UNIVERSITY OF LJUBLJANA
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MASTER'S THESIS

THE CHARACTERISTICS OF FOREIGN DIRECT INVESTMENTS IN THE EMERGING MARKET OF KOSOVO

Ljubljana, September, 2020 DONJETË REXHA

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INTRODUCTION

This master`s thesis focuses on foreign direct investment. With the trend of globalization, the value of foreign direct investment (hereinafter: FDI) has increased. Countries have become more accessible and exposed to FDI flows. Transitional and developing economies, characterized by a lower level of productivity, wages, and consequently, lower investments, have been prone to developing policies and strategies for the attraction of FDI. It is widely accepted that FDI brings positive effects like economic development, higher income, technology, knowledge, commercial experience, and employment. However, large amounts of FDI are not automatically converted into positive effects for the host country. Therefore, the determination of the host country to create the best outcome is important. After the global financial crisis in 2015, a recovery point was reached. According to the (United Nations, 2016), global FDI flows increased by 38 % or $1.76 trillion, and by 9 % or $765 billion in developing countries. However, FDI flows fell by 23% in 2017, continuing downward by 13%, in 2018. Although, mainly developed countries faced this continuous fall, without a significant rise in FDI in transitional economies, the effect of FDI is hardly visible (United Nations, 2019).

The thesis consists of four parts; each part covers a piece of the country's mosaic, attempting to provide a better understanding of the FDI framework in Kosovo. A literature overview explaining the definition of FDI, current global and Western Balkans' trends is included in the first part of the thesis. The second part covers the analysis of the motives of firms to invest abroad, a depiction of Kosovo's macroeconomic and business environment, and the identification of foreign firms' motives to invest in Kosovo. Kosovo faces distinct political obstacles compared to the rest of the region, struggling for recognition in the international arena and bordering with neighboring Serbia, which still claims its territory. Kosovo was ranked 44th out of 190 countries for "Doing Business" (Word Bank, 2019), easing administrative procedures like registering a new business, property transfer procedures, and access to the electric network. This may not reflect the real situation, as some key barriers like corruption, informality, and bureaucracy remain at elevated levels, leading to a harsh economic environment. The third part elaborates on the political stability importance on investing abroad decision-making, a broad explanation of Kosovo's political situation and the identification of political factors that most hamper foreign investments in Kosovo. One factor often mentioned as an advantage of Kosovo is the young age of human capital. So, this section also addresses some features of human capital important to foreign investors, including the advantages and disadvantages of the labor force in Kosovo. The fourth and final part will reflect the preferred entry modes of foreign investors in the market of Kosovo. Based on the literature overview and findings of the thesis, conclusions take place at the end.

Methodology - To provide an accurate overview of the FDI structure in Kosovo, the motives and challenges of investors, a process of primary data collection was undertaken. Due to the lack of secondary data that would address all the elements of this thesis, the survey was conducted using questionnaires, compiled based on quantitative methods, where respondents selected one of the answer options provided in each question. Answer options were provided using the Likert scale in the range of one to five, where:

1 – Not important
2 – Slightly important
3 – Moderately Important
4 – Important
5 – Very Important

Primary data is collected on 250 foreign-owned firms in Kosovo. The selection of the sample is made based on the non-probability sampling method – convenience sampling, which meant the participation of firms in the survey is based on availability and willingness to take part.

There were 4510 firms with foreign capital operating in Kosovo in 2018. The sample is statistically representative, with a confidence level of 95% and a margin error of ± 5%. The sample composition is as follows: Pristina District 68.0%, Ferizaj District 9.60%, while an average of 4% of the firms were from other Kosovo districts: Peja, Prizren, Mitrovica, Gjakova, and Gjilan. A high percentage of participant firms were from Pristina and Ferizaj due to the considerable number of businesses in these regions. Regarding the ethnic origin of investors, 36.4% of participant firms involve at least one Albanian shareholder, while 63.6% consist of entirely foreign ownership. 41.2% of foreign firms operating in Kosovo were established prior 2008 while 58.2% during and after 2008. As seen from the data, the declaration of independence and its recognition by the majority of Western states influenced the growth of FDI inflows in the country. According to our data, trade is the most preferable field to invest with 35% of foreign firms operating in this sector, followed by 33.6% in services and 31.2% in manufacturing. More details of the sample are displayed in Table 1 and will be analyzed throughout the thesis. The data is collected from April to July 2019.

Table 1. Sample Characteristics

	The Total	Pristina	Mitrovica	Peja	Gjakova	Ferizaj	Gjilan	Prizren
No of Firms	250	170	13	11	9	24	11	12
No of Firms (%)	100	68.00	5.20	4.40	3.60	9.60	4.40	4.80
Firms, Albanian Shareholders (%)	91	34.11	30.76	45.45	44.44	37.50	54.54	41.66
Firms, Entirely Foreign Ownership (%)	159	64.70	69.20	54.54	66.60	62.50	45.45	66.60
Firms Established Prior to 2008 (%)	103	41.17	15.38	63.60	22.20	25.00	72.70	66.60
Firms Established After 2008 (%)	147	58.23	84.60	27.20	66.60	66.60	63.60	58.20
Firms (%) (Trade)	88	71.59	3.40	2.27	4.54	5.68	4.54	6.81
Firms (%) (Manufacturing)	78	53.80	8.97	7.69	3.84	16.66	5.12	3.84
Firms (%) (Services)	84	77.38	2.38	4.76	2.38	5.95	3.57	3.57

In terms of data analysis, the results were processed via the statistical software SPSS. The result of each thesis section was derived through descriptive frequency analysis, which represents the number of occurrences of each response selected by respondents. The frequency measurement involved Likert Scales from three to five to display the results. Given the purpose and structure of the topic, four research questions were posed, and three hypotheses were tested, as delineated below.

- Research Question (RQ1): What are the motives of foreign firms to invest in Kosovo?

$$\text{Ho (1): } \mu_{\text{Low labor costs}} = \mu_{\text{Geographical Proximity;}}$$

$$\text{Ha (1): } \mu_{\text{Low labor costs}} > \mu_{\text{Geographical Proximity;}}$$

- Research Question (RQ2): Which political problems discourage foreign firms from investing in Kosovo?

$$\text{Ho (2): } \mu_{\text{Corruption after 2008}} = \mu_{\text{Corruptionprior2008}};$$

$$\text{Ha (2): } \mu_{\text{Corruption after 2008}} > \mu_{\text{Corruptionprior2008}};$$

- Research Question (RQ3): Which features of human capital are the most important for foreign investors and what are the disadvantages of human capital in Kosovo?

$$\text{Ho (3): } \mu_{\text{Migration}} = \mu_{\text{Weak Quality of Education}};$$

$$\text{Ha (3): } \mu_{\text{Migration}} > \mu_{\text{Weak Quality of Education}};$$

- Research Question (RQ4): Which is the preferred FDI entry mode in Kosovo?

Except for descriptive frequencies which are used to identify the characteristics of foreign investments in Kosovo, T-tests will take place for the hypotheses testing. T-tests are used to search for differences among the means of two groups of samples (Kallajxhë, 2016). Since, the groups of samples stem from the same population, paired samples T-tests will be used for the research purposes of this thesis. Frequency tables will display differences among various groups of firms operating in Kosovo. Groups' comparison will include firms where all shareholders are of non-Albanian ethnicity and firms where shareholders of Albanian ethnic background were involved. The distinction was made to determine whether the reasons for both groups of firms to invest in Kosovo differed. In the third part of the thesis which addresses the political risk of the country, firms cluster into two other groups: firms established prior to 2008, the year of Kosovo's declaration of Independence, and firms established after 2008. Research is conducted to evaluate how the political risk barriers differed among firms before and after the state-building processes' completion.

1 A LITERATURE OVERVIEW OF FOREIGN DIRECT INVESTMENT FROM THE HISTORICAL PERSPECTIVE

1.1 A Historical Perspective

Studies of the ancient trade system find that the practice of trade between ancient populations was used to ensure food, weapons, and spices necessary for their survival. As nation-states were established, the movement of goods in distant territories was recognized as international trade. Along the way in history, citizens and governments have always had a propensity to control resources and restrict others from accessing their territories. Phoenicians, great traders of ancient times, were vigilant about investments in their areas (Cartwright, 2016). In certain circumstances, throughout history, nations have seen foreign investments as harmful to their national resources. Decolonized countries perceived foreign investments as an instrument of powerful countries for undermining their sovereignty and manipulating domestic affairs; whereas, the socialist countries rejected free-market and private property principles, which resulted in denying foreign investments (Trakman & Ranieri, 2013). In contrast to the global era where countries compete in attracting FDI, they played no significant role up to the 1980s. History affects the present and as such can influence the future. In this regard, a better comprehension of the evolution of FDI demands an explanation of a few historical events that preceded the process of globalization, a period when FDI flows reached their peak.

1.2 Victorian Era 1837 – 1901

Queen Victoria's reign was a period of transformation of British society from a rural, land-working population to an urban and industrial one (Stagl & Fahrnberger, 2016). During the 18th and 19th centuries, the Industrial Revolution took place in Britain, a politically stable country, and a power of the time. The invention of the steam engine, development of textiles, and iron industry played a crucial role, having an enormous impact on the economy. It resulted in the expansion of urban areas, mass production, and construction of railways systems and steamships, with the latter facilitating the transport of goods overseas. Being the primary possessor of global capital, Great Britain transmitted the effects of the Industrial Revolution, mainly in Continental Europe and Northern America (Clark, 2010). The second Industrial Revolution marked the entrance of a new leading economic power – the United States. Precious natural resources, abundant workforce, state policies based on free-market principles prompted innovations and development. By 1890, the US had surpassed Great Britain, by doubling its per capita income, becoming the leading economic power in the world.

1.3 The World Wars Period 1914-1945

Globalization began in the 19th century, because of industrial development, which affected the rise of global trade, transfer of capital, and movement of people. Technological innovations facilitated trade, travel, and communication. The rise of nationalism, bilateral alliances among countries, and ambitions to gain new territories were some of the causes of World War I[1] (WWI). Millions of lives lost, trade, capital flows, and migration constraints were a few of the long-term consequences that led the world toward the Great Depression and World War II[2] (WWII). WWII left Europe and Japan destroyed; in the first decade, they had to face struggles of reconstruction, heavily-dependent on US financial aid. As the US was still recovering from the Great Depression, its involvement in WWII had an impact on economic growth, as American manufacturing oriented to fulfilling the increased demand for war products. This involvement dropped unemployment rates and brought prosperity, finding the US in a consolidated position in the post-war period (Baldwin & Wyplosz, 2012). After the 1950s, global economic growth raised the average GDP for developed countries at a level of 5% (Roser, 2019). However, constraints on international trade, capital flows, and free movement of people remained powerful. For communist countries, foreign investments were unacceptable; decolonized countries were still having an aggressive approach towards investors originating from ex-colonialist countries. On the other hand, developed countries still could not provide guarantees for the property rights of foreign investors. State policies of excluding foreign investments from specific sectors of the economy and prohibiting 100% foreign ownership were applied (Chang H.J. 2003).

[1] World War I – 1914-1918
[2] World War II – 1939-1945

1.4 Global Era

The recent decades have witnessed a significant growth of FDI, and this surge has been associated with a wider phenomenon: “globalization”. Defined as a trend that increases the interdependence of economic activities, technology, productivity, migration of labor, and cultures across borders, it shaped the way the world operates. The rise of international economic integration is attributed to the changes that took place by the end of the WWII (Teeple, 2000). As the shadow of communism was threatening Western Europe, the US provided financial aid for countries “West of the Urals[3]”, encouraging them to build up economic cooperation institutions. The establishment of organizations such as the European Economic Community (hereinafter: EEC), International Monetary Fund (hereinafter: IMF), the United Nations (hereinafter: UN), and the European Court of Justice (hereinafter: ECJ) helped to promote the liberalization of trade, the free movement of goods, people, and the elimination of trade barriers (Baldwin & Wyplosz, 2012). Even though the global economy has moved to trade based on liberalization, and the ideals of free movement, it was only the last decade of the 20th century when globalization effects became apparent. Technological development was crucial in facilitating communication and improving infrastructure. Many countries, being aware of the benefits of foreign investments, directed their national policies toward open-ness and attraction of FDI.

1.5 Interpretation of Foreign Direct Investment and Its Global Flows

Foreign Direct Investment is the process where a firm from a country provides capital to an existing or newly-created firm in another country. FDI is defined as “the process of obtaining assets ownership by a resident of one country (investing country) and thereby controlling production, distribution and other activities of a firm in another country (host country)” (Moosa, 2002). Among a variety of definitions, FDI is defined as “an investment involving a long-term relationship and reflecting a lasting interest, and control by a resident entity in one economy (foreign direct investor or parent firm) in a firm, resident in an economy other than that of the foreign direct investor (foreign affiliate)” (United Nations, 2017). The Organization for Economic-Cooperation and Development (OECD) defines control as owning at least 10% of property rights of a business.

Table 2 reflects the global macroeconomic environment and the level of FDI flows in the period of 2017-2018. The year 2018 marks a slight decline in the majority of macroeconomic variables.

[3] Ural Mountains – the traditional boundary between Europe and Asia.

Table 2. Growth Rate of Global Macroeconomic Variables and FDI Flows

Year	**2017**	**2018**
GDP (%)	3.16	3.03
Exports of Goods/Services (%)	10.21	9.17
Imports of Goods/Services (%)	9.9	9.94
Inflation Rate (%)	2.18	2.46
Unemployment Rate (15+) (%)	5.1	5
FDI Inflows (% GDP)	2.32	1.4
FDI Outflows (% GDP)	2.25	0.89

Source: World Bank, 2017-2018, *International Labour Organization*, 2017-2018.

The increase in FDI stocks as a percentage of Gross Domestic Product (GDP) in recent decades reflects FDI's contribution as an important source of economic growth. Globally, FDI stocks increased from 22% in 2000 to 38.9% in 2017. The advanced economies traditionally attracted up to 70% of FDI, also being the dominant source of FDI outflows by making up to 90% of the amount (European Central Bank, 2018). However, the advancement of emerging markets has shifted the FDI landscape, with the latter absorbing 50% of global FDI inflows in 2013.

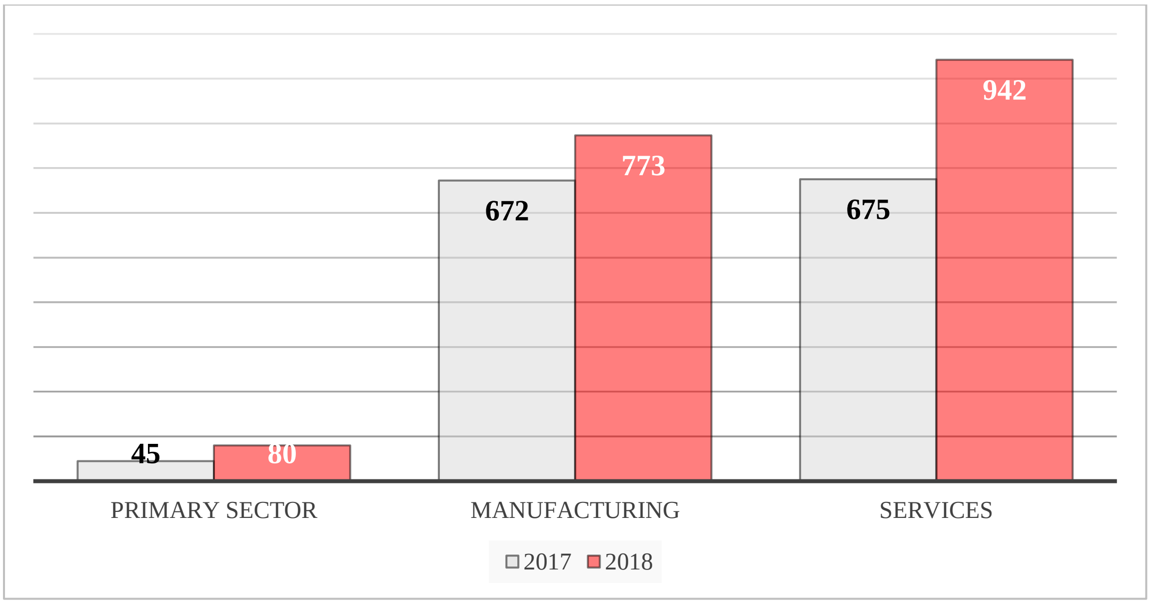
The year 2017 remarks a substantial improvement of global macroeconomic variables, followed by a slight drop in 2018. Fiscal reforms and the rise of business confidence in the US, the economic growth cycle in Europe and Japan, the expansion of natural resources exporting countries, due to the increase in commodity prices impacted growth. Contrarily, in 2017, there was a significant drop of 23% in global FDI inflows, at $1.43 trillion, compared to $1.87 trillion in 2016. The slide continued in 2018, with FDI inflows reaching only $1.3 trillion (United Nations, 2019). Developed countries and emerging economies experienced a sharp decline in FDI inflows in the two last years. The advanced economies' drop was primarily as a result of large repatriations of accumulated foreign profits by US Multinational Enterprises (MNEs), following tax reforms in the US, geopolitical risks such as BREXIT, elections in the European Union (EU), and the warning of the US administration about renegotiating economic agreements (North American Trade Agreement). Regarding transitional economies, a 27% drop in inflows reflects geopolitical problems and the lack of investment in natural resources. The inflow of global FDI remained stable in developing economies. The US continues to lead as the world's biggest FDI recipient, with China, Hong Kong, Singapore, and the Netherlands making the top five host countries in 2018. Japan was the largest investor in 2018, followed by China, France, Hong Kong, and Germany. Table 3 presents the global share of FDI while Figure 1 shows global flows of FDI by sector.

Table 3. Global Share of FDI

Region	FDI Inflows				FDI Outflows			
	2017	**%**	**2018**	**%**	**2017**	**%**	**2018**	**%**
World	1430	100	1297	100	1425.08	100	1014	100
Developed Economies	759	53.07	557	42.94	925	64.9	558	55.02
Developing Economies	691	48.32	706	54.53	461	32.34	415	40.92
Transitional Economies	48	3.35	34	2.62	38.45	2.69	38.17	3.76

Source: United Nations, 2019, *World Investment Report: Special Economic Zones*, p.3, Fig.1.2

Figure 1. Value of Global FDI Flows by Sector



Source: United Nations, 2019, *World Investment Report: Special Economic Zones*, p.9, Table 1.2
Values in Millions ($)

1.6 Pattern of Foreign Direct Investment in Western Balkans

Western Balkan countries have been less successful in attracting FDI compared to the rest of the Southeastern Europe. As formerly-centralized economies, because of specific historical and political reasons, they have faced a lack of capital movement. War images and ethnic conflicts still haunt this part of Europe, 20 years after the Kosovo crisis. There is a negative “Balkan Effect” when it comes to the absorption of FDI, which refers to the troubled past of the region and unsettled political issues, even when important other requirements are met (Estrin & Uvalic, 2013). Small national markets, low levels of intraregional trade, lack of sustainable development strategies were causes of low FDI inflows. The investment inflows were not significant during the 1990s. However, starting from the 2000s, a range of positive changes have been taking place in the region. Free market orientation was followed by deep economic reforms, restructuring of public property ownership, financial and technological activities. FDI is the major capital source for the Western Balkans; thus, governments are committed to progress on fiscal reforms and developing competitive strategies for FDI attraction. In support of the transition process, the International Monetary Fund (IMF) and the World Bank (WB) have assisted reforms in establishing macroeconomic stability in the region. Improved macroeconomic performance, growth of GDP, trade liberalization within the region and with the European Union, induced FDI inflows, even from global Multinational Enterprises (MNEs).

The competitive business environment, with low labor costs, abundant skilled labor, the supportive approach of governments, and first-mover advantage in a growing market are some appealing characteristics of the Western Balkans (Redzepagic & Richet, 2009). With many obstacles to be tackled, the market of around 20 million consumers aims to create sustainable economic growth for the region. Average GDP growth of 2.4%, in 2017, was driven by higher rates of trade, large investment projects, and an increase in commodity prices in the Western Balkans. In 2018, a growth rate of 3.8% was reached, supported by higher public spending and the rise of exports in Albania and North Macedonia. As recent fiscal stimuli and favorable external conditions forecasted positive prospects for the future, increased public discontent raises political uncertainty however. 190,000 new jobs were created in 2017, slowing to 96,000 jobs created in 2018, a decrease of 49.47%, which reflects limited dynamics in the private sector.

