Healthcare and Social Work Activities	1.8	2.1	2.2	2.2
(Arts, Entertainment, and Recreation) + Other Services	**0.9**	**0.8**	**0.6**	**0.5**
Arts, Entertainment, and Recreation	0.4	0.4	0.2	0.2
Other Services	0.5	0.4	0.4	0.3
Gross Value Added, Total	82.4	81.3	80.8	80.1
Net Taxes on Products	17.6	18.7	19.2	19.9
TOTAL GDP (at current prices)	100	100	100	100

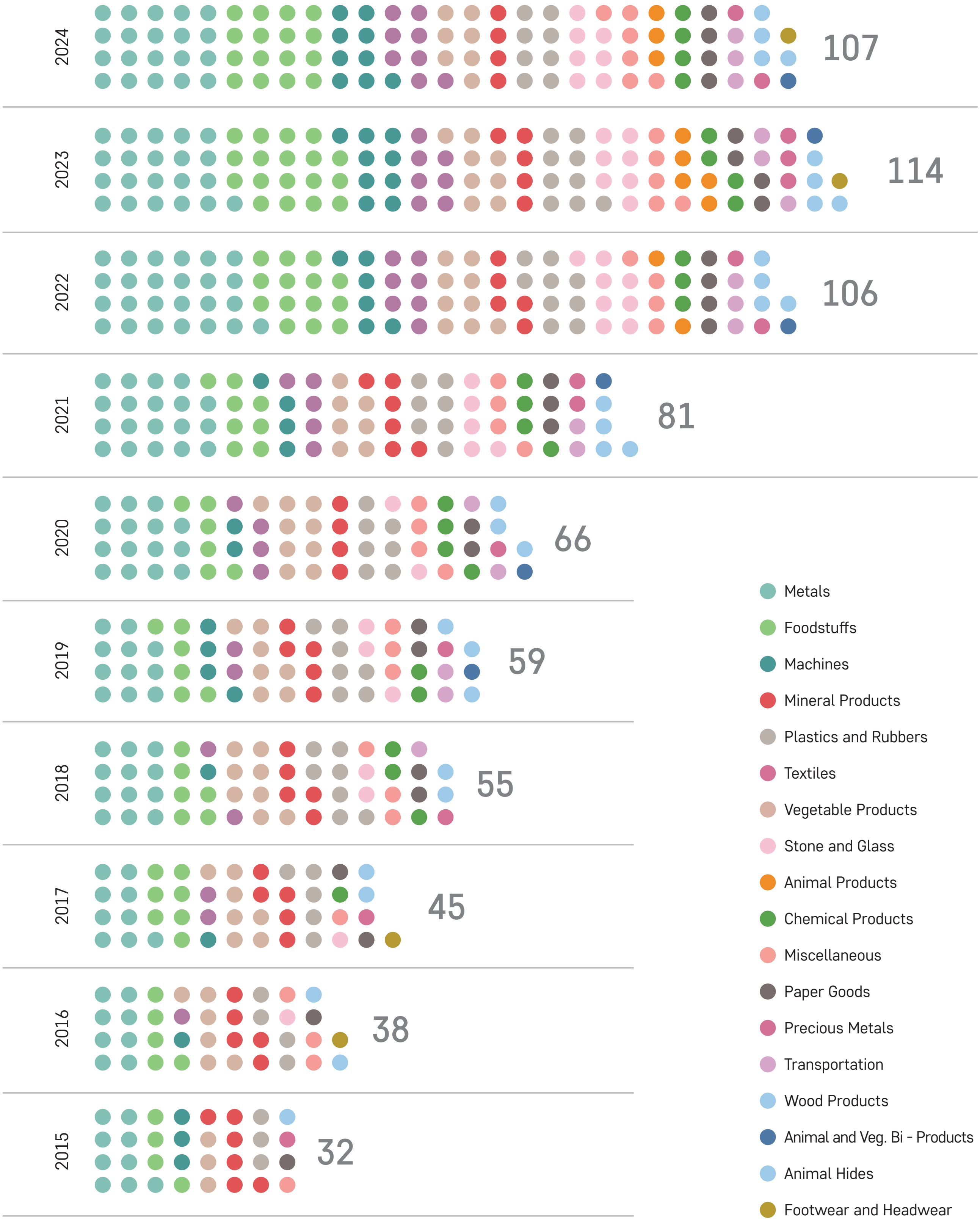
Source: ASK, 2024

Annex A2. Exports and Imports of Goods (in millions of euros)

Year	Export	Import	Trade balance	Export coverage by imports (%)
2019	393	3233	-2840	12.2
2020	475	3048	-2573	15.6
2021	753	4320	-3567	17.4
2022	932	5219	-4287	17.9
2023	871	5469	-4598	15.9
January - September 2023	643	4249	-3606	15.1
January – September 2024	690	4554	-3864	15.2

Source: KAS and CBK

Annex A3. Number of products exceeding one million euros in annual export value (2015-2023, January – September 2024)

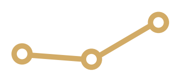
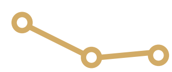
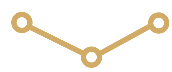


Annex A4. Export and import of services over the years (in millions of euros)

Year	Export of services	Import of services
2019	1,675	749
2020	995	603
2021	1,906	871
2022	2,503	1,127
2023	2,966	1,337
2023 January - September	1,579	694
2024 January - September	1,781	864

Source: CBK

Annex A5. Technical Structure of Investments in Kosovo

	2023	2024	2025	Trendi
Land	29.69	30.33	16.72	
New Buildings	58.43	57.17	49.64	
Machinery and Equipment	4.02	8.51	22.63	
Research and Development (R&D)	0.16	0.14	0.38	
Training; Consulting	0.44	0.33	0.34	
Working Capital/Circulating Capital	6.98	3.01	7.69	
Other Investments	0.28	0.50	2.60	

Source: Riinvest Institute Survey, 2024.

Annex A6. Sectoral participation in investments, GDP, and turnover

	Share in Investments	Share in GDP	Share in Turnover
Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles	31.23	14	53
Construction	17.13	8	10
Manufacturing	15.43	13	14
Supply of Electricity, Gas, Steam, and Air Conditioning	8.23	4	8
Information and Communication	4.96	2	0
Accommodation and Food Service	4.89	2	2
Real Estate Activities	2.75	7	0
Professional, Scientific, and Technical Activities	2.28	1	2
Transport and Storage	1.88	4	3
Mining Industry	1.65	2	1
Agriculture; Forestry and Fishing	1.09	7	1
Financial and Insurance Activities	0.42	4	4
Human Health and Social Work Activities	0.24	2	1
Education	0.18	3	1

Source: Authors based on data from: Riinvest Institute Survey, 2024; TAK; KAS.

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