During 2017 and 2018, unemployment rates declined in the region by 5.6% and 7.7%, respectively, but in Kosovo and Bosnia-Hercegovina the drop was related to the emigration of the labor force. As government revenue increased in most countries, public spending on wages and social benefits was 21.1% of the region's GDP, with capital investments reaching merely 5.2% of GDP. Low productivity, inadequate government policies, and a difficult business environment hampered growth of the region. Advanced reforms and investments in human capital are necessary for the Balkans, to match the EU and ensure future growth (World Bank, Western Balkans Regular Economic Report, 2019).

Table 4 reflects the macroeconomic indicators of Western Balkans in the period 2017-2018, showing that GDP marked a similar growth rate for all countries of the region mainly induced through capital investments by governments and private consumption. The unemployment rate of the region remained the highest in Europe with an average of 19.46%, particularly high in Kosovo, North Macedonia and Bosnia-Herzegovina.

Table 4. Macroeconomic Indicators - Western Balkans 2017-2018

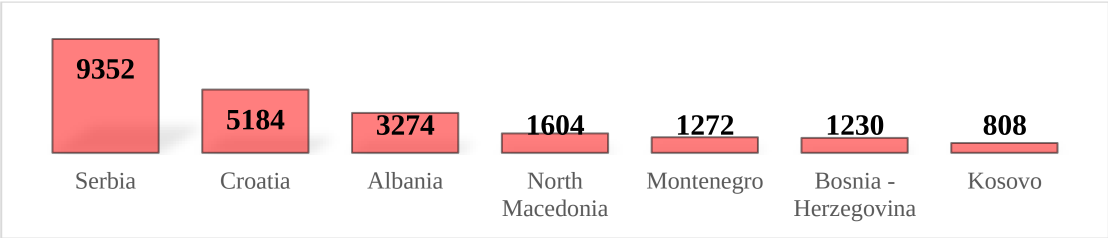
	GDP Growth (%)		Unemployment Rate (%)		Government Spending (%)	
	2017	**2018**	**2017**	**2018**	**2017**	**2018**
Albania	3.83	4	13.75	12.34	11.45	11.16
Bosnia-Herzegovina	3.16	3.06	20.52	18.4	19.82	20.02
Kosovo	4.22	4.14	30.34	29.42	11.72	12.04
Montenegro	4.71	4.85	16.07	15.17	18.66	18.71
North Macedonia	0.24	2.66	22.38	20.73	15.59	15.23
Serbia	2.04	4.3	13.47	12.73	15.92	16.67
Western Balkans	3	3.83	19.46	18.13	15.55	15.63

	Government Debt (%)		Inflation (%)		Wages (USD)	
	2017	**2018**	**2017**	**2018**	**2017**	**2018**
Albania	67.16	63.63	1.99	2.02	476.74	555.84
Bosnia-Herzegovina	26	24.8	1.16	1.6	763.12	822.5
Kosovo	16.22	17.12	1.48	2.9	511.13	575.15
Montenegro	62.5	62.27	2.38	2.61	864.67	904.75
North Macedonia	39.5	40.7	1.35	1.45	617.85	683.5
Serbia	58.7	54.5	3.13	1.96	615.3	684.91
Western Balkans	45.01	43.83	1.92	1.64	646.04	704.44

Sources: World Bank, 2017-2018, *Global Economy Database,* 2017-2018, *Trading Economics Database,* 2017-2018, *CEICDATA*, 2017-2018)

Regarding the pattern of FDI in the Western Balkans, after a slight decrease in 2016, FDI inflows recovered in 2017 by 14.01% and in 2018 as well, at a rate of 20.35%. Macroeconomic stability, support for the private sector, and enhanced cooperation with the EU boosted growth. Croatia, an EU member, was the most attractive country for foreign investors overall. However, in the last few years, Serbia and Albania upgraded their position as FDI recipients. Serbia showed a growth of 22% in 2017, via re-invested earnings and inter-firm loans to their international business units. In Albania, the second-highest amount of FDI inflows was registered in 2018. The energy and mining sector absorbed the most significant share, and an increased volume of Chinese investments has been noticed. Mainly, re-invested earnings increased FDI inflows in Bosnia-Herzegovina, while, in the smallest economy of the region, Montenegro, inter-firm loans and investments in real estate doubled inflows. Figure 2 presents the FDI inflows of Western Balkans in the period through 2016-2018.

Figure 2. FDI Inflows of Western Balkan Countries 2016-2018



Source: *World Bank*, 2016 – 2018 / Values in Millions ($)

2 MOTIVES FOR FOREIGN DIRECT INVESTMENT

2.1 A Summary of the Motives Underlying Foreign Direct Investment

For all nations, stable economic growth is a priority. Significant research has been conducted to determine what drives economic growth, with FDI showing as an important instrument to enhance growth and development. Investment growth in the form of FDI has increased faster than most other international transactions, leading to a major interest in understanding the fundamental drivers of FDI. The reason why firms take the risk of expanding activities abroad, in the form of FDI, is thoroughly explored and produced in various streams of literature from many perspectives. Avoiding export obstacles such as transportation costs, tariffs, exchange rate risk, and exploiting firm-specific assets such as knowledge, managerial skills, or technological advantages impelled investors to expand abroad, choosing FDI as the mode. External factors determining a firm's decision to undertake foreign investments in a particular location are related to economic characteristics of the host country, approach toward FDI, trade restrictions, institutional factors such as government stability, political risk, lack of corruption, and enforcement of contract law. The level of control that FDI provides to investors enables firms to exploit competitive advantages more efficiently compared to other entry modes in the international market (Nayak & Choudhury, 2014). While many distinctive hypotheses have emerged to describe FDI motivations, no theory is widely accepted or dominant with every bit of new evidence adding additional elements and criticism to the previous ones (Blonigen, 2005; Franco, et al., 2010). Hence, a better understanding of FDI demands a further explanation of the basic motivations of a firm to invest abroad in the form of direct investments.

As many empirical papers explored the phenomenon of FDI, the taxonomy of theories regarding this issue differs among researchers; Vernon, Hymer and Dunning are mentioned for their notable contributions regarding research into the motives of FDI (Denisia, 2010;

Moosa, 2002). The first attempt to theoretically elaborate FDI was based on perfect competition theory treating FDI as part of international trade capital, also known as the Heckscher-Ohlin model (1933). This model suggests that countries with abundant wealth are willing to invest in countries with scarce capital, if the rate of return is higher and labor costs are lower. The theory assumes that countries are risk-neutral, considering only the rate of return as a key determinant of the process of decision-making to invest abroad. This hypothesis was not considered realistic regarding motives to invest abroad, as the world is characterized by imperfections in the goods and factor markets, which act as barriers to free trade and impede international investments (Denisia, 2010; MacDougall, 2009; Moosa, 2002). Two other hypotheses assuming perfect competition are the portfolio diversification hypothesis and the market size hypothesis (Agarwal, 1980). In FDI decision-making, the first hypothesis views risk as the decisive variable, while the other hypothesis considers a host country's market size, usually measured by GDP. While there is weak empirical evidence regarding the relationship between FDI flows and diversification, the size of the market appears to have a major impact on the relationship with FDI (Moosa, 2002).

The imperfect markets theory put forward by (Hymer, 1960) and (Kindleberger, 1969), emphasizes that in a world with perfect markets, there would be no foreign direct investments. Local firms would always have better information about the local market compared to international firms, thus implying imperfectness. Being one of the first to highlight the importance of market structure and investing firm’s characteristics, (Hymer, 1960) posits two major reasons why firms aim to attain control of another firm in a foreign country. As firms of different countries compete, sometimes it is beneficial for the firm to attain control of firms in other countries to remove competition and increase profits. The second reason lies in the basic idea of Hymer's dissertation - that firms may possess advantages in certain activities and they can exploit them further by establishing foreign affiliates. On Hymer's line of thought, (Kindleberger, 1969) gives weight to two conditions for FDI to take place:

- Investing firm must have some specific advantages to overcome the disadvantages of being a foreigner; and
- The distinct advantages could be patent-protected technology, economies of scale, managerial skills and the good name of the firm.

The internalization theory derives from imperfect markets justifying FDI decisions of firms involved in technology and intermediate inputs. Innovative firms engaged in the development of modern technology or inputs may find it challenging to sell the product to other firms, due to high costs. Therefore, the ability of the firm to use inputs or technology from a subsidiary leads to internalization abroad (Rugman & Verbeke, 2003). “The product life cycle” theory depicts four cycles of the life of a product in the market. When a firm presents an innovative product, it fulfills local demand and creates a competitive advantage. As other firms become capable of producing the same product, the slowdown process begins, forcing the source firm to undertake FDI abroad, to maintain its market share (Denisia, 2010). The theory became less important as the technological gap between the US and other countries narrowed. Production facilities could be located in another country since the first stage of the product life cycle, and the international system of production became too complex to be explained with a simple production cycle version (Moosa, 2002). In an oligopolistic environment, firms' decisions to become multinational can be triggered by the actions of other members of the oligopoly. Involvement in FDI seeks to reduce the risk of market share loss and considering internationalization at the same time as competitors keeps the investing firm up to pace with them. The theory fails to explain why the initial foreign investment was undertaken by one of the members of the oligopoly and ignores the importance of other FDI determinants (Moosa, 2003).

The internal financing hypothesis assumes that the expansion of FDI is affected by re-investing profits obtained in the host country. A tax-based explanation notes that repatriated earnings are a source of tax liability in the home country, inducing MNEs to finance FDI with foreign profits. The theory is partly significant for FDI expansion (Agarwal, 1980; Moosa, 2002).

It is the eclectic approach, probably one of the most influential theories that offered a more detailed explanation of FDI motives. Also known as the OLI paradigm, it suggests that if three separate conditions are met, a firm will undertake FDI activities. 'Ownership' refers to the importance of 'owning' some unique competitive advantages relative to other firms in the host country. Initially, advantages were related to the resources and capabilities of the firm at home, with FDI adding additional value. Ownership advantages were then further developed, including monopoly power, by creating some entry barriers for other firms, possession of scarce resources and capabilities, which led to higher efficiency and managerial competencies coordinating core advantages for the best interest of the firm in the long-term. Location is the second sub-paradigm where explanatory variables vary according to motives for FDI, home and host country of the investing firm and firm-specific characteristics. The advantage of using a business asset in a foreign country must be greater than its domestic use. The third part of the OLI model gives weight to transaction costs of using external arm's length markets[4]. As long as transaction costs of using intermediate products, technology, and information are higher than those of internal markets, it is worthwhile for the firm to expand through FDI rather than other modes of cross-border expansion (Dunning & Lundan, 2008). Configuration of the OLI paradigm heavily depends on the economic and political circumstances of the source and the host country, industry and, characteristics of the individual firm; thus, any change in OLI advantages leads to a shift in the internal or external position of a country relative to FDI.

[4] An arm`s length market describes a financial market consisting of parties that have no relationship or contact with one another aside from the transaction at hand.

A taxonomy developed by (Dunning, 2008) and interpreted by many scholars (Bitzenis, 2014; Franco, et al., 2010) identifies four main types of MNEs activities regarding FDI:

- Market-seeking FDI: MNEs are designed to meet the needs of a foreign market. An investment decision is based primarily upon features such as market size and market growth opportunities, and also on the presence of major suppliers, major competitors, and consumers with the investing firm making efforts to adapt the products to regional preferences and tastes in those markets.
- Resource-seeking FDI: MNEs are oriented to gain access to natural resources, raw materials, unskilled labor, technological capabilities, and managerial skills. The primary motive of resource-seeking FDI involves the acquisition of higher quality resources and production tools at lowered costs, therefore creating a competitive advantage in the market. It is also known as supply-oriented FDI.
- Efficiency-seeking FDI involves activities to promote efficiency and specialization of a MNEs' assets. An efficiency-seeking enterprise is mainly motivated to foreign investment, through the reduction of costs of production and the improvement of proficiency in the division of labor. It aims to benefit through economies of scale by taking advantage of the market structure, consumer demand, and state policies.
- Strategic asset–seeking FDI involves protection, or increase of ownership, advantages and reduction of those of competitors. The main distinguishing feature of this type of activity implies that the main objective of the investment is not exploiting existing assets but to acquire new assets in a foreign country and add value and comparative advantages to the existing portfolio of the investing firm.

Hence, the eclectic paradigm emphasizes that FDI only occurs if three OLI paradigm requirements are fulfilled. The OLI model combines previous theories of ownership advantages, internalization stemming from imperfect markets, and adds location as a third dimension tending to explain why a foreign firm chooses a particular country. Considered the most influential framework, the theory has also been subject to criticism because the multiple variables involved cause a loss of functional practicality. The vast numbers of FDI determinants that recent theories go through provide different empirical results regarding their significance relative to FDI, and this always varies depending on the time and circumstances the research takes place.

The traditional focus of scholars has been researching the impact of economic determinants on the level of FDI flows. This was not an unexpected occurrence considering that major theories about FDI and international trade were initiated by scholars of well-established countries. The approach of identifying potential FDI determinants should include the analysis of both economic and non-economic factors to reflect more significant results regarding this topic (Dung, et al., 2018). The size of the market is now the only widely-recognized major driving force in FDI inflows, as a large market is needed to allocate capital and maximize economies of scale effectively.

The market size theory suggests that the market size criteria should be fulfilled for an efficient application of production technology by foreign investors. Different variables such as Gross Domestic Product (GDP), GDP per Capita, Income per Capita, land area, and population density could be used as a proxy of market size (Randelovic, et al., 2017; Dung, et al., 2018). When foreign investors decide to relocate their production facilities to the host country, the national market size and economic growth prospects are strongly taken into consideration. Higher economic growth rates would result in higher consumer demand, leading to greater revenue opportunities, thereby increasing the motivation for investments. Positive market growth prospects ensure that foreign investors can make a long-term commitment to the host country (Iamsiraroj & Doucouliagos, 2015; O'Meara, 2015).

There are also empirical studies that document adverse or non-significant economic growth effects on FDI. During a recession, a host country tends to attract FDI in the form of mergers and acquisitions, with MNEs acquiring ownership of host bankrupted firms or those with major financial problems. Also, a low economic growth host country with abundant cheap labor force and natural resources could be associated with excellent prospects for future profits. Also, it can be quite likely that market size proxies are of no interest in export-oriented firms, which are usually motivated to undertake FDI due to cheap labor and transportation costs (Iamsiraroj & Doucouliagos, 2015).

Literature has been intensively studying the effect of macroeconomic conditions on economic growth and foreign inflows of investments. A stable country with a steady rate of growth would attract more inflows of FDI than a more unstable state (Alguacil, et al., 2011; Kurečić, 2015). Macro-level uncertainty appears to be detrimental for the business environment and, therefore, FDI. The performance of the proxies of the macroeconomic environment may determine the level of FDI inflows and contribute to the host country. Regarding inflation, as an FDI driver, changes in host country inflation rates are expected to adjust the net returns and decision-making of foreign investors. There is a prevailing opinion among researchers that inflation has negative consequences for FDI. High rates of inflation could diminish foreign investors' perspective of the host country by eroding the value of their profits and increasing uncertainty (Udoh & Egwaikhide, 2010; Sayek, 2009).

Other assertions note that very low inflation rates reduce nominal interest rates and therefore push down the cost of capital for investors, emphasizing that an inflation rate that does not exceed a certain threshold could have a positive impact on FDI inflows (Alshamsi, et al., 2019). Considering the issue of external debt, it represents a major source of investment funding and is commonly high, especially in the initial phases of economic development. If debt levels of a country are expected to overcome its potential repayment capacities, then distorting policies, including economic recession, taxation, or cuts in public spending should be anticipated, resulting in increased insecurity and lower investments (Tanna, et al., 2018). Nonetheless, the impact of debt cannot be perceived as entirely negative. The theoretical research indicates that foreign debt induces larger capital investments and therefore growth, with its adverse impact emerging beyond a certain level of debt. To ensure fiscal discipline, the EU has set the threshold of 60% GDP allowance on public debt (European Commission, Fiscal Sustainability Report, 2018; Clements, et al., 2003).

The classical theory regarding the impact of population on economic growth lies in the belief that a large population tends to hinder the economic growth rate of a country due to the scarcity of available resources. The theory, widely accepted in the 19th and the beginning of the 20th century, affected policies of large countries such as China and India, who applied mandatory or voluntary family planning policies (Aziz & Makkawi, 2012). Nonetheless, the classical view of population growth rate failed due to not taking into account technological advancement, which improves production and quality. Also, the recent economic growth and volume of FDI those countries absorbed imply that large populations have a positive relationship with economic growth and consequently FDI inflows. Population ageing is associated with the lack of an abundant workforce; a phenomenon faced especially by developed countries, shows the important impact of population on the economy (Donaldson, et al., 2018). A larger population in the host country provides economies of scale for many products within the domestic market, an abundant workforce at lower cost, and a broad base of skills. The bulk of graduates and professionals available in the market induce MNEs to invest in such regions (Gharaibeh, 2015; Randelovic, et al., 2017; Aziz & Makkawi, 2012).

Numerous studies have examined that countries with great reserves of natural resources tend to grow slower than scarce resource countries (Sachs & Warner, 2001). The role of the abundance of natural resources in absorbing FDI inflows, considering them to be a factor of attraction has been examined too (Asif & Majid, 2017). However, what might be the effect of FDI inflows for the resource-rich host country? Although, the abundance of natural resources is considered an attractor for FDIs, it is anticipated that the FDI inflow in the natural resources sector will lower the inflow in other industries. In countries which are rich in resources, FDI inflows are commonly oriented in the natural resources sector and exports, therefore usually hampering FDI positive spillovers, such as job creation, know-how, and technology transfers (Poelhekke & Ploeg, 2010).

The composition of exports consisting of natural resources reduces the exportation of manufacturing and services products, both being essential drivers of economic growth. Also, the abundance of natural resources may reflect the false confidence of nations, thus neglecting the development of their business environment. Rich resource countries' weak economies demonstrates the inability of public authorities to channel suitable policies, and failing to use the blessing of being naturally rich to attract investments (Gylfason & Zoega, 2000). Preference for a lower cost of production by corporations is one reason behind FDI. The availability of cheap labor is primarily important for export-oriented firms, and resource-seeking investors and this has contributed to capital flows from high-salary industrial countries to low-salary developing countries (Eckel, 2003; Slaveski & Nedanovski, 2002).

Moreover, a decline in transportation costs triggers FDI. In the US, around 30% of FDI outflows occurred in a territorial perimeter less than five thousand kilometers, while more than 80% occurred over distances less than ten thousand kilometers. However, there is a significant difference between FDI and trade levels when it comes to distant expansion. Trade activities are narrowed, with 60% of trade occurring at shorter distances, and this indicated that in a time where transport and communication costs have fallen significantly, FDI flows are expanding across the world. As high transportation costs would induce firms to replicate production in another country, the decrease in transportation costs would make it possible for businesses to better leverage cross-country cost differences. This is because MNEs face significant exchange costs compared to domestic firms, by importing their intermediate products and targeting downstream consumers (Alfaro & Chen, 2017). Transportation costs are a proxy for geographical distance and infrastructure quality. Basic facilities are necessary to attract investments abroad; the more the basic infrastructure is complete in an investment area, the lower the production cost of firms, encouraging firms to invest (Kinoshita & Kampos, 2003; Yu & Shen, 2013).

Telecommunication development and the reduction of transport costs have raised the question among scholars whether distance should matter on trade and FDI. Distance involves not solely transport costs but also costs related to financial transactions, communication, and cultural differences. As the importance of the distance effect has not decreased, despite the constant decline in transportation costs, many of the research practices, therefore, still include distance as a determinant of trade and FDI (Daniels & Ruhr, 2014).

Geographical proximity may lead to the exchange of information between firms and offer opportunities for personal exchanges. In contrast, the cost of information and technology transfer rises with geographical distance, making firms more willing to invest in proximate areas (Yu & Shen, 2013). Furthermore, geographic proximity leads to costs reduction for information, management, and monitoring. Hence, as many research studies imply a negative tendency between FDI and geographical distance, firms are more prone to invest in less distant countries with a similar language and culture. A common language makes communication simpler; it increases trust and reduces asymmetric information (Ly, et al., 2018).

Historical relationships, whether formal or informal, reflect the relations between countries. As formal relations are purposely established and take the form of treaties, agreements, and alliances, to foster shared national interests in one particular area, informal relations occur as a result of geographical closeness, colonization, and immigration bringing closer individuals and nations in the form of culture, race, and social relations (Makino & Tsang, 2011). Being near and familiar with the host country lessens ambiguities about the local market climate, and decreases transaction and psychological barriers. As formal ties among countries are established for the sake of shared objectives, they may be abandoned. However, the informal relationships remain persistent in influencing economic exchanges. The personal ties and previous business relations, comprising an extensive business network, induce investments. Hence, the presence of historical relations in the sense of culture and coexistence positively impacts business relations and, therefore, FDI (Bandelj, 2002). However, this is not always the case. Wars, land-disputes and other types of conflict between countries can mean hostile relations and bring long-lasting consequences in the sense of ethnic or racial hatred, lack of trust, therefore hampering economic progress.

Government incentives are known as any governmental action to influence the process of investment decision-making. Among the fiscal, financial, and non-financial incentives are grants, preferential loans, loan guarantees, support agencies, free trade, enterprise, and technology zones, and research & development. The aim of innovation policy should be to enhance the business environment by identifying the weaknesses and strengths of the host country and developing policies to improve them. Innovative ideas, technology, and a skilled labor force are strongly associated with the research and development process (Owczarczuk, 2013). Depending on the purpose of the investment, location, entry mode, and size of the investment, preferences toward government incentives vary among investors. Exemption from import duties and tax holidays matched with other factors such as labor cost and infrastructure seems to have a significant effect on attracting investors, being particularly important for export-oriented firms whose inputs consist of many imported components. Low corporate taxes and limitations on profit repatriation are other government important incentives. Countries pursuing major firms should orient their stimuli for investors on grants, land subsidies, and subsidized borrowing (Erdoğan & Ataklı, 2012; Rolfe, et al., 1993).

2.2 An Overview of Kosovo

Kosovo, a small landlocked country, accounts for 10908 km² and borders with: Albania, Serbia, North Macedonia, and Montenegro. Ranked as the poorest in Europe, the country declared its independence only in 2008, through a destructive and challenging path. 114 states (Government of the Republic of Kosovo, 2020) recognize it, and among them, 23 are members of the EU, while 25 are members of the North Atlantic Treaty Organization (NATO). Kosovo provides easy air, road and rail links to the EU. Albania's port of Durres is 242km away, Montenegro Bar 299km, and Greece Thessaloniki 329km. Several countries in the Western Balkans have made efforts to boost their infrastructure, enhancing their attractiveness for investments. However, sparse transport networks can severely restrict the connectivity between producers and consumers to global and regional markets.

Poor public infrastructure in the Western Balkans has been the case for a long time. The development of basic infrastructure, particularly in the former Yugoslavia, began later because of its political and historical fragmentation. Following initial international initiatives in the post-war period, Balkan governments increased domestic funds for capital spending, in line with the rise of donor funding. Nonetheless, the region's infrastructure remained well below the EU average. Within the Western Balkan area, Kosovo lagged behind other countries, mainly due to a legacy of under-investment and the armed conflict (International Monetary Fund, 2018). However, government policies were highly oriented to public infrastructure in the two post-war decades. The road network consists of 630km of highways and regional roads, connecting the main towns of the country.

Furthermore, 88% of regional roads and 74% of local roads are in good condition. Regarding the density of road infrastructure, Kosovo has 4.2km/1000persons, ranking above Albania with 3.5km and behind other regional countries: North Macedonia 4.3km, Serbia 4.8km, and Bosnia-Herzegovina 5.6km (Rashica, 2016). Two significant public investments funded the highways connecting Kosovo with Albania and North Macedonia. Route Seven, also known as “Ibrahim Rugova” highway, links the capital Pristina with the border of Albania. Its total cost neared 20% of GDP, making it the largest infrastructure project in the country. Even though the trade flows with Albania are still limited, the project was justified considering the importance of cultural links between Albanians. Also, having access to the seaport of Durres is an agreement of significance to Kosovo, signed by the governments of two countries recently. The Kosovo customs office in Durres was officially opened at the beginning of 2019. Route Six links the capital Pristina with the border of North Macedonia at a length of 65km. The excessive cost of the project was highly criticized (650mln €).

However, the strategic importance of both roads lies in the development of the shortest route that connects the Black Sea with the Adriatic Sea. The optimal ratio of volume/road capacity is one, and according to European and American standards, a rate below the coefficient of eight tenths creates the need for road reconstruction, expansion, or increasing the number of lanes to maintain a satisfactory level of functioning. Regarding the road network in Kosovo, only the two highways mentioned above match the optimal ratio one, while for most other roads, the average rate falls below of eight tenths, illustrating the need for improvement (Mazrekaj, 2016). The suitable relief enabled road infrastructure to be expanded throughout the majority of the country, providing the passage of approximately 10mln/t of commodities per year with Kosovo being the destination or transit country. The railway network accounts for 330km over the entire territory of the country. Currently, there is only one international line connecting Pristina with Skopje, and two local lines connecting Pristina with Peja and Fushe-Kosova with Elez Han (Infrakos, 2020). The network is obsolete, while the latest grant by the European Bank for Reconstruction and Development (EBRD) will cover the reconstruction of the current rail lines. Also, Kosovo Railroad X, the recent project signed between Kosovo Government and EBRD, forecasts the upgrade of railroad X which will connect Kosovo to the European network through Pan European Corridor VIII and Corridor X (EBRD, 2016).

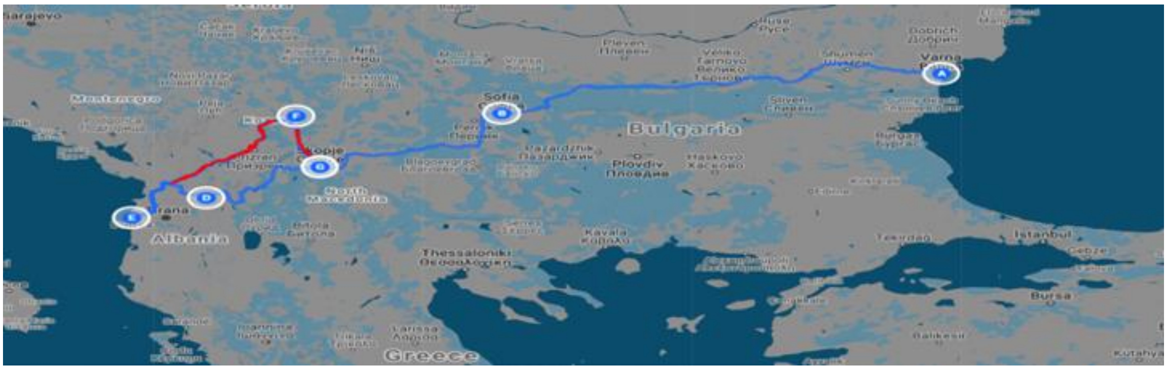
Regarding the airlines, Kosovo has only one airport, “Pristina International Airport,” which provides connections to main European centres, with an annual number of passengers reaching a record 1.88mln in 2017 (EX-YU Aviation, 2018). Kosovo does not meet its domestic needs for electricity. Energy interruptions, combined with major distribution failures, arising from obsolete and low-capacity power stations, weaken the quality of infrastructure in the country. Internet connection is stretched in 80.4% of the territory, a percentage above the region. Its strategic location in the Centre of the Balkan Peninsula gives Kosovo rapid access to other countries of the region.

The Western Balkans comprises a market with an estimated population of 20mln, excluding countries that became EU members already (Eurostat, 2020). Geographic proximity with Turkey, a market with a population of 80mln, the connection bridge of Europe and Asia, and the high potential of resources and trade is of importance. The Balkans improved its risk profile with global credit ratings confirming this economic outlook and is often called the gateway to Europe due to its geographical position between eastern and western countries. Easy access to EU markets is another crucial advantage of Kosovo. The geographic proximity, and the ratification of the stabilization and association agreement (SSA), enabled the establishment of economic relations with the EU. The access to Pan-European Corridors VIII and X, which will connect the Adriatic coast (Albania) with the Black Coast (in Bulgaria and Turkey) and Central Europe with Turkey, is expected to upgrade trade flows and investments in the country.

Kosovo's economic growth was traditionally far below neighboring economies' growth rate. The economic transformation from agrarian economy to industrialization was highly associated with the development of the mining sector. However, the events of the 1990s, not only caused de-industrialization but damaged physical and human resources, with the country starting economic reconstruction at an extremely low point. The post-war recovery was massively supported by foreign donations and remittances, leading the country on the right track of economic growth with a constant growth rate of GDP (Kirkpatrick, 2011). Over the last four years, Kosovo outpaced the region with an average economic growth rate of 4.2%. Nonetheless, the higher growth rate of population affected income per capita, still ranking Kosovo the last in the region with 4821$/capita slightly below Albania 5253$/capita and North Macedonia 6083$/capita. The main GDP components in the time frame 2013-2017 were private consumption of households, with an average of 85%, investments 27%, government spending 13.4% (United Nations, 2017). “A fragile growth” is the World Bank's assessment of recent higher rates of growth in Western Balkans. It is an economic model mostly based on spending and public investment that prevails in the region. Kosovo induced its economic growth by public investment, which tends to be at higher levels compared to its neighbors.

Figures 3 and 4 present the strategic connections of Kosovo ensured by investments in infrastructure.

Figure 3. Kosovo`s Strategic Connection - Pan European Corridor VIII



Source*:* (Google Maps)

Figure 4. Kosovo`s Strategic Connection – Pan European Corridor X

Source: (Google Maps)

The high degree of public investments is related to the necessity of the country to improve basic infrastructure. The quality of investments is often questionable (especially in health and education), raising doubts about project implementation and institutions' efficiency. A budget surplus is standard at the local level (10%- 15% y-o-y). Investments are financed mainly by internal sources. Regarding public debt, Kosovo has the lowest level compared to the region and Eurozone, but there's a high chance it will increase. Public debt in 2013 was 8.94% of GDP, while, in 2017, public debt was 16.63% of GDP; hence, an increase of over 100%. For comparison, rates of public debt in the region were as follows: North Macedonia 39.3%, Serbia 57.7%, and the highest in Albania at 67.8% (United Nations, 2017).

As for exports, an average increase of 15.8% during this period has reduced the trade deficit. However, the huge gap between exports and imports, with the latter increasing quickly and the former at a slow pace, meant a trade deficit opened up. A high deficit characterizes trade exchanges despite export rate improvements. The compounded annual growth rate of exported goods is 5.17%, covering only 12.4% of imports, in 2017. On the contrary, exported services cover 248% of imports (World Bank, 2017). Kosovo imports in a high percentage from the Central European Free Trade Agreement (CEFTA) and EU countries where the top four consists of Serbia, Germany, Turkey, and China. Regarding exports, countries where Kosovo mostly exports are Albania, India, Serbia, Macedonia, and Germany. Private consumption, an important driver of growth, constitutes 84% of GDP. It is highly reliant on loans and particularly remittances. Remittances are an important infusion for the domestic market, with an average of 703 million euros per year. Only 3.9% of this is used for business investments (Government of the Republic of Kosovo, 2018). Inflation, as an important indicator of family life quality, increased during 2017, in the region. For Kosovo, as an import-oriented country, the inflation rate is highly influenced by movements in foreign markets. The monetary policy is stable as Kosovo adopted the EURO as its currency, eliminating exchange rate risk and reducing transaction costs.

A diverse, financially healthy, and profitable banking system in Kosovo consists of commercial banks, which are mostly foreign branches, non-banking financial institutions, microfinance institutions, and money transfer agencies. Stress test analysis provides results of a stable banking sector capable of facing possible credit portfolio and liquidity shocks. Financial stability has increased recently, impacted by the economic growth of the country and improvement of payment capabilities of economic agents. According to (Moder & Bonifai, 2017), access to financial resources is a major concern for businesses in Western Balkans, more important than tax rates or corruption, for instance. The Global Competitiveness Forum 2017 ranks the region poorly on this issue. A survey of the (European Central Bank, 2014), showed that, in Kosovo, respondents had to pay a 12% interest rate while the lowest rate of interest was in Serbia at 7%. High lending rates in Kosovo are attributed to the high concentration of the banking sector. However, lately, as a result of competitive pressures, interest rates have dropped significantly. The effective interest rate is 6.6% for enterprises, and lending increased by 11.1% for this category, in 2017. Hence, as the country has made significant improvements regarding macroeconomic indicators, infrastructure, and business environment, the fragile growth should be converted into sustainable economic growth. Despite the recent growth rate, a 29.42% unemployment rate remains the greatest obstacle for the country.

Kosovo has been ranked 44th on the "Doing Business" report in 2019, behind North Macedonia and above all other regional countries. Progress in several dimensions of the business environment such as starting a business, construction permits, enforcing contracts, getting electricity, and trading across borders facilitated any enterprise aiming to operate in Kosovo. Three tax regimes are applied in Kosovo: personal income tax, corporate tax, and

VAT. A new fiscal policy, to reduce informality was approved in 2015, adjusting the tax rates as follows:

- Value Added Tax: 8% for services and food basket/ 18% for all other items;
- Corporate Profit Tax 10%;
- Income Tax (progressive): 0% - 10%;
- Mandatory Pension Contribution: 5% in gross salaries;
- Customs: 0% import tariffs on production lines and equipment for production, raw materials, and IT equipment.

Table 5 presents the tax system of regional countries, reflecting possible country differences.

Table 5. Tax System of Regional Countries

	Standard V.A.T	Corporate Tax Rate	Personal Income Tax Rate
Albania	20	15	0-23
Bosnia-Herzegovina	17	10	0-10
Kosovo	18	10	0-10
North Macedonia	18	10	10
Montenegro	19	9	9
Serbia	20	15	10-20

Source: *Trading Economics Database*, 2018 / Values in Percentages (%)

Quick access to large markets, abundant workforce, rich natural resources, and agricultural land make the country appropriate for investments to blossom.

- <u>Agriculture</u> - Kosovo has an agricultural tradition, with around 52% of farmland and 62% of the population living in rural areas. However, the distribution of land into small parcels prevented economies of scale, reducing productivity. Domestic consumption is supported by imports with a growing demand due to living standards rising. Fruits and vegetables, livestock and meat processing, milk, and dairy products will grow in demand domestically and across the region. Investment opportunities and profits are foreseen in these sectors (Government of the Republic of Kosovo, 2018).
- <u>Energy</u> – Kosovo does not fulfill internal demands for energy. Currently, 98% of energy is produced by two thermal plants and a few small hydro plants. Reserves of lignite rank Kosovo the fifth in the world and the current legislation does not restrict private entities to request licenses for lignite exploration, providing opportunities for potential investors. Due to environmental concerns, the construction of wind power plants is supported by the government. A project of wind power plant construction has been approved lately by the government (170 million euros, foreign strategic investment); another major project in the energy sector is “Kosova e Re” thermal plant construction,

with a forecasted value of over one billion euros (Government of the Republic of Kosovo, 2018).

- Tourism - Tourism is growing in the region. Kosovo natural environment, beautiful landscapes, and high mountains represent valuable resources. Potential for developing winter tourism has remained unexploited. Brezovica Skiing Centre and “Borea” in Rugova Valley, two projects still in their initial phase, aim to make Kosovo a regional Centre of winter tourism (Government of the Republic of Kosovo, 2018).
- Mining and Minerals have been traditionally an important sector for the economy. Kosovo owns sources of chrome, nickel, aluminum, iron, zinc, gold, and has large reserves of lignite. There have been plenty of foreign investments in this sector, and Kosovo exports a range of metal products to around 15 EU states. However, many firms entering the market through the privatization process failed to meet their obligations. Also, Trepca, Kosovo's largest mine, which employed 22,000 workers during the 1970s, operates in constrained capacities due to its un-resolved status as an enterprise (Government of the Republic of Kosovo, 2018).
- Healthcare Industry – A weak healthcare system inherited from ex-Yugoslavia continues to hamper citizens’ life. In 2017, approximately 200 million euros were spent by Kosovo’s citizens for healthcare services out of the country. High demand and the lack of previous investments make this sector highly attractive (Government of the Republic of Kosovo, 2018).
- Food Industry - Considering Kosovo's current account deficit and high reliance on imports, there is a wide range of opportunities to meet market demand in the food industry (Government of the Republic of Kosovo, 2018).
- Construction and Technology - Construction remains one of the most profitable sectors due to the expansion of major cities, whilst the IT & Technology sector potential promises growth considering the young labor force’s capabilities and government policies to support this sector (Government of the Republic of Kosovo, 2018).

2.3 Motives for Foreign Direct Investment in Kosovo

The economic challenges Kosovo faces are considerable. The fragile economic growth demonstrates the need of the country for FDI. With the lack of access to international financial markets, FDI remains the most important external source of finance. However, inflows of FDI have been characterized by continuous political and economic problems. Even though not at a satisfactory level, FDI inflows maintained their steady increase. The aim of the questionnaire in this part of the thesis is to shed light on the motives of foreign firms for investing in Kosovo. By identifying their motives, it will be easier to find out the advantages and disadvantages of the country, both being essential for the establishment of a genuine strategy for the attraction of foreign investment. Elements included in the questionnaire were selected based on the literature overview and modified to the circumstances of Kosovo. Table 6 presents the motives of foreign firms to invest abroad.

Table 6. Motives of Foreign Firms to Invest Abroad

No	Description
1	Low Labor Costs
2	Local Market
3	Regional/Continental Market
4	Local Suppliers
5	Double Taxation Treaties
6	Incentive Packages
7	Cultural Closeness
8	Geographical Proximity
9	European Perspective
10	Export Base
11	Quality of Infrastructure
12	Previous Business Relations
13	Economic Stability

In figure 4 are introduced the main motives of foreign firms to invest in Kosovo. Also, an analysis of possible differences among firms owned by shareholders of Albanian ethnic origin, and firms of shareholders of other ethnic backgrounds will take place below.

Figure 5. Motives of Foreign Firms to Invest in Kosovo

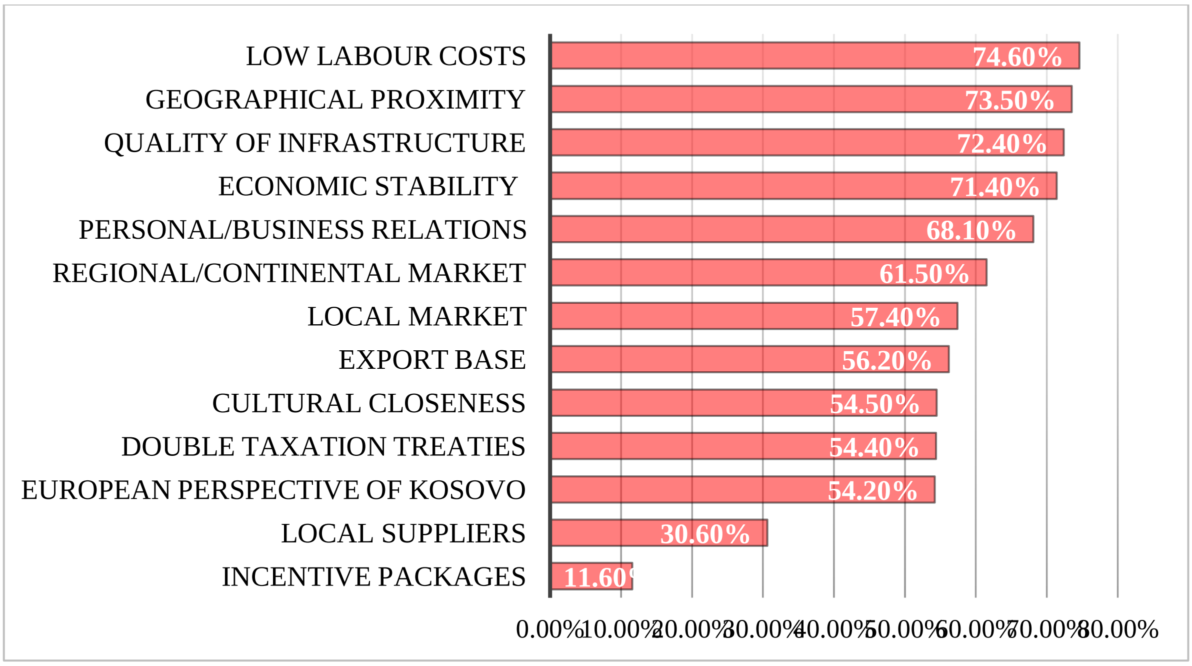


Figure 5 shows that FDI inflows in Kosovo were attracted mostly by low labor costs, geographical proximity, quality of infrastructure, and economic stability. Personal/ Business relations and regional/continental market scored more than 60%. There is only a slight difference among local markets, export base, cultural closeness, tax system, and EU perspective as determinants of FDI. The majority of foreign investors consider that the country does not provide attractive incentive packages. Low labor costs derived from the young workforce and the highest unemployment rate in the region.

Not surprisingly, it was an important determinant of FDI inflows in Kosovo, as the focus of FDIs has been trading and services so far; both sectors are characterized by wages lower than the average income in the country. Geographical proximity follows as the second most important determinant, with 30% of foreign investments in the period through 2007 – 2018 coming from Balkan countries and 51.4% from Western Europe. Geographically well-positioned, the country managed to reconstruct its infrastructure, building a network of roads that stretched all over the country, highways that connect well to domestic and neighboring states' cities. The Internet network is also widely-used by households and businesses, even in rural areas, ranking the country above the region regarding internet usage.

A component of infrastructure where Kosovo lags is the problem of energy supply. However, the problem is more apparent in rural areas and remote villages. Quality of infrastructure ranked as the third most crucial factor shows that the energy supply does not have a significant effect on hampering investments. The continuous macroeconomic stability, reported by the World Bank, has ranked fourth of the motives of foreign investors, indicating that the government is on the right path by improving the business environment. Our results affirm that previous personal contacts or business relations seem to be crucial for the first sight impression of foreign investors, indicating that there is a lack of data provided from appropriate bodies to international firms.

The local market was considered important or particularly important by 57.4% of participant firms in the survey, indicating that the local market, which consists of 1.8 million inhabitants, is the main target of foreign firms. 56.2% of investors ranked export as an important motive to invest in Kosovo, where the preference for the regional/continental market ranked slightly above the local market. Kosovo does not provide a much more favorable tax regime compared to regional countries, but is not disadvantageous either. A fiscal package that included exemption from import tariffs for production equipment, raw materials, and technology was an effort of the government to induce private investments. Kosovo also signed bilateral agreements with states to eliminate double taxation for non-resident taxpayers. However, this factor lies at the bottom of the table, not being crucial for investors. Many empirical studies imply that EU integration boosted FDI inflows to South-Eastern European countries (Medve-Balint, 2014; Sakali, 2013).

Kosovo progressed in its EU integration path, signing the stabilization and association agreement, which liberalized trade between Kosovo and the EU. A significant step forward for the country, however, it failed to impact economic growth and attract investments, mainly due to the lack of experience and quality of firms operating in the Kosovo market, to face competition from the EU. This fact reflects in the results of our survey, where the EU perspective as an attractor of FDI is ranked at the bottom of the list. Nonetheless, the EU perspective should be particularly important for investors aiming to export to EU countries. Regarding local suppliers, foreign firms are less likely to purchase from them. The survey result reflects the trade deficit of the country; machinery, chemical products, plastics, transport vehicles make around 40% of imported products, all being important tools for business firms (Government of the Republic of Kosovo, 2018). Incentive packages provided by the government were the least important for foreign investors and the result indicates that there should be additional efforts by the government to attract foreign investors.

Existing empirical research about FDI motives indicates that there is no significant difference among Western Balkan countries and Kosovo, in terms of the motives of FDI in the region. In Albania, Serbia, and North Macedonia, similar to Kosovo, low labor costs, geographic proximity, economic stability, and business/personal relations were important motives for foreign investment. Also, the easy access to regional and EU markets is a common motive for firms to undertake investments in the Western Balkans. As economies of scale and creating an export base is the primary motive of foreign firms to invest in Serbia, in Albania, 72% of investors targeted the local market as a motive for investment, followed by geographic location, and investment incentives (Bitzenis & Szamosi, 2009; Bitzenis & Žugić, 2014).

Regarding our empirical results, Kosovo could be classified as attractive to ‘resource and efficiency hunters’. As mentioned in point 2.1 of this part of the thesis, efficiency-seeking firms aim to promote efficiency or specialization at lower costs, benefiting from the market structure, public policies, and consumer demands in the host country, while resource seekers in Kosovo hunt for low labor costs and managerial skills. This conclusion should serve as a hint for government institutions to note the motives that are essential to such firms. Moreover, as the motives of foreign firms to invest in the Western Balkans are similar, absorbing higher levels of FDI relies heavily on the development of strategies that could generate competitive advantages for the host country. Maintaining the improvement of economic stability and the business climate should be combined with favorable incentive packages. Promoting the country’s values and enhancing contacts with potential investors is another important pillar.

Foreign firms’ orientation mainly towards trade and services indicates that they are seeking workforce capabilities. Thus, building skills is necessary, a long-term goal, and not an easy task. Within a landlocked country like Kosovo, it is not easy to achieve a satisfying economic growth rate by relying solely on local consumption. Considering the market orientation towards exports of 40% of foreign firms, survey participants consider that the country should concentrate more on productivity and increase its export potential.

Our first hypothesis implies that there is no statistically significant difference between the two primary motives of foreign firms to invest in Kosovo: low labor costs and geographical proximity. A paired sample T-test was conducted to compare whether there is a significant difference between the two variables. There was a significant difference in the scores for low labor cost (ME 3.51 SD 1.39) and geographical proximity (ME 3.08 SD 1.10) conditions; t – 11.72, p – 0.000. The result indicates the rejection of the null hypothesis Ho (1), implying that there is a statistically significant difference between the two variables, specifically low labor cost has a higher mean compared to geographical proximity.

$$\text{Ho (1): } \mu_{\text{Low labor costs}} = \mu_{\text{Geographical Proximity}};$$

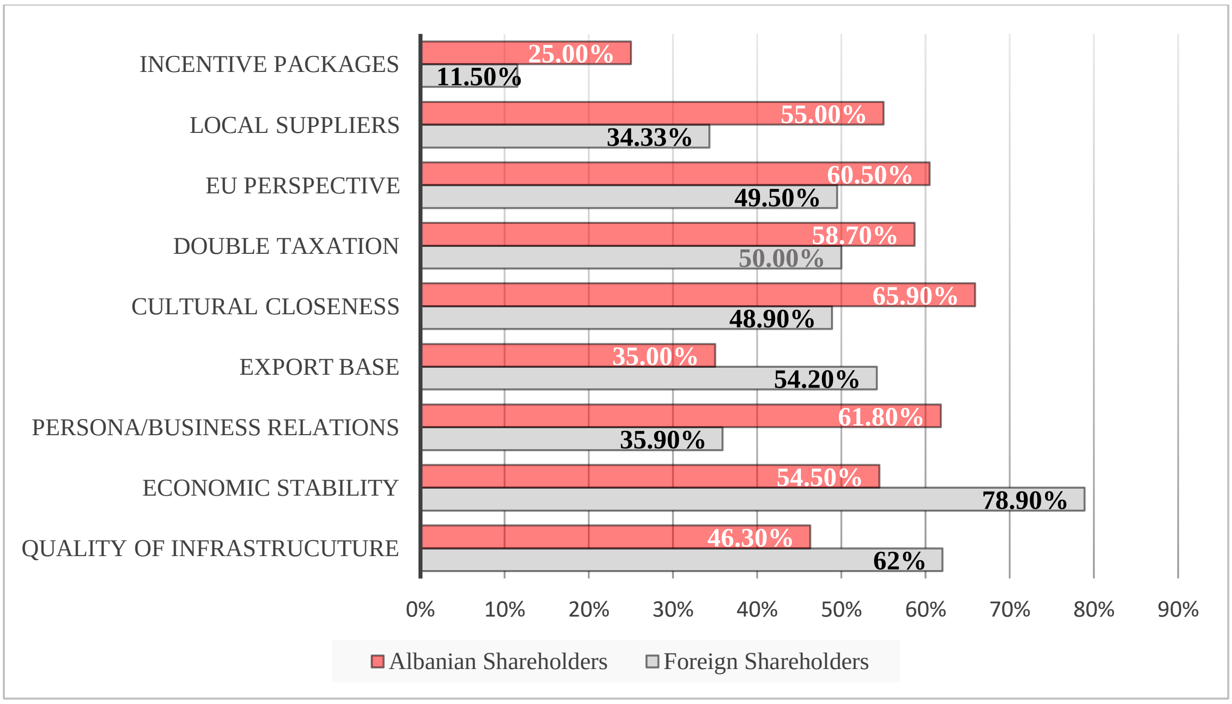
$$\underline{\text{Ha (1): } \mu_{\text{Low labor costs}} > \mu_{\text{Geographical Proximity}};}$$

2.4 Differences between Albanian and Foreign Investors

Cultural closeness has been recognized as a significant motive for foreign firms to invest in a foreign market. Cultural closeness, which might be language, religion, ethnic background, or business culture, was assessed as an essential motive by 54.5% of foreign investors in Kosovo. 63.6% of participant firms in our survey had entirely foreign ownership, while 36.44% consisted of Albanian shareholders. Clustering the data into two groups of shareholders reflected the significant differences among them. Figure 5 presents the differences in motives to invest abroad of foreign and Albanian shareholders. Regarding the importance of cultural closeness, it was ranked as the 3rd most important motive of investing in Kosovo by foreign firms of Albanian Ownership, and as the 10th by entirely foreign firms. This result reflects the strong ties of the Albanian Diaspora with the country of origin. An average value of 700mln € of remittances, investments in real estate, and frequent family visits to the country indicate the commitment of migrants to maintaining relations with Kosovo. Efforts by the government should be focused on redirecting the Diaspora's capital to investments that would generate economic growth, employment, and long-term positive spillovers. The usage of remittances up to now was mainly oriented on private consumption, implying that a significant amount of these monetary amounts purchased imported products, thus indirectly flowing out of the country.

Figure 6 shows the differences in motives to invest in Kosovo of foreign and Albanian shareholders.

Figure 6. Differences in Motives to Invest in Kosovo of Foreign and Albanian Shareholders



Observing the motives of investors of an international background and those of Albanian ethnic origin to invest in Kosovo, significant differences in views were found on the quality of infrastructure, export base, geographical proximity, cultural closeness, and the EU perspective. Cultural closeness and personal/business relations are far more important for Albanian investors and reduce the significance of other motives in their decision-making process. For foreign investors, having no cultural or emotional closeness with Kosovo, the country seems to be important as an export base implying the significant importance of geographical proximity, quality of infrastructure, and low labor costs for them.

3 RELEVANCE OF POLITICAL RISK AND HUMAN CAPITAL TO FOREIGN DIRECT INVESTMENT INFLOWS

3.1 Some features of Political Risk

Political instability generally has a negative effect in an investment environment, reducing FDI flows and, in turn, causing slower economic growth. Most transitional and developing countries are politically unstable and suffer from poor governance. Nonetheless, decent results can be achieved by better performance on lowering political risk and enhancing economic growth. The host country's political risk has been a significant component of foreign investment decision-making since the rise of FDI flows in the 1980s. Protective policies of the host country, such as foreign ownership constraints, limiting the sectors in which foreigners can invest, or the imposition of unfavorable tax rates make political risk a significant factor in the decision-making process. Looking back at the historical development of political risk, this concept was part of ideologies such as nationalism and Marxism until the 1970s. As the subsequent years showed a rise of FDI flows, the judgment of potential investors was increasingly influenced by political risk. From this point on, the concept of political risk was analyzed not solely by the development of quantitative methods but from a social sciences perspective as well, such as psychology and sociology. But, what might be the role of the political risk of the host country in attracting foreign investments? In all its simplicity, political risk relative to FDI refers to potential political events that could impact the investor's profitability.

Many researchers draw their conclusions on the role of political risk in attracting foreign investments. A consensual finding implies that the risk of political instability harms the host country's business environment and discourages investors by increasing their insecurity regarding direct costs and future returns. Since foreign investors seek profit-generating projects, they tend to require a higher rate of return on investment in a challenging business environment, thus restricting the range of potential projects in which they can invest. Political risk could be classified as macro-risk affecting the whole business environment, and micro-risk affecting an industry, sector or firm. Macro-risks such as expropriation of foreign firms, limitations on foreign ownership, and restrictions on the number of foreign workers are more visible, but micro-risks, which tend to hit a particular firm or industry, are more important to firms. Political risk can be classified into three main categories:

- The transfer risk or the risk related to the transfer of funds, products, and people;
- Risk of capital control, which is related to any unfair treatment of foreign investors, limitations of foreign ownership and expropriation;
- Operational risk, which consists of the host country’s policies, administrative procedures, and legal regulations (Clark & Tunaru, 2005);

A more thorough assessment of a country's political risk is shown in the combination of economic and political indicators. A country's risk is affected by the level of economic progress, assessed by metrics like the rate of economic growth and GDP per capita. Substantial concerns include protectionism, trade barriers, and capital flow constraints. In terms of external and internal political factors, those that weight the most are government stability, level of democracy, bureaucratic procedures, regional or international political conflicts, the level of international cooperation, and the host country's approach toward foreign investors. In the past, political risk has been related to nationalism, control, capital flow limits and inhospitable feelings for foreign investors. Today, political risk has another dimension. Nowadays, political risk determinants vary across researchers, however common indicators usually found in the literature include: government stability, the rule of law, corruption, terrorism threats, respect of human rights, and currency stability (Khan & Akbar, 2013).

3.2 Components of Political Risk in Relation to Foreign Direct Investment

Like any other risk, political risk harms the economy. Even though it did not receive much attention compared to economic determinants, mainly to the lack of data, a growing number of scientific papers have evaluated the relevance of political risk to FDI inflows. Political risk indicators limit flows of FDI, but these limitations vary according to each country's features. Political risk in large countries does not represent an important concern to investors; empirical evidence shows no significant differences among politically stable and politically unstable developed or large economies and the level of their FDI inflows. Political risk is much more significant in small economies as an initial condition taken into account in the process of investment decision-making. A negative relationship between FDI inflows and political risk is more notable for upper-middle-income countries, being slightly significant for higher-income countries too (Khan & Akbar, 2013). The saturation of domestic markets leads investors to invest abroad in foreign capital markets. As the process of market saturation is more common in stable and developed countries, there is a tendency of capital movement to emerging or least developed economies seeking for new profit opportunities. It is these regions where political risk fluctuations are not rare. It is challenging to achieve government stability in the weak and newly-established democracies, which relates to the government's ability to fulfill its mandate and its program.

Frequent changes show indications of instability in the host country regarding policies and treatment of foreign firms, thus raising the uncertainty of foreign investors. Since FDIs involve long-term commitment, the bargaining power of host governments may lead to policy changes to obtain a more significant share of benefits. Hence, stable governments and multi-political bodies are important to limit policy changes lifting the opportunity to attract more FDIs as they increase policy predictability. About the host government's approach, expropriation has traditionally been described as the principal threat to foreign assets from local governments. This phenomenon faded over time by the change of FDI structure. Initial foreign investment flows have been concentrated on the host countries' natural resources, gradually moving into production and services. The growth of the global chain of MNEs made assets' expropriation worthless for host governments, making other indirect policies such as taxation, tariffs, and selective law enforcement an investment policy concern. Therefore, policies aimed at restricting government intervention and at promoting trade and openness to attract investment should help (Buthe & Milner, 2008).

Trade openness is defined as the approach of promoting free trade of goods, services, and capital in international markets. Expressed as the ratio of the total amount of imports and exports to Gross National Product (GNP), trade openness positively influences economic growth and inflows of foreign investments. Access to major markets, production inputs, or spillovers of technology, are some of the advantages associated with trade openness. Although the flows of foreign investments vary across time and countries, empirical research strongly suggests that international trade agreements substantially increase the level of foreign investments by providing greater and safer access to new markets. From a political dimension, commitment to international agreements imposes specific rules, and any violation of these principles bears costs. These costs probably would be lower in circumstances of domestic policy violation, thus reducing the risk of policy changes that could harm the business environment (Buthe & Milner, 2008).

Commitment to International Organizations, World Trade Organization (WTO), or Preferential Trade Agreements (PTA) facilitates identifying members who renege on their commitments by monitoring policies' implementation, and annual reports analyzing each country's macroeconomic performance and host government behavior. Given the endless tools for changing the business environment that could hit investors' profitability, a liberal system with limited government interventions in the economy seems more attractive. Except for multilateral trade agreements, expansion of the domestic market by preferential trade agreements could arouse the interest of third countries (not being part of the agreement) to make investments in the expanded local market. Hence, commitment to either multilateral or preferential trade agreements reveals liberal policies, competition, and peaceful relations among countries, thereby boosting the level of FDI to the involved countries (Pandya, 2016).

Socio-economic conditions that refer to the social welfare, wages level, workplace conditions, and education determine the overall satisfaction of the society, thus influencing the business environment and stability in the host country, resulting in a positive relationship with FDI inflows (Ökten & Arslan, 2013; Cleeve, 2012). Unfortunately, there is a lack of sufficient empirical evidence of the direct impact of FDI on socio-economic conditions growth. But, whatever types of FDI such investments carry, business growth, job creation, and technological advancement are a valuable tool for fostering socio-economic development. Research, however, indicates that improving socio-economic conditions leads to increased savings and new domestic investment opportunities (Busse & Hefeker, 2005).

In a narrow definition, corruption is defined as the usage of public power for private benefits. Considering various corruption forms such as fraud and bribery, the empirical research shows mixed findings regarding the impact of corruption on FDI inflows. Most of the findings show a negative relationship between inflows of FDI and corruption (Bayar & Alakbarov, 2016; Cuervo-Cazurra & Genc 2008). Increasing uncertainty, extra costs, financial and human capital commitment to managing bribes are some of the challenges in a very corrupted business environment. While this practice is considered illegal, the noncompliance of the pledge of favors or facilitation by the investing firm cannot be referred to the court for damages or misuse of cash. Except for the negative impact of corruption; some scholars show a positive connection between FDI inflow and the latter under certain circumstances. Ethically unacceptable, corruption may, in some circumstances, facilitate transactions and accelerate procedures in projects or contracts that are otherwise hard for implementation. This is more obvious in transitional economies with no effective institutions and legal regulations (Al-Sadig, 2009; Cuervo-Cazurra & Genc, 2008). However, its adverse effect on economic stability, infrastructure quality, education, and healthcare makes it a social disease and an important location determinant.

Another critical issue of improving the FDI performance of the host country is to consider the impact of historical relations on the performance of FDI. A severe historical conflict like a war between countries can create a deep hostility engraved in the mind of the citizens of a war-victim nation. Findings show that foreign investors are reluctant to invest in regions that have suffered a high number of civilian deaths during wars before any decision about the FDI location is taken, origins, evaluation, and consequences of the conflict should be deeply understood (Hayakawa, et al., 2013; Gao, et al., 2017). Typically, the process of reconciliation between ethnic groups involved in a historical conflict is long and tough because of the negative feelings of the people of each group toward one another and sentiments that pass from generation to generation. Strong efforts are required to build confidence, accept each other, and establish bridges for cooperation on mutual needs.

Therefore, confidence has a significant effect on investors` willingness to invest in another country. The issue of trust is also linked to the cultural proximity of investors being more prone to invest their capital where the culture and mentality of society are easier to understand (Guiso, et al., 2009)**.** If culture promotes trust and has a significant impact on economic exchanges as a system for moral values and behavioral standards, then religion is an important variable of cultural proximity. Religion's moral values consist of a language that is implicit and unique, generating cultural closeness and trust. A few questions could be addressed regarding religion's role as a cultural proxy among nations. As at the Centre of all economic activities is the person, it is her/his personal and cultural characteristics that decide how and with whom they interact. While globalization tends to bring down cultural differences, culture is the principal driver that distinguishes people in distinct groups. But what is the importance of culture, and more particularly, religion in the globalization era of economic exchanges and investments? While globalization has introduced a universal way of living, various cultural elements are embodied in distinct groups of people, differentiating them from each other and even raising concerns about possible preservation of their cultural identity.

An important influence of human behavior is religious beliefs; many religions regard trade as a need while others as an activity of creating values, logically having their impact on economic activities. Sharing religion as a common value increases trust between trading partners and investors, -enhancing the flow of business cooperation, trade, and investments (Helble, 2007). This is particularly important for countries with poor institutional framework quality. Religious similarity and religious diversity are found to promote FDI. Regarding religious diversity, the philosophical rationale implies that trade and investments foster in more open-minded, innovative, and less risk-averse societies. However, in situations of a weak institutional framework, religion-based diversity increases the risk of religious tensions (Helble, 2007; Hergueux, 2011). The negative effect of any religious tension on the business environment raises the voices to increase tolerance among different religious groups and to further investigate the role of culture in economic prosperity (Dolansky & Alon, 2006; Rafat & Farahani, 2019).

Regardless of the motives and interests of investors, any security threat in the host country will repel them. Security stability is seen as a crucial factor in a favorable investment climate. It is not very easy to invest in a country that does not provide proper physical security for the investor's workers and its capital. The decision to invest in a post-conflict country will always be affected by the status of the area and whether the conflict is truly over (Fahad, 2014; Ali & Gang, 2016). As the level of safety in the host country is the initial factor considered by potential investors, there are sometimes concerns that FDI outcome could threaten national security. Concerns about national security sometimes limit FDI inflows. Limitations are related to reliance on foreign-controlled suppliers for goods and services crucial to the functioning of the country. The transfer of technology or other expertise to an externally-controlled entity that could be used in a harmful way, harming the host country's national interests also constrains FDI inflows (Graham & Marchick, 2006).

3.3 Political Risk in Kosovo

Based on the literature review regarding the relevance of the political stability of the host country towards FDI, in the section below, the evaluation of Kosovo's political environment will be presented. The analysis will describe events, obstacles, and determinant factors that shape the country's political climate in the context of historical circumstances, empirical research, and statistical data, attempting to reflect the importance of the relationship between the country's political risk and the level of foreign investments.
When discussing the political risk of a country, probably one of the most crucial factors an investor pays attention to is security stability and the lack of conflicts that could threaten its capital. The Western Balkans has a history of disputes and political instability, with Kosovo being the heart of the crisis. In the past, several rulers controlled the territory of Kosovo. In its recent history and, contrary to the will of the majority of the population (ethnic Albanians), initially it became part of the Kingdom of Yugoslavia by the end of WWI and an autonomous region of the People's Republic of Serbia, part of the Yugoslav Federation in 1945 (Domachowska, 2018). Regarding the economic system, Yugoslavia adopted a socialist economic model, which initially was similar to that of the Soviet Union

with its typical features: economy controlled by the state, central planning, and major means of production controlled by the public. Distancing from the Soviet Union (mainly due to the poor relations between leaders of both countries, Tito and Stalin), the federation moved forward an economic reform plan based on the socialist Yugoslav model. Maintaining basic elements of socialism, such as state ownership of production means, reforms gradually morphed the economic system toward decentralization. Public enterprise management was transferred to the employees, aiming to stimulate their efficiency but always keeping ownership rights with the public. Reforms with free-market elements, such as relaxation of price controls and decentralization of the banking system, which was followed with the establishment of sectorial banks for agriculture, investment, and foreign trade, took place.

The strategy of elevated levels of investments to foster economic development resulted in success. Economic mid-term plans, with priority given to investments in heavy industry and long-term plans that defined the course and issues of economic development that needed to be addressed, improved living standards. There was a GDP growth rate with an average of 6% through the 1950s to 1970s for the countries of the Federation of Yugoslavia. The General Investment Fund (abolished in 1963) and the Regional Fund were established to channel the economic development priorities for the growth of less-developed republics and regions (Uvalic, 2018). Despite the growth, a country that insisted on remaining faithful to socialist principles failed to manage macroeconomic problems, such as unemployment and inflation, properly. The Federal Development Fund, established to induce the growth of undeveloped regions (Kosovo, Bosnia-Herzegovina, and Macedonia), obligated member states to contribute 2% of their social product to the fund. The difference in living standards between the developed and the undeveloped regions was nevertheless high. For instance, in Slovenia, the social product per capita was eight times higher, in 1989, compared to Kosovo.

Different debates, opinions, and research papers have been written concerning the question of “What caused the fall of Yugoslavia?” The rise of Serbian nationalism and its aspirations to dominate the region is considered as the principal cause of a decade of conflicts and destruction. Around three decades after the fall of Yugoslavia, the region remains the poorest in Europe, with the lowest level of income per capita and higher rates of unemployment. The decade of armed conflicts in the 1990s hampered the transition process, while flows of foreign direct investments in the region have been delayed. A history of diversity, territorial aspirations, and ethnic conflicts still bears the image of the region. Nevertheless, the peripheral area of Europe drew the attention of Western Allies by initially intervening to cease the ethnic cleansing in Bosnia-Herzegovina and Kosovo and, thereafter, assisting economic reforms and adding a modern European perspective to the region (Uvalic, 2018).

The roots of the ethnic conflict in Kosovo can be traced back to historical events. While Albanians regard themselves as Illyrian descendants – the indigenous people of the Balkans, hence they are autochthonous with incontestable Illyrian cultural and ethnic continuity, Serbs consider Kosovo as part of the territory of old Serbia and the cradle of their cultural, religious, and national heritage. The myth of Serbians over Kosovo dates back to 1389 when the famous battle of Kosovo took place near a region of what is now Pristina. The Balkan allies were beaten, and the region fell under the Ottoman rule. The lack of historical records about the battle shows that the latter gained importance in the upcoming centuries in the Serbian national mythology. Serbs treated the battle as a confrontation between them and Ottomans, a clash between Islam and Christianity, while the war was more of a conqueror-defender conflict than a titanic struggle between the two civilizations (Šuica, 2011).

The London Conference of 1913 made Kosovo part of the Kingdom of Yugoslavia, while the Paris Conference of 1946 recognized a degree of autonomy for Kosovo within Serbia. Discrimination on Albanians on an ethnic basis over the 20th century made them require a republic status for their territory via massive demonstrations. In 1974, a significant level of autonomy was recognized for Kosovo, and this period is known for its economic and educational improvements, investments in infrastructure, and cultural affirmation. However, the economic development was highly concentrated in heavy industry (exploitation of natural resources), and this was perceived as "economical utilization" of Kosovo for the needs of Serbia. At the same time, the province remained the most impoverished region of the federation. Poverty and mistreatment of Albanians, which comprised a population number similar to Slovenia and higher than Montenegro, made them revive their request for the status of a republic within Yugoslavia, demanding equal economic and judicial rights like other republics. Military forces brutally crushed the demonstrations of 1981, initiated by students and strongly supported by the population (Demjaha, 2017).

In 1989, inspired by the myth of the Kosovo battle (1389), Milosevic[5] deprived Kosovo's of its autonomy; the conflict reached a new level with Albanians being dismissed from their jobs, prohibited from education in their language and being exposed to human rights violation. Accordingly, Albanians started their peaceful political movement led by Ibrahim Rugova[6]. At the referendum of 1991, 99% of the population voted in favor of independence, therefore, in compliance with the wish of the people of Kosovo, temporary institutions were established. Dr. Rugova was appointed as the President of the country while the interim government had its headquarters in Germany. However, international recognition was not achieved. Except for separate institutions, a separate educational and healthcare system was established. The mission of this political movement (Democratic League of Kosovo) led by President Rugova, and hugely supported by the population, was

[5] Slobodan Milosevic – President of Serbia (1989-1997)
[6] Ibrahim Rugova – President of Kosovo (1992-2006)

to make Kosovo's request for independence internationally recognized. The continuity of repression by Serbian authorities and the non-recognition of the Kosovo issue internationally, despite warnings of political observers of a potentially violent conflict, led to the establishment of the Kosovo Liberation Army. The armed conflict of 1998-1999 involved the killing of thousands of Albanians, around one million refugees fleeing their homes and destruction of property and the economy. NATO intervention put an end to the conflict, the Serbian military withdrew, and Kosovo was put under international administration (Domachowska, 2018).

Kosovo's ethnic composition from the last census of 2011 consists of Albanians 92.9%, Bosnians 1.6%, Serbs 1.5%, Turks 1.1%, and others 2%. Since the conflict has not been solved yet, ethnic Albanians and Serbs rarely mix. The Serbian minority is concentrated in the northern part of Mitrovica, which is not adequately controlled by Kosovo institutions; they do not recognize the state of Kosovo, receiving pensions from and applying the education system of Serbia. The constitution of Kosovo guarantees ten parliamentary seats for the Serbian minority, and few parties politically represent them. Although incidents among ethnic groups are rare, war wounds are still fresh, and perhaps it remains for future generations to achieve a full reconciliation. A more significant obstacle for the new state is the constant attitude from Serbia of hindering its consolidation, with the conflict remaining one of the most challenging issues still not resolved in the Western Balkans. Serbia continues to recognize Kosovo as part of its territory, ignoring the fact that Kosovo is independent. To delegitimize Kosovo's status, Serbia encourages tensions between Kosovo Serbs and state authorities. The dialogue between two sides facilitated by the EU has the purpose of establishing peace and security for the region, also inducing cooperation for progress in the common path of EU integration.

However, expectations for concrete results have reduced due to rejection by Serbia and the lack of unity of the EU toward the independence of Kosovo. Since the dialogue initiation in 2011, the parties succeeded in signing several agreements: free movement of people, recognition of customs stamps and return of civil registers seized by Serbs, recognition of university diplomas, an energy agreement that regulated the supply of electricity for Serbians, and a telecommunication agreement, that allowed Kosovo to have a country code. Apart from the technical deals, an important agreement of political character signed in 2015 was about the establishment of the “Association of Serb Municipalities”, which was the basis for a higher degree of self-governance for municipalities of Serbian majority under the judicial system of Kosovo. The agreement anticipates the abolition of Serbian parallel structures governing in the north of the country and giving control of the border to the Kosovo authorities. The agreement was strongly opposed by opposition parties in Kosovo, claiming that the implementation of this agreement would lead to the federalization of the country. At the same time, the Serbian opposition considered it a step further in recognizing Kosovo's independence. Of 17 technical agreements, only four of them have been fully implemented, five of them have been partly implemented with the remaining parts pending implementation (Kosova Democratic Institute, 2018). Blocking Kosovo's membership in international organizations, such as the International Criminal Police Organization (Interpol), or the United Nations Educational, Scientific, and Cultural Organization (UNESCO), the diplomatic campaign of Serbia to convince different states to withdraw Kosovo's recognition and the recent idea for territorial exchanges have stagnated state-building; increasing the number of reluctant states to recognize Kosovo and setting the country into a security dilemma (Columbia University & Kosovar Institute for Policy Research and Development, 2018).

Prompt of international trade and multilateral agreements of trade reduced tariff barriers, but many countries have been oriented to non-tariff barriers as a way to control trade and protect domestic markets from imports. Kosovo is not a member of the World Trade Organization (WTO) yet, but has free trade agreements with a few countries. These agreements obey WTO principles but the country lacks the benefits of membership due to political reasons. Benefits of becoming a WTO member include equal treatment with other WTO members, lower trade barriers and harmonized legislation regarding international trade, access to developed countries at lower tariff rates, additional assistance and grants provided for least developed countries, and handling trade disputes. Kosovo's reluctance to apply for WTO membership comes from the fear of rejection by countries that did not recognize it yet. However, membership is a prerequisite of EU integration, and institutional authorities emphasize that they will announce the application soon (Nagy, 2015).

Kosovo became a member of CEFTA in 2006 (represented by the United Nations Interim Administration Mission in Kosovo - UNMIK) with elevated expectations for a positive impact from the agreement. The free trade agreement was an opportunity to boost exports, trade, and attract foreign investors. The trade deficit, however, remained huge, especially in commodities. Common obstacles faced by private firms are various non-trade barriers such as customs procedures and technical obstacles of trade that hinder a rise in exports. Issues related to customs procedures refer to all the phases associated with the cross-border movement of commodities and make up 38% of customs barriers. Technical barriers such as technical regulations and assessment standards of the products reach a rate of 28%. Quantity restrictions like quotas on imports and exports make 13% of the identified barriers. Trade barriers faced by Kosovar firms are imposed at higher rates by Serbia and Bosnia-Herzegovina 50%, Albania 22%, Croatia 17%, Macedonia 6%, and Montenegro 6%. From CEFTA members, Serbia is the most important trade partner of Kosovo, followed by Albania. Serbian trade barriers imposed on Kosovo, which are both costly and time-consuming include:

- Products whose origin is “Republic of Kosovo” cannot be imported into Serbia and Bosnia-Herzegovina;
- Dumping prices for agricultural or industrial products;
- Unpredictable changes in customs procedures;

- Non-recognition of quality and sanitary analysis issued by Kosovar authorities;
- Long waits at the border;
- Kosovo-based firms that use Serbia as a transit road for imports are required to obtain an import license issued by Serbian authorities;

Regarding Albania, the second-largest trade partner, barriers include non-recognition of quality and sanitary analysis issued by Kosovar authorities and seasonal reference prices applied to agricultural products of Kosovar origin. While North Macedonia and Montenegro cause 12% of trade barriers, they are mainly related to technical regulations and standards for particular products (Sutaj, et al., 2018). Trade disputes with Albania are usually solved through intra-governmental dialogue, those remain unsolved with Serbia due to political problems and no solution has been found so far to any compliance with CEFTA mechanisms. Violation of CEFTA principles by Serbia (that promote free trade and prohibition of tariff and non-tariff barriers among member countries) is justified by the fact that Serbia is not violating principles towards UNMIK/Kosovo but instead it is acting against the Republic of Kosovo, a state that the neighboring country does not recognize.

Nevertheless, Kosovo could be accused of the violation of CEFTA free trade principles, after the 100% tariff imposed on imported goods with Serbian or Bosnian origin. This step was taken by Kosovar government, rather than an economic measure. It has a political character coming as retaliation to Belgrade’s attempts to undermine its statehood by campaigns to block Pristina's bid to join Interpol and other international organizations and appealing for its recognition withdrawal by states that already recognized Kosovo. But what are the consequences of the import tariff? Initially, the tax failed to benefit domestic producers as statistics show no significant increase in domestic production or employment. The tariff, imposed as a political reaction rather than an economically-analyzed measure, benefited regional countries, which replaced the drop in Serbian imports (88%) and Bosnian Imports (83%). The primary beneficiaries since November 2018 have been Slovenia, which increased its exports to Kosovo by 125%, Israel by 659%, and Turkey by 34%, and the price of the consumer shopping basket has increased (Balkan Insight, 2019). CEFTA mechanisms have proven inefficient on disputes settlements since the party that imposed illegal measures must vote for CEFTA to regard it as an illegal action. A new dispute settlement mechanism that is close to WTO rules has been negotiated in CEFTA, but its implementation has not started yet.

As trade barriers of Kosovo within CEFTA are mainly of administrative and customs procedures, exporting to the EU entails technical barriers. Kosovo signed the SSA with the EU in November 2015, remarking the first official step toward the process of integration. SSA aims to assist the economic transition of Kosovo, liberalizing trade and providing directives regarding standards, certification, customs procedures, competition, and intellectual property. It also includes the commitment to introduce a series of reforms, to strengthen regional cooperation through the adjustment of economic and political common priorities, to develop an effective institutional framework, and to move toward the harmonization of national legislation with the EU. As barriers have already been eliminated for some products, just after the agreement, a free trade regime will be implemented gradually, within 5 to 10 years, for goods and services. Successful implementation of the agreement demands progressive efforts of the government to reconstruct the internal market, improve the business environment and enhance innovation, to create competitive advantages and boost exports and comply with EU technical and quality requirements, product compliance and unification standards. Since the signing of SSA in 2015, exports (% GDP) increased from 21.93% to 27.88% in 2018. Nonetheless, Kosovar firms have faced difficulties competing in the EU market and matching international standards of production. 21.3% of them declared they have challenges with quality management and higher exporting costs compared to other regions (Group for Legal and Political Studies, 2018).

The government of Kosovo outlined its commitment to strengthen the investment climate, and support for the private sector, including legal regulations about foreign investors, an issue relatively new for the country. However, tracing back to the past, pieces of legislation with regard to foreign investors' treatment could be encountered in the former Yugoslavia. In 1978, the former Yugoslavia initially allowed foreign investments by approving the "Law on Investment of Foreign Persons". The law, however, was restrictive with high requirements for the invested capital and limited profit repatriation. Foreign investors were also made to adopt Yugoslav self-management rights of workers, a demand often unacceptable for foreign firms (Gray & Stiblar, 1992). The cornerstone of the Kosovo FDI legal framework is the law in foreign investment nr. 04/L-220 (Assembly of Kosovo, 2013), and the law nr.05/L-079 approved in 2016 (Assembly of Kosovo, 2016). The primary purpose of this law was to attract foreign investments in Kosovo by providing them essential legal rights in harmony with international standards of investors' treatment. The law consists of 26 articles with a few of them explained below:

- Article nr.3: Guarantees equal and similar treatment of foreign and local investors;
- Article nr.4: Guarantees equal treatment regardless of ethnicity, race or religious background;
- Article nr.5: Guarantees that the Republic of Kosovo will fulfill all obligations that may derived from laws applicable in the country toward foreign investors;
- Article nr.7: Guarantees that the Republic of Kosovo will not undertake any direct or indirect expropriation and nationalization of the assets of foreign investors except in particular public interest cases, and in such a situation immediate compensation will take place according to law procedures applicable in the country;
- Article nr.8: Emphasizes that in cases of expropriation or nationalization, the foreign investor will be compensated in a currency that can be freely exchanged into other currencies with a LIBOR plus 2% interest rate beginning at the date of expropriation and nationalization and ending at the date when the compensation is entirely completed;

- <u>Article nr.11:</u> In the event of armed conflict or civil unrest, the state of Kosovo is obliged to compensate the foreign investor if the damage to its assets has been unnecessary;
- <u>Article nr.14:</u> Allows foreign investors to employ foreign workers to exercise their activities, providing residence permits according to the longevity of the working contract. During their stay in Kosovo, foreign investors and foreign workers are subject to the laws in force in Kosovo;
- <u>Article 15:</u> It provides that a foreign investor may cease its operations in Kosovo and that physical and non-monetary assets may be repatriated. The investor has the rights, after payment of the tax liabilities, to convert and transfer the monetary assets acquired into Kosovo;

Another step of crucial importance regarding foreign investors' treatment is the approval of the Law for Strategic Investments Nr.05/L-079, aiming to facilitate bureaucratic procedures for potential investors in Kosovo. The law intends to promote, attract, and create the conditions for the implementation, administration, and control of strategic projects. Targeted sectors are energy, tourism, and agriculture without excluding mines, technology, health, food industry, and sport. Criteria for a potential investor to qualify as a strategic investor are as follows:

- A minimal amount of investment (ranging regarding the investment sector);
- Minimum number of new jobs created (varying regarding the investment sector);
- Respecting environmental criteria of EU;
- The potential investor must guarantee to fulfill up to 60% of the investment;

The government provides technical assistance, land, and property (with the price determined by an expert in procurement procedures). Based on each case, the Inter-Ministerial Committee consults with the Kosovo Investment and Enterprise Support Agency (KIESA) and makes a recommendation. At the same time, it is the government deciding whether the status of a strategic investor should be granted to the interested party. The exclusive right of the government to make decisions upon strategic investments has raised concerns of Non-Governmental Organizations (NGOs) about corruption possibilities. Similar legislation is in force in Albania and Croatia, while other regional countries like North Macedonia and Serbia provide grants and financial aid to foreign investors. Favorable fiscal packages including tax breaks, avoidance of double taxation, and tax deduction for annual income, Value Added Tax (VAT) exemption and a subsidy up to 50% of the costs of new jobs created are provided across the region, aiming to attract foreign investors. The Western Balkans has thus evolved in terms of the FDI flows in the last decade. Regarding Kosovo, the Law for foreign direct investments/strategic investments put the country on a competitiveness map of the region (Gap Institute, 2016). However, in the fourth year after the approval of the law, only one strategic investment was recorded. In February 2019, the government approved a project in renewable energy with a value of 170 million euros. An increased control and accountability of government negotiations (e.g. approval of parliamentary investments), better business environment, favorable fiscal packages, and innovative projects all combined should connect the country with greater FDI inflows in the future.

Kosovo's political bodies have a new history. Its institutions were established in 2008 as the country declared its independence. The constitutional framework determines Kosovo as a parliamentary democracy with a multi-party system designed to preserve pluralism and guarantee ethnic diversity as well as ensure women's representation in the system. Since the establishment of its institutions, a history of short-lived governments has characterized the new state. None of the parties has ever won 60+1 parliamentary seats; thus, coalitions before or after elections were unavoidable. The political unprincipled coalitions could explain the fragility and their short life, often imposed for the sake of the state-building process. None of the post-war governments could complete its 4-year term, instead usually averaging a 2-year term in governance. Nonetheless, the government's unsustainability does not automatically make the country undemocratic. Kosovo has been suffering from the longevity of bad decision-making. (Freedom House, 2018) has qualified Kosovo as a semi-consolidated democracy or hybrid regime. The 4.93 democracy rating in 2018 is the highest score the country ever reached, however still lacking behind the region.

Kosovo has an extraordinarily complex and volatile rule of law, unique regarding its background and foundation. In the 1990s, Albanian prosecutors and judges were dismissed from legal institutions, being allowed to exercise only the role of defense attorneys in a system entirely controlled by politics. Following the NATO intervention, the United Nations mission UNMIK, which operated under the Security Council Resolution 1244, was focused on short-term challenges, including the judicial system, attempting to fill the gaps and ensure normal life in a post-war society. In continuation of this mission, after the foundation of governmental institutions of the country, The European Union Rule of Law Mission in Kosovo (EULEX) was established. The police and civilian resources make the largest civilian mission of the EU, and it aims to assist the authorities of Kosovo in establishing stable and autonomous legal institutions. As it previously had executive functions, initiating investigations and judging selected cases, its mandate with monitoring and operations pillars was extended until June 2020. As well as assisting local institutions to increase effectiveness, accountability, be free from political interference, and matching the best practices of the EU, the mission has capabilities as a second security responder in support of Kosovo police. With the constitution being the primary legal document, the rule of law is still in the making. The paper that shapes the legal system of the country was drafted, being highly-influenced by the constitutions of developed countries, consequently, many provisions are not guaranteed or respected. Limited implementation and political influence in appointing and controlling judges and prosecutors represent huge challenges of the rule of law (Gashi & Musliu, 2013). The annual (World Bank, 2018) report, which estimates the magnitude of the rule of law, respectively the perceptions of the degree to which agents trust and respect social rules (especially the quality of contract enforcement, property rights, courts and the probability of crime and violence) ranks Kosovo the last in the region.

The inefficient rule of law and the fragile political system in transitional countries have led to an increase in corruption under formal institutions. A wave of international aid has marked the period of reconstruction. In the following years, international institutions such as the OECD and World Bank initiated programs to encourage good governance and anti-corruption policies, since initially deviant behavior was tolerated due to post-war circumstances (Belloni & Strazzari, 2014). In Kosovo, cases of corruption trials and assets' confiscation have been low, and given the (Transparency International, 2018), in the period 2013-2018, the country is ranked as the most corrupt in the region by an average score of 35.7, followed by Albania with 35.5 and Bosnia-Herzegovina 34. This indicates that corrupt practices have become the norm. The phenomenon could be distinct in two categories: the grand corruption which is generally considered harmful by society, and the petty corruption, which is widespread in all levels of the community and is deemed essential to achieve the fulfillment of any need (Spezio, 2017).

There are several reasons that explain the use of corruption as a survival tool; Kosovo went through a double transition – from war to peace and from communism to democracy, creating preconditions for the growth of corruption. From the armed conflict emerged criminal organizations often working closely with political leaders. The post-war elections gave power to political leaders with nationalist rhetoric who thereafter used their institutional positions to establish ties and influence with groups of interest and retained their power through clientelism. Also, the law provisions adopted from developed countries, that have no similar characteristics with Kosovo's circumstances, and the tolerance of the international community toward this phenomenon, cultivated it in higher structures of public institutions, for the sake of peace and stability, and has worsened the situation. In the perception of the public, corruption represents the biggest threat to the country (16% of respondents), followed by political issues (15.6%) and unemployment (14.1%). Perception of corruption in public institutions, rank courts as most corrupted (50.8% of respondents), prosecution (49.3%), municipalities (29%) and Kosovo police (29%) (Avdiu, 2019). Kosovo's Criminal Code prohibits any form of bribery, money laundry, and abuse of office, with penalties ranging between 1 to 10 years imprisonment. A vital requirement of the EU before Kosovo could be granted visa-free traveling in the Schengen area is the fight against corruption. Addressing this issue requires long term efforts at all levels of governance. The law anti-money laundering, the audit of political parties financing, the introduction of a mechanism to track high-profile corruption cases, declaration of assets for senior public officials represent some sparks toward progress.
By the end of the XIX century, the fall of the Ottoman Empire was followed by the establishment of national movements by the nations until then under Ottoman rule. Examining the historical significance of religion in the polarized Western Balkans, religion was closely affiliated to ethnicity and has been used by politicians as a tool to breed

mistrust among people and induce violence. Ethnic groups were unified by their religious beliefs to build their national identity, ties that remain important (Elzarka, 2018).

Albanians were the last of the Balkan nations to begin their national movement for independence, and, contrary to other nations, they had no common religious belief, being divided into three main religions. Demands of the Ottoman Empire and neighboring countries to divide Albania based on its religious map pushed the Albanian Renaissance to put its efforts for unification based on secularism. Albanians identified themselves by their language and common culture rather than religious diversity, with tolerance and peaceful coexistence of religions stemming from this orientation. Kosovo is a secular country with its legal constitution prohibiting religious discrimination, subject to limitations for ensuring public order, health and safety or protecting the rights of others. The religious demography identifies that out of 1.8 million of the total population, 95.6% declare themselves as Muslims, 2.2% as Roman Catholics, and 1.4% Serbian Orthodox. Being under communist rule and the long years of resistance for national survival have set religion as a secondary issue among Kosovar Albanians. The population rejected every attempt of promotion of political Islam, and the religious clergy (Islamic and Catholic) worked according to the national agenda for resistance and freedom. Immediately after the war of 1999, only 5.8% of Kosovar Albanians declared they were regular practitioners of religious rules, 12.2% several times per month, and 28.9% several times per year.

However, a revival of religion, specifically Islam (since most of the population holds this belief), has emerged in the following years, due to internal and external factors. A weak economy, high levels of poverty, and the lack of control by international supervisor mechanisms and local institutions later let the road open to many humanitarian international organizations with a religious character, coming from Persian Gulf countries, especially Saudi Arabia on one side, and Turkey on the other. This new form of Islam, known as “Wahhabism”, aimed to promote political Islam, increasing intolerance toward secularism, religious plurality and paling national identity. Middle East religious organizations invested around 800mln $ in Kosovo since the end of the war. The effects of such investments and the influence of radical religious preachers, educated mainly in Saudi Arabia, started emerging in the last decade. Young people with a dress style, behavior, and religious practices, different from traditional Islam cultivated over centuries, were not rare all over the country. Political parties with an Islamic agenda won seats in Parliament. Concerns about external influences, the spread of radicalism, and national safety was raised, as the number of young Kosovars joining the war in Syria reached 314 people (the largest number of fighters per capita joining ISIS in Europe). These recent events have created a bad taste in the long-living tradition of a moderate Islam in Kosovo. However, the strong reaction of state authorities, including the ban on activities of many religious organizations, investigations of preachers suspected for radicalizing young people, and approval of the law which permits punishment up to 15 years of prison for each Kosovar citizen who joins foreign wars have settled matters normality (Kosovar Institute for Policy

Research and Development, 2016). Rare attacks against religious monuments stem from ethnic tensions rather than from religion.

Kosovo Police, Security Forces, and Kosovo Force led by NATO are the responsible authorities for the security of the country. The annual report regarding the global peacefulness level in 2018 classifies Kosovo as a country with a medium level of peacefulness, being ranked in 92nd position, in the same group as North Macedonia and Bosnia, both of them ranked in higher positions. Albania, Croatia, Serbia, and Montenegro are classified as a group of countries with a high level of peacefulness (Institute for Economics and Peace, 2018). The global terrorism index, which measures the extent to which terrorism threats the security of a country clusters Kosovo and regional countries in the group of countries with very low impact of terrorism on its security (Institute for Economics and Peace, 2018). The risk of crime in Kosovo is moderate. Undoubtedly, the lack of sustainable economic development impacts the rate of crimes in the country. Robbery often targets properties of migrants (homes, businesses, and vehicles), assuming they are affluent. Regarding public safety, 52.4% of citizens perceive Kosovo as a safe country, while a higher percentage feel safer at micro-environments such as home, village, or city. In citizens' perception toward security threats, organized crime scores 20%, followed by murders 4% and theft 3%. It is important to highlight those issues such as problems with Serbia, corruption, unemployment, and political confrontations are perceived as the main threats to internal security in Kosovo (Kosovar Center for Security Studies, 2018).

3.4 Obstacles of the Kosovo Political Environment

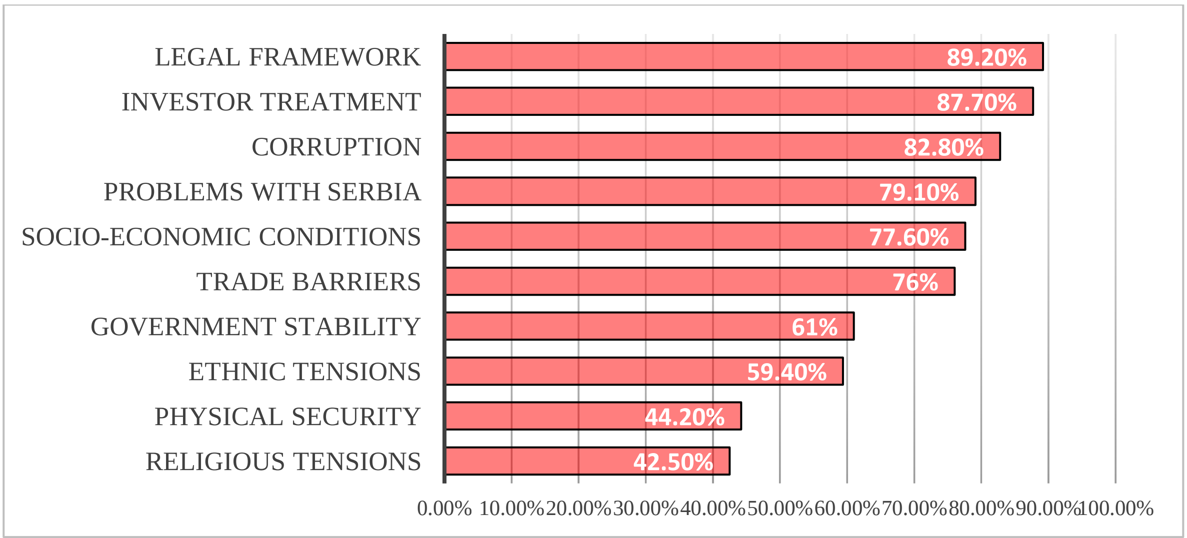
The definition of the challenges to the country's political risk has been determined considering previous empirical research and adoption to Kosovo's political circumstances. A short questionnaire regarding this issue has been addressed to firms with foreign capital operating in the Kosovo market. In the research question, "Which political problems discourage foreign firms from investing in Kosovo according to your perception"? Table 7 shows a list of ten components of political risk that were rated. Data analysis in this section also involves the distinction of the collected data into three groups. The first data group uses a frequency table to show the perception of foreign firms regarding political risk components. The second group splits data according to foreign investor's origin, dividing firms into those that have entirely foreign ownership and those where ownership also involves shareholders of Albanian origin. The third distinction includes two sub-groups, specifically, foreign firms operating in Kosovo before and after 2008 – the year of the independence declaration.

Table 7. Components of Political Risk

No	Description
1	Physical Security
2	Ethnic Tensions
3	Religious Tensions
4	Government Stability
5	Conflicts with Neighbor Countries
6	Corruption
7	Legal Framework
8	Socio-Economic Conditions
9	Trade Barriers
10	Investor Treatment

Figure 7 shows the main political obstacles faced by foreign firms in Kosovo extracted by the survey.

Figure 7. Political Obstacles of Foreign Firms in Kosovo



According to Figure 7, 89.2% of foreign investors assess the legal framework as the greatest obstacle of the political system in Kosovo, followed by "Investor Treatment" 87.7%, "Corruption" 82.8%, and "Problems with Serbia: 79.10%. The results are not surprising, considering the fragile legal system of the country, political influence within this system, and its lack of capabilities to guarantee respect of the law. A weak legal system is, therefore, followed by mistrust, investors' mistreatment, and elevated levels of corruption, obstacles that are highly-ranked by foreign firms. Another grave concern that deprives firms of a normal business climate is the unsolved problem with Serbia. Ranked fourth in the list at 79.10%, Serbia seems to be problematic for many investors', not only for the uncertainties it has with continuous attempts to undermine the statehood of Kosovo but also leaving a negative mark on other political stability determinants. Trade barriers were considered as an obstacle by 76% of foreign investors, government stability 61%, and ethnic tensions 59.4%, and physical security 44.2%. The low standard of living, quality of life, and education have been ranked high in the list at 77.6%, followed by trade barriers as a serious concern that hinders the free movement of products, particularly with Serbia.

Physical security and the threat of potential conflict are ranked last, reflecting two decades of the peace-building process in Kosovo. The displayed results of our survey extracted two main pillars of the political environment where Kosovo should focus: the legal system of the country and unsolved problems with Serbia. Even though, always a priority of governments, the legal system remains highly fragile and politically-influenced. Consequently, the chain of negative phenomena like corruption or investors' mistreatment has flourished. Legal reforms and increased independence of the legal system should be one of the top priorities of the Kosovo institutions. Dialogue with Serbia has stagnated for more than one year and desired results have failed to be achieved. This complex issue, intertwined by the wounds of the past, regional stability, and international strategic interests may affect the country for long in the future. Figures 8 and 9 display graphically the differences among groups of firms.

Figure 8. Perception of Foreign and Albanian Shareholders
about the Political Risk Components

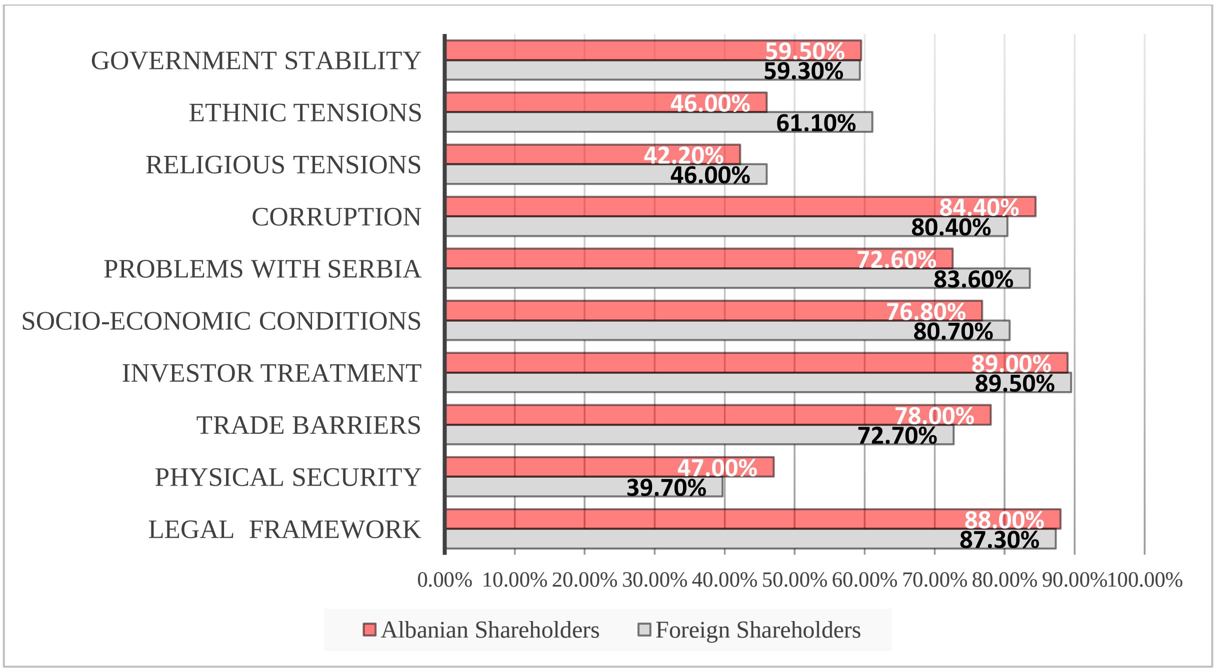
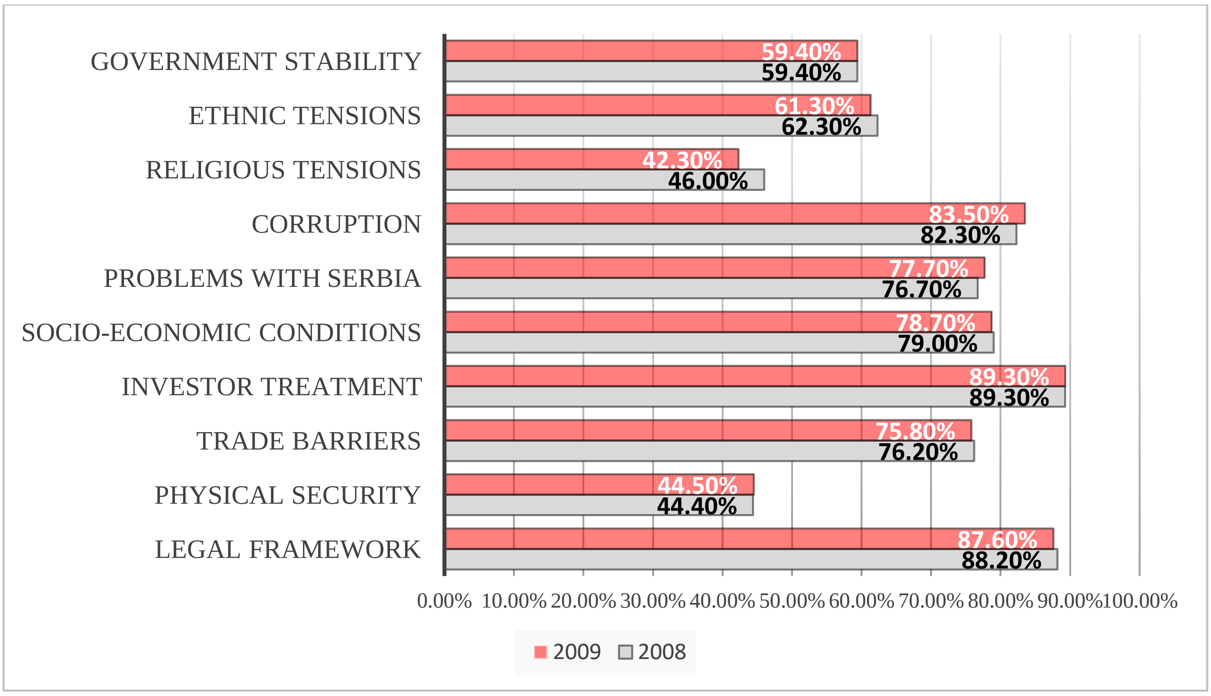


Figure 9. Perception of Foreign and Albanian Firms Established Before and After 2008 about the Political Risk Components



As there could be found more significant differences among Albanian and Non-Albanian investors regarding political barriers for investment in Kosovo, empirical results show that the perception of foreign investors prior to and after 2008, toward political stability, have slightly changed. The year 2008 marked the declaration of independence, establishment of independent governmental and legal institutions, thereafter, followed by international recognition, membership of a few international organizations and economic reforms. The results indicate that this progress is not sufficient, and Kosovo institutions have failed to improve the political stability of the country in large part due to internal factors.

The second hypothesis is predicated upon political instability of the host country, considering corruption as an important determinant, hence:

$$\text{Ho (2): } \mu_{\text{Corruption prior 2008}} = \mu_{\text{Corruption in and after 2008}};$$

$$\underline{\text{Ha (2): } \mu_{\text{Corruption prior 2008}} > \mu_{\text{Corruption in and after 2008}};}$$

A paired samples T-test was conducted to compare whether there is a significant difference between the variables of corruption prior 2008 and thereafter. The scores of "corruption prior 2008" (ME 3.66 SD 1.20) and "corruption in and after 2008" (ME 3.19 SD 1.05) conditions t – 7.71, p – 0.000 indicate the rejection of the null hypothesis Ho (2), implying that there is a statistically significant difference between the two variables, specifically the mean of corruption prior 2008 is higher than the mean of corruption thereafter.

3.5 Human Capital and Its Role in Economy

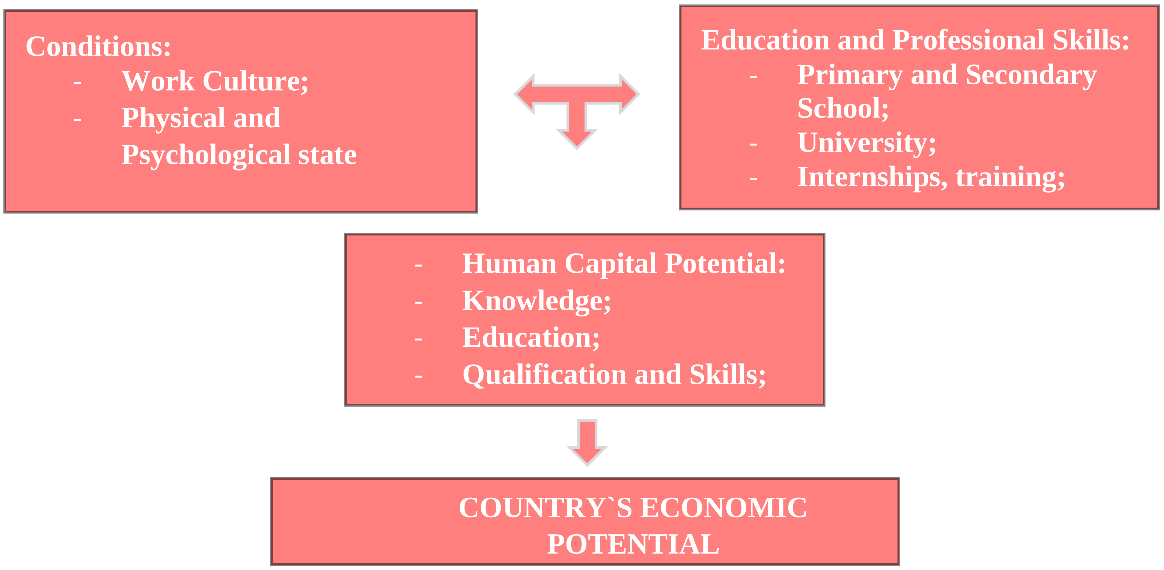
For many years, human capital has become a significant factor in economic growth. A widely-agreed consensus recognizes human capital as a major determinant of productivity, and its role in the knowledge-based economy of today is particularly important. A broad explanation of (Fuente & Ciccone, 2002) emphasizes that "human capital has to do with the knowledge and skills embodied in people and accumulated through schooling, training, and experience that are useful in the production of goods, services, and further knowledge".

Research about the importance of human capital in the economy occurred long ago. Human capital is an aspect of strategic development and has grown significantly faster than non-human capital, particularly in Western societies, and may well be the most distinctive feature of the economic system. Even though economists have long understood that human capital is an important factor in a nation's wealth, they have been reluctant to consider human capital as wealth, or capital, due to philosophical concepts and the difficult past of people as human beings. Free people are not commercial assets, and our inner convictions and values do not allow us to see human beings as capital goods except in slavery (Schultz, 1961). Adam Smith, known as the founder of the "free-market economy", included all learned and valuable skills of people as part of the capital in a country. The outlook of shying away from the importance of investment in capital faded through time. Hence, investments in human capital such as education and training just enhance their value and enlarge their opportunities and advantages in the market (Schultz, 1961).

By the end of the Second World War (WW2), physical capital was provided to countries damaged by the war for the reconstruction process. According to Schultz's theory of economic growth, rich countries divested by war absorbed vast amounts of physical capital, while emerging countries failed to utilize even lesser amounts. This indicates that the capability of a country to be productive on the usage of physical capital goes along with its human capital capabilities. Since these two factors complement each other, the lack of investment in human capital tends to limit economic growth even when investments of physical capital exist (Breton, 2013).

As technological development and knowledge have become important determinants of economic growth and prosperity, education, training, R&D, and other investments in knowledge enhancement can be seen as a common good that generates externalities to prevent economies of scale and physical capital from decreasing (Blomstrom & Kokko, 2003). The natural talent of individuals could be shaped through a few channels creating the common good of society and therefore foster economic potential. Figure 10 presents the significant attributes of the human capital.

Figure 10. Conditions Shaping the Potential of Human Capital



Source: *Dorozynska*, 2014, pp.222

Whilst macroeconomic policies are critical for development, economic growth often requires other policies which are even more important. Investments in human capital which involve education, training, courses, and good health aid the long term economic growth of a country (Barro, 2001). As efficiency at work among individuals differs significantly, replacing poorly-educated or trained workers by better educated and skilled workers, increases productivity and generates higher wages (Jorgenson & Fraumeni, 1992).

Investments in education are of importance, while the marginal return to investment in education is much larger for less-educated countries. Educated workers increase the national revenue of a country by initially increasing their marginal productivity and, thereafter, the productivity of physical capital and other workers. The effect of a properly-educated employee to the rest of the workers appears to be larger in less-educated countries (Breton, 2013). Regarding the education level, poor countries must provide support for primary and secondary education to reach adequate economic growth. This has long been emphasized by the World Bank; however, in a knowledge-based economy, the attitude toward tertiary education has begun to shift. Salaries have recorded an increase for employees with higher education in most OECD countries, and increased tertiary education may be necessary to encourage faster technological updates and to improve the ability of a country to optimize its economic performance (Bloom, et al., 2013).

As education consists of just one side of the human capital coin, creating human capital capabilities begins with health. As access to basic health services is lacking for half of the population of the world, investing in healthcare to ensure that all people access at least essential services enhances the quality of life and, therefore, productivity (World Bank & World Health Organization, 2017). A qualitative healthcare system implies a mortality decline, and consequently, human capital investments become more likely to pay off due to the increase in working life longevity. To increase the level and, therefore a key input into the R&D sector, the complementarity between health and education is necessary. Therefore, health expenditures boost long-term economic growth (Bloom, et al., 2018).

3.6 Human Capital and Its Role on Foreign Direct Investment Inflows

The pace of economic development, particularly in emerging markets, depends on a country's potential to acquire profitable investments. FDI inflows are one of the channels that transmit knowledge and technology into the host country, whilst the level of FDI spillovers that the recipient country can absorb varies to a great extent on its human capital capabilities. The theoretical elaboration of human capital has included it as a driving force for foreign investments. But, what are some of the human capital characteristics which interest foreign investors? The logic behind profit organizations is to maximize their profit while minimizing costs. Hence, cheap labor costs are an important feature of human capital that generally attracts investors. However, depending on the market orientation, entry mode, business strategy, and firm's characteristics, other features of human capital may be relevant.

A skilled labor force is desirable for firms motivated by low transaction costs because training expenses for employees will be minimized. With the growing number of high technology manufacturers and service firms, MNE's are aware of the importance of a qualified workforce embodied by scientific, technical, management, and organizational skills (Dorozynska & Dorozynski, 2014; Cleeve, et al., 2015). The quality of human capital appears to be a challenge for foreign investors. The extent to which the skilled labor supply matches market demand, also known as the external efficiency of the education system, could be related to FDI inflows, for several reasons. Typically, MNEs want to subcontract to local firms or offshore, especially in countries with a highly-qualified local workforce. Hence, higher education efficiency appears to be appealing to foreign investors (Miningou & Tapsoba, 2017).

While a majority of empirical research concludes that there is a positive relationship between economic growth, or the level of FDI inflows, and education, there are also findings of the impact of FDI inflows on education (Miyamoto, 2003). A research conducted in countries of Central and Eastern Europe (Poland, Bulgaria, Hungary, Romania and Czech Republic) shows that there is a significant impact of the primary level of education on FDI inflows, as basic education is associated with a stable economic environment. Tertiary education as a proxy of qualified workforce attracts foreign investors, and vice-versa, FDI inflows encourage the inhabitants of the recipient country to pursue higher education. Hence, a minimum threshold of skills is required to be reached by the host country to attract foreign investors (Strat, 2015).

Many countries and mainly developed countries have seen a significant demographic change in recent decades. There are certainly some economic consequences of an ageing population trend because of the decline in fertility rate and an improvement in life expectancy. Developed countries' population ageing is likely to impact positively on capital flows to transitional and developing economies through different channels. Changes in demographics are likely to impact the capital rate of return between developed and developing or emerging economies. The elderly economy lowers capital returns, leading to an increase in FDI outflows. Hence, if the host economy is older, the capital inflows into the host country will decrease. Lastly, as the population grows old, the demand for pension reforms rises and this makes pension funds commonly more responsive to investments in less-developed countries (Narciso, 2010; Davies & Reed, 2005). The age, education, and quality of workforce are highlighted as competitive advantages by many researchers. An overwhelmingly ageing population tends to impede FDI because of its shorter lifespan and maturity in consumption, while a middle-aged population (14 – 65 years) is positively related to FDI inflows.

A qualified, young, and educated workforce in Ireland (40% of the population below the age of 25) has positioned the country well in the FDI attractiveness map. The strategy of the government to invest in higher education, particularly in R&D, engineering, and business schools and double the number of PHDs by 2013, presented an example to be followed (Akin, 2009; Khan, et al., 2018). In the last few decades, foreign migration has reached unprecedented rates forming an increasingly ethnically-diverse and socially-connected world. While our understanding of the socioeconomic impact of migration appears to be incomplete, the economic consequences of migration have been central to the massive political debates on immigration policy. Population ageing of developed countries has pushed them to facilitate migration policies and absorb young people of less-developed countries to reduce the scarcity of human capital.

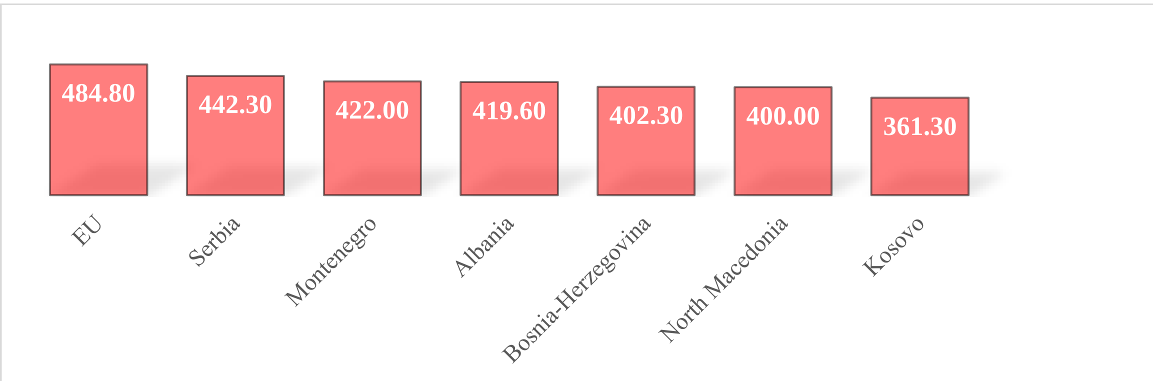
About the migration-FDI relationship, the growth of FDI inflows in the host country will generally increase the demand and income of the country's workforce, therefore reducing migration, whilst the emigration of skilled labor is prone to attract more FDI in the recipient country of qualified workers (Ivles & Melo, 2010). As migration of workforces has become common, the phenomenon is much more appealing in less-developed countries, and it has both benefits and negative consequences. Immigration of low-skilled labor and brain drain "reduce" unemployment rates in the short term and alleviate poverty, by increasing the level of remittances. Experience of the returnees abroad could also benefit the source country. "Where human capital leads, finance follows", an adaptation of "where enterprises lead, finance follows" which has long guided empirical research of firms' foreign activities, coined by Joan Robinson in the 1950s in the context of how human capital could explain the impact of migration on FDI. Migration and FDI have a complementary relationship, observations suggest. Capital and labor often have a good relationship with each other. Transfer of machinery and skilled human capital occurred between the UK and the US at the time of the Industrial Revolution. German migrants transferred machinery needed for production at the beginning of the 20th century to Brazil, whilst a determinant factor of Intel choosing Ireland as a location for investments was the Irish origin of its engineers (Buch, et al., 2006).

Hence, whilst immigration externalities in the long term are correlated with remittances and FDI inflows, influenced by the stock of ethnic networks in the investing country, reduced savings, cost of employee increases, and shortage of workforce causes a negative effect on the level of FDI inflows in the host country (Tomohara, 2017). Total effects must, therefore, be analyzed, taking into account the balance between contemporary substitutes and long-term ethnic network effect complementarity. In general, features of human capital such as skills, training, and education have different importance relative to the type of FDI. Therefore, human capital tends to be more important to efficiency-seeking firms and less important to market and resource-seeking firms (Strat, 2015; Okafor, et al., 2017; Kamal, et al., 2019).

3.7 Human Capital in Kosovo

For poor countries, human capital is often their most important capital. A high quality health and education system means a skilled and qualified workforce which therefore generates an improvement in society's welfare and sustainable economic growth. Although considerable progress has taken place in transitional economies of South East European countries, the development of the region is less positive compared to other neighboring transitional economies. Adequate reforms are necessary to offset the human capital and labor market deficit, which is limiting the economic growth of the region. Despite the national strategies to improve the level of education in the region, the Programme for International Student Assessment (PISA) has put South Eastern European (SEE) countries below the average of OECD countries as presented in Figure 11.

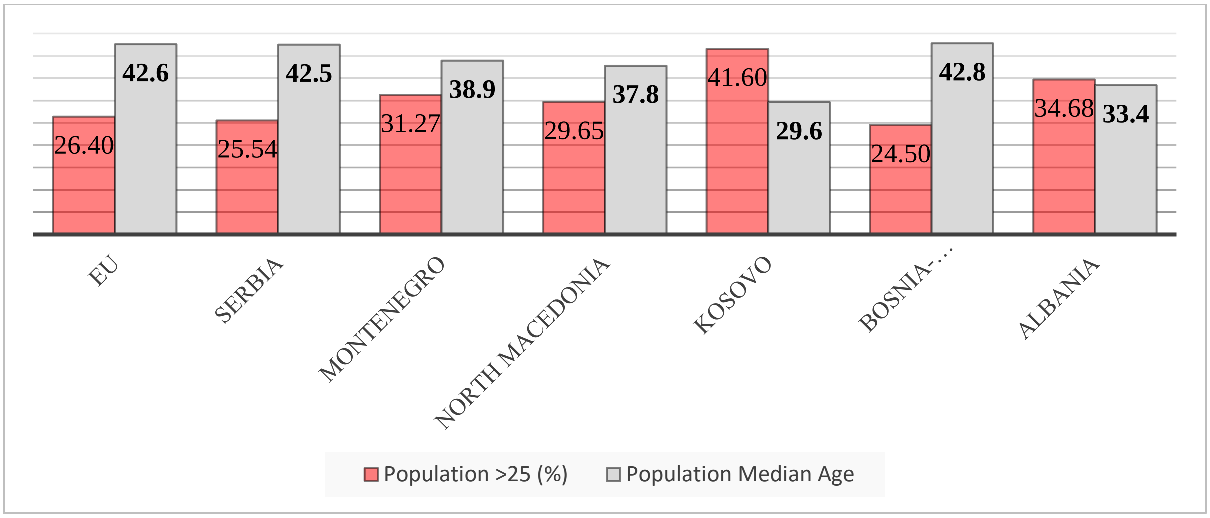
Figure 11. Results of the Programme for International Student Assessment 2018



Source: *PISA* (2018)

PISA focuses on proficiency in reading, mathematics, and science of 15-year-old students, evaluating the level of acquired essential knowledge and skills is important for participation in society. From figure 10, countries of the Western Balkans rank far below the average of OECD countries, and Kosovo lags behind the region. Kosovo Institutions promote the young age of the population as one of the key advantages of the country, to attract foreign investors; however, challenges to build and develop youthful human capital remain. Figure 12 shows the average age of the population in Western Balkan countries and the number of population under the age of 25 in percentage.

Figure 12. Western Balkans Demographics



Source*: Index Mundi Demographics* (2018)

Kosovo has the youngest population in Europe, with a mean age of 29.6 years, whereas the average of the EU is 42.6 years. Also, 41.6% of Kosovars are under the age of 25 versus 26.4% of the EU. In terms of young people, Kosovo is better than regional countries too. A well-educated, young population would be a driver for economic growth. Nonetheless, PISA results show that educational system quality is poorly-rated, positioning the country as the last in the region and far below the EU average. A historical context is important to understand the education system, its shortcomings and challenges. Education in Kosovo has historically been followed by prohibitions, suppression of teaching in the Albanian language, and parallel systems of education. Under Ottoman rule, education in the Albanian language was not allowed, whilst the first school in the Albanian language was that of "Shën Lluka" (Saint Luka), a Catholic school opened in 1584 (Gjergji, 2014).

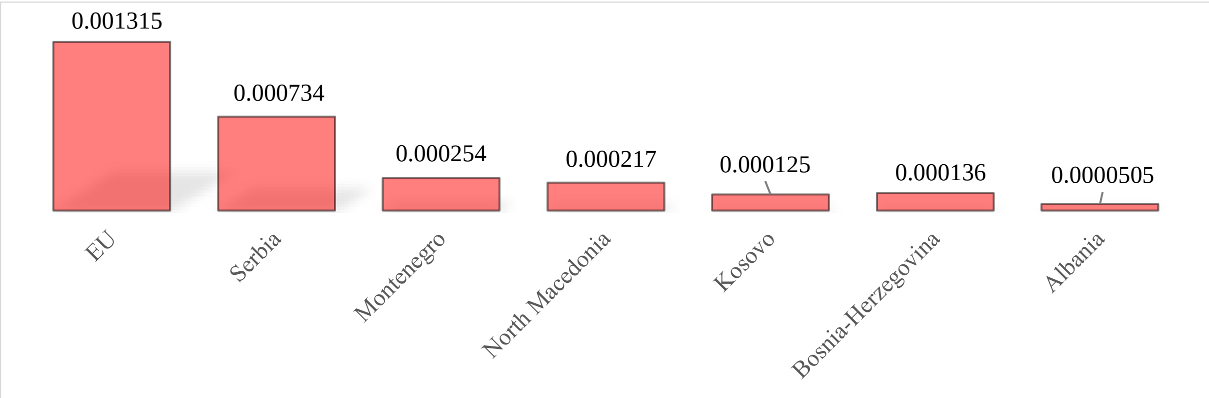
A few other Catholic schools were established, starting with a primary school in 1665 and a few others afterward. Nevertheless, most of the population belonging to Islam could not have been taught in their native language. Efforts to establish a national system of schools within the Ottoman Empire were increased during the 18th and 19th century. After several reforms and National Renaissance pressures, several schools in the Albanian language were opened in Kosovo, the first secular school being in Prizren in 1889. However, depending on the empire's approach, the Albanian school was opposed at various times, while the Albanians were the last citizens within the empire to be allowed to teach in their mother tongue (Maliqi & Kamberi, 2014). After the fall of the Ottoman Empire, Kosovo became part of the Yugoslav Kingdom, and Albanian schools were once more prohibited. In 1948, 74% of the population was illiterate. During WW2, as the country fell under the Nazi ruling, schools in the Albanian language were opened; a 5-year cycle of primary education was mandatory and secondary education schools opened too.

The education system consisted of three languages: Albanian, Serbian, and Turkish. Over time, a core of Albanian intellectuals emerged who took new steps to improve Albanians rights. In 1970 the University of Pristina was established, while the constitutional changes of 1974 gave the country the status of an autonomous province, and, for the first time, the education system was legally equal with other republics of the Yugoslav Federation. However, economic conditions, discrimination in employment, and social life led to massive protests of Albanian students in 1981; demonstrations were suppressed violently by Serbian forces. The University of Pristina was considered the center of Albanian separatism, and after abolition, pre-university and university education was suspended in the academic year 1990/1991. History was repeating itself, and the damage would be immense. For this reason, Albanian leaders organized home-education in a parallel education system, which lasted until the start of the war of 1999 (Ademi, 2017; Maliqi & Kamberi, 2014).

At the beginning of the 1990s, the parallel education system marked the start of several critical changes that have since influenced Kosovo's educational system. Funding networks connected Albanians abroad with their home country to pay for education costs. Three funding mechanisms have been established: remittances, in-kind donations, and an informal income tax of three percent paid by both citizens living inside the country and abroad. The battle for education was fundamental to Kosovo. Teachers, students, and all layers of society were connected to political resistance and cultural identification (Sommers & Buckland, 2004). Immediately after the war, there was a great need to reform and strengthen the education system. It was the collaboration of UNMIK and local institutions that initially contributed to education system reforms. Education system reform has been carried out to harmonize with international standards. The application of modern teaching and learning methodologies, the expansion of the compulsory education system by one year, and the organization of private education as an alternative were included. Reform has also involved the digitalization of education in some cities and the improvement of infrastructure.

Kosovo has a 5+4+3 system of education from age 6. The university system works according to the Bologna system. Education remains one of the new country’s major bottlenecks, however. The illiteracy rate in Kosovo is the highest in Europe. In 1999, the illiteracy rate was 2.3% of men and 10.2% of women aged 15, and above, while in 2014, the illiteracy rate of the total population was 3.2% (Kosovo Agency of Statistics, 2004) (Tota, 2014). Although there have been significant improvements in infrastructure, there are still many schools working on two shifts and lacking science laboratories. There is a lack of literature in many areas, especially at the tertiary level, while online teaching materials are scarce in the Albanian language.

Figure 13. Mean per Capita of Scientific and Technical Articles for the Western Balkans

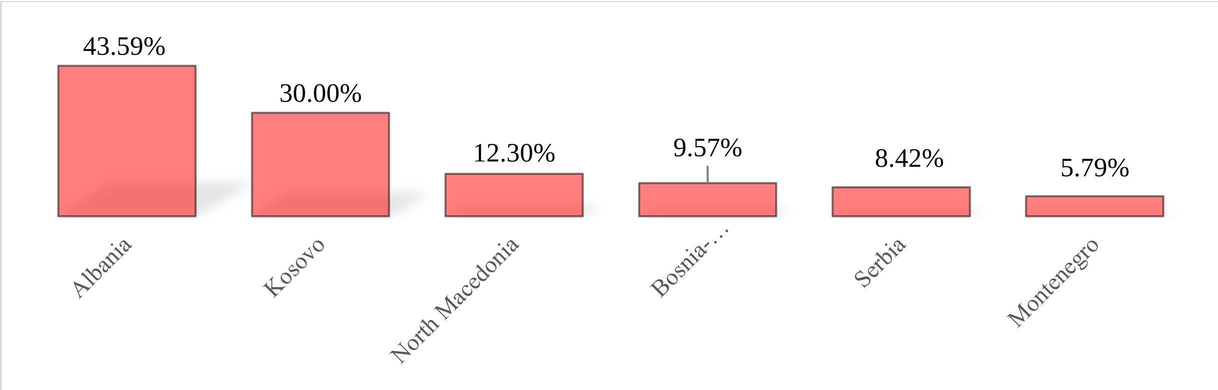


Source: *World Bank 2008-2016 Data* (Mean per Capita= Population Mean/Scientific Articles Mean)

Figure 13 shows the average number of scientific articles per capita in the Western Balkans region. In the region, Serbia is significantly higher, while all countries are well behind the EU. There are no substantial differences between other countries, with Kosovo and Albania ranked last. Often called "The lost generations", there are ten generations that have finished their high school or college at "home-schools" facing basic studying conditions. Studies suggest that experiencing war, violence, and continuous suppression has a long-lasting impact not only on those who have experienced it but also on future generations (Llapi & Peterson, 2015). Entire generations emerging from a "house-schooling" education system, and a post-war system thereafter, produced quantity but not quality at all levels of education. Until now, the government has not had a clear strategy to improve the situation while educational inspectors lack quality control. Another sensitive topic about human capital is migration.

The Western Balkan's migration flows to the EU are not new. Emigration was a historical and cultural feature of Kosovo due to the specific circumstances of the country. Settlement of Kosovars in Western Europe started from the late 1940s and there have been substantial changes in the level of emigration in three periods, since the 1960s. In the 1960s, Kosovo sent a first wave of migrants for temporary work in the West. The second wave was influenced by distressing events in 1989, and the third wave was fed by the 1999 war in Kosovo. While in the post-war years the people had high optimism for a better future, a new wave of migration has hit the country since declaring independence. In the period from 2008 to 2018, 529,647 Kosovars left the country via legal and illegal routes. This consists of 30% of the population. Moreover, 58% of the population declared that they are willing to leave the country (European Policy Institute of Kosovo, 2019). In 2015, a vast number of people illegally left the country while thereafter the government has signed agreements with a few EU countries for the legal recipient of seasonal and qualified workers. The trend of emigration toward Western Europe is widely spread in the region - the main destination is Germany. Albania had the highest number of people leaving the country during the last decade. Figure 14 presents the emigration level of Western Balkan countries in a decade (2008-2018).

Figure 14. Emigration Level of Western Balkans



Source*: European Policy Institute of Kosovo* (2019)

Socioeconomic factors are the most evident reason so many people have emigrated, or think to, from Kosovo. 91% of the respondents described the reasons for migration as unemployment, lack of the rule of law, and overall unhappiness with the situation in Kosovo in a survey conducted in 2015 during the massive departure from the country. The average age of emigrants was 26, while the dominant numbers were men. 88% of them were of primary or secondary education, whilst 9% were graduates. The emigrants toward the EU believe they can find a better life there and a brighter future for their children (Friedrich Ebert Siftung, 2015).

3.8 Features of Human Capital in Kosovo

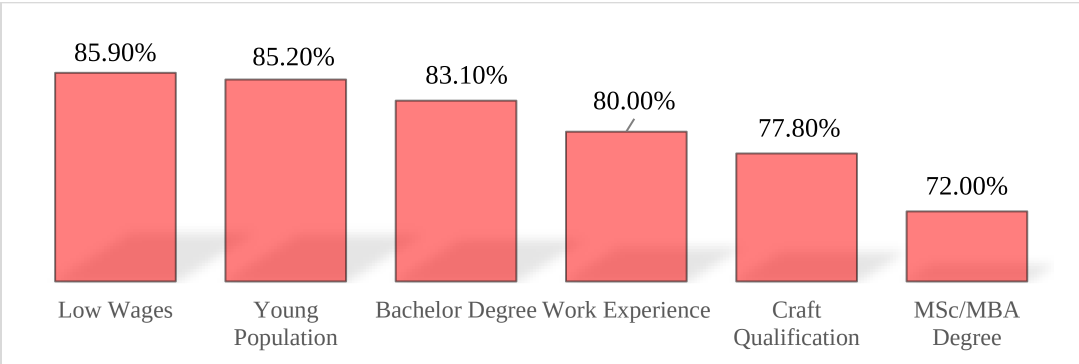
In the third part of this thesis, a literature overview of the importance of human capital for economic growth, and attraction for foreign investors, and a depiction of Kosovo's features regarding human capital took place. The data collected through two short questionnaires generated the results of what foreign investors consider as advantages and disadvantages of human capital in Kosovo. Table 8 presents the advantages and disadvantages of human capital in the labor market.

Table 8. Human Capital Advantages and Disadvantages

Advantages	Disadvantages
MSc/MBA Degree	Isolation
Bachelor Degree	Migration
Craft Qualification	Quality of Education
Work Experience	Lack of Qualified Workers
Young Population	
Low Wages	

Figure 15 presents some important attributes of human capital for foreign investors in Kosovo.

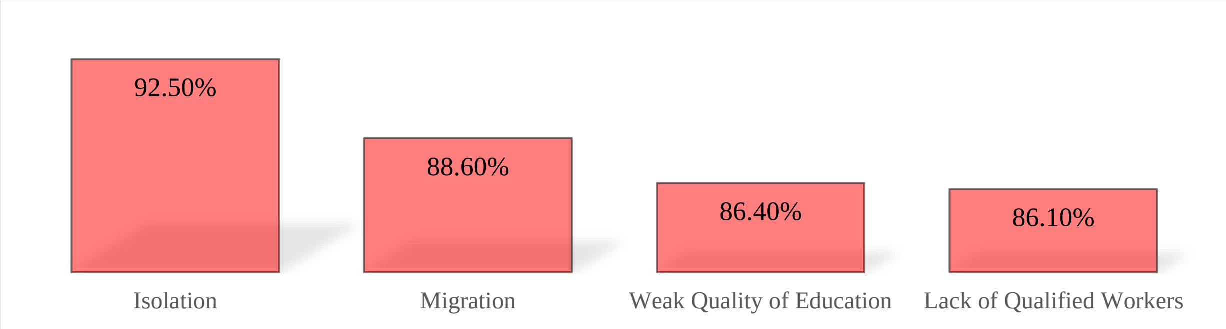
Figure 15. Important Features of Human Capital for Foreign Investors in Kosovo



Investors have assessed the low cost of the labor force as the most positive feature of human capital, followed by the youthful age of the population, and graduate studies. Professional schools and postgraduate degrees are the least important. Linkage could be created between features of human capital important for firms and the firms' orientation in the market. Since most of the foreign firms in Kosovo are trade and service-oriented, this may imply that they prefer a young and low-cost labor force. Regarding education, graduate studies are the most important, while professional schools in Kosovo which provide qualifications mainly for electricians, mechanics, welders, gastronomy and trade are less important. The smaller number of manufacturing firms and the lack of quality in professional schools caused a lack of interest from young people to orient themselves there. Owning a postgraduate degree is considered less important by foreign firms operating in Kosovo. Higher education qualifications are more required in the market for leadership and management positions, which are far fewer in number. Therefore, the need for such qualifications is less.

Figure 16 presents the challenges of foreign investors in Kosovo related to human capital.

Figure 16. Human Capital Challenges of Foreign Investors in Kosovo



For the question "What are the challenges a foreign firm faces regarding human capital in Kosovo?" investors assessed isolation and youth migration as the two biggest challenges of human capital. Kosovo is the only country in the Western Balkans lacking free movement of people to the EU. The process of obtaining a visa for unrestricted movement in the EU is time-consuming, demands numerous documents from the relevant embassy, and bears excessive costs for the living standard of the country. The needs of firms to move freely outside Kosovo are related to basic needs, such as attending staff training, education, for import purposes, or building potential partnerships with other firms. Hence, complex procedures, costs, and often visa rejections hamper firms' activities, career advancement of employees, and potential business opportunities.

Isolation and the inability to properly grasp how life takes place in the EU has often created illusions among young people that the EU is the "heaven" they should reach, thus causing an increasing level of emigration. High migration figures of the Kosovo population have left marks at least in the short term. Reduction of consumption, rising labor costs, and the image of a sinking economy is a challenge for firms operating in the Kosovo market but also a discouraging sign for potential investors.

Figure 16 shows that the difference in percentages is insignificant with respect to factors that are regarded as important human capital challenges. Emerging from an education system characterized by many challenges and lacking practical job opportunities during studies makes employees unprepared for the job market, causing firms to have difficulties with recruited workers who may need additional training to gain the necessary skills. The lack of qualified workers may be related to the weak education system and the tendency of young people to orient themselves toward study programs that do not meet the demands of the market.

A paired sample T-test was conducted to compare whether there is a significant difference between disadvantages of human capital: migration and quality of education. There is a significant difference in the scores for the migration (ME 4.07 SD 1.15) and weak quality of education (ME 3.76 SD 1.07) conditions; t – 8.214, p – 0.000. The result indicates the rejection of the null hypothesis Ho (3), implying that there is a statistically significant difference between the two variables, specifically migration has a higher mean compared to weak quality of education.

$$Ho\ (3): \mu_{\text{Migration}} = \mu_{\text{Weak Quality of Education}};$$

$$\underline{Ha\ (3): \mu_{\text{Migration}} > \mu_{\text{Weak Quality of Education}};}$$

3.9 Impact of Political Risk and Human Capital Advantages on Foreign Direct Investment Inflows

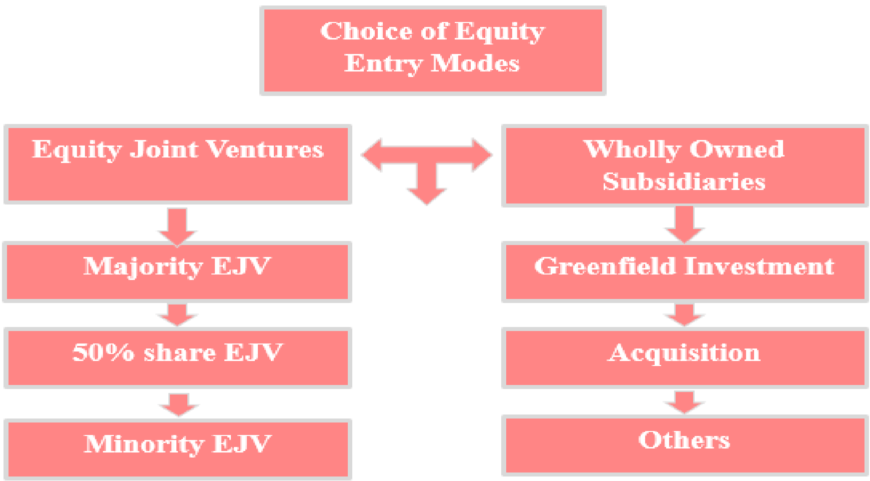
Political risk is generally considered as an essential determinant of FDI inflows within a host country, with its impact fading in particular cases when competitive advantages such as market size or natural resources occur. In Kosovo, a tiny newly-established state, political stability is considered crucial for the progress of the country, which is still known as a point of conflict. Political stability facilitates the consolidation of statehood and implementation of reforms to improve the business environment, increasing confidence of foreign firms to invest in Kosovo. The obstacles of the political environment in the country, like the legal framework, investor treatment, corruption and unsolved problems with Serbia have been considered a huge concern, at a rate of 80% or more as data indicates. As foreign firms in Kosovo seek resources and efficiency at lower cost, human capital availability is an important motive for investment. This is positively related to the identified qualities of human capital like low wages, young population, and education. However, also considering the disadvantages of human capital which mainly stem from the harsh political, social and economic environment, the positive or negative impact of the latter on FDI in Kosovo remains an issue of further research.

4 FOREIGN DIRECT INVESTMENT ENTRY MODES

4.1 Foreign Direct Investment Entry Modes

Considering a satisfactory performance in FDI operations, successful entry into a foreign country is crucial. This reflects many investors' concerns when entering a foreign country, such as efficient entry, risk reduction and the elimination of market access barriers. Numerous factors have been found to affect the choice of entry mode for investors, involving cultural closeness, firm size, resources, and management experience (Cui & Jiang, 2002). Hence, FDI activities, including the entry mode and performance, are affected by the strategic orientation of the firm. Entry mode is a contractual arrangement that enables a firm to carry out its business activities in a foreign market (Shen, et al., 2017). The choice of entry mode in a foreign market determines the extent to which an investor has control over the investment, the level of profit, commitment of resources, and risk exposure in the host country, with equity-based entry modes providing the largest degree of control. Research on this topic, which mainly stems from mature economies, attributes more importance to firm-specific factors on determining the entry mode in a foreign market. Nonetheless, in emerging economies, country-specific factors appear to have the same importance on entry mode decision-making. Hence, the entry mode choice depends on different types of firm-specific factors, industry-specific factors, and host country-specific factors (Pan & Tse, 2000). There are two types of entering a foreign market: non-equity mode and equity mode. Non-equity mode involves exporting and licensing while equity mode involves two forms of decision-making on the entry process: ownership decision and decision on the set-up mode. The ownership decision is an agreement on joint ventures, which are either fully owned or partly owned subsidiaries. The set-up method involves the establishment of an entirely new plant i.e. Greenfield investment, or by acquiring an existing local firm (Stampfli & Vladimirov, 2017). Figure 16 presents the entry modes of foreign direct investments in the host country.

Figure 4. Framework of Entry Modes



Source: *(Isa, et al.*, 2012, p. 2)

Definitions of each category are presented below:

● Joint Venture is a business agreement where two or more partners decide to invest together in a common project. Depending on the level of capital invested, the foreign investor can be a minority partner of the joint venture, owning equal common stock and owning the majority of the shares of the joint venture.

● "A wholly-owned subsidiary is an investment firm with a 100% ownership by the parent firm investing in the host country. It can take the form of Greenfield investment and merger & acquisition. When the wholly-owned subsidiary invests in the host country by establishing an entirely new firm that is defined as a Greenfield investment. When the investing firm unites its operations with another firm in the host country to establish a new entity that is defined as a merger. While, when the investing firm takes over the ownership of a local firm that is defined as an acquisition (Pan &Tse, 2000).

The selection of entry modes has been discussed by three major schools of thought (Pan & Tse, 2000). The first school of thought advocates that a firm aiming to invest abroad should do this gradually, suggesting low resource commitment modes such as exporting. Only by gaining experience should the firm consider higher-risk investments in the future. The second school of thought is focused on the transaction cost viewpoint. The fundamental principle is that businesses internalize these operations, which they can carry out at a lower cost, but will outsource them to other suppliers if they have a cost advantage. The third viewpoint emphasizes the importance of location, specifically country and industry factors. In addition, there are a variety of theories that explain the factors that firms take into consideration when evaluating the foreign market with transaction cost theory, cultural closeness, institutional theory, learning perspective, and organizational capabilities being more notable (Ko, 2019).

From the perspective of the OLI paradigm, a business seeking entry into a foreign market must have an important strategic advantage which, therefore, will determine the mode of entry to be used for that market. Competing in foreign markets, firms must possess superior resources and expertise, which are sufficiently high to offset the higher costs of operations abroad. Superior resources are related to the firm size and international experience, while expertise lies in its capabilities to provide differentiated products. Firms with lower ownership advantages are either less likely to enter a foreign market or use a low-risk mode of entering, such as exporting. Regarding the equity entry modes, such firms entering foreign markets have been observed choosing joint ventures as their entry mode, particularly in high potential markets (Agarwal & Ramaswami., 1992). Firms that can provide differentiated products prefer higher control modes of entry (Greenfield Investment and Acquisition) to avoid the risk of long-term loss of revenue as local firms may acquire the knowledge of this process. Retaining control over resources, organizational, and management processes demands higher investments; thus, these entry modes are preferable for firms of a larger size. Interestingly, larger size firms also prefer joint ventures, and this phenomenon may be related to the fact that those kinds of firms may be less concerned about exploiting the host country compared to smaller size firms.

Regarding experience in the international market, firms with a lack of experience prefer non-investment modes. Modes of low control are considered superior for firms willing to achieve economies of scale and avoid administrative drawbacks of the host country. If there is a contractual risk or lack of contract enforcement in the host country, firms prefer wholly-owned subsidiaries, thus retaining business assets and skills within the firm. The markets of lower potential commonly attract joint ventures; however, MNE's tend to include these countries on their investment maps for the sake of their global strategic positions. Less experienced and smaller firms in the international market are prone to invest abroad through joint ventures; due to the lack of resources and skills they share costs, risks, and experiences with local partners. Investment risk in the host country discourages foreign investors. However, based upon ownership advantages, there are firms able to overcome risks; this is especially the case when the foreign firm owns technological advantages or has differentiated products, and bargaining with the host government may provide them immunity against these risks. Such firms are prone to invest in sole ventures. Changes in the institutional climate are more frequent in emerging and developing economies, so changes that lift constraints or facilitate the entry mode are more likely to occur.

Institutions' efficiency discourages Greenfield foreign investments (Demirbag, et al., 2008). Empirical research implies that foreign investors are more willing to cooperate with local firms, hence, establish joint ventures if the government shows effective results in improving the rule of law, freedom of expression and fighting corruption (Slangen & Tulder, 2009). The link to local networks and access to resources obtained by many market-based investors through their local partners are of less concern to export-oriented investors. Therefore such firms are more likely to engage in Greenfield investments, implying that local-oriented firms are more oriented into joint ventures or acquisitions (Meyer & Nguyen, 2005). Incentive packages by the government and taxation policies are important determinants of location choice for potential foreign investors. Favorable tax policies and incentive packages are especially undertaken for Greenfield investments, considering the perception that this entry mode increases employment and generates positive know-how and technology spillovers (Demirbag, et al., 2008). A well-qualified, cheap labor force is a primary motive for Greenfield entry mode; a skilled local labor force also induces acquisitions. Similarly, acquisitions are also driven by the quality of local inputs and the good name of finished or semi-finished products (Szanyi, 2001).

In culturally-close countries, transaction costs are assumed to be lower, and as the cultural distance increases between host and investing countries, the greater the differences among them. This implies that foreign investors prefer Greenfield entry mode when the culture is distant, hiring local staff but transferring their working culture and management habits (Larimo, 2003). A contrary assertion emphasizes that cultural distance is a synonym of uncertainty for foreign firms. As entering the new market through sole ventures or full acquisitions is associated with full control by the parent firm, interaction with the local norms and values would be difficult. Hence, firms are prone to choose joint ventures, which will reduce the gap of cultural differences by the in-depth knowledge they own about the local values and practices (Slangen & Tudler, 2009). Previous business experience abroad favors wholly-owned subsidiaries, while the lack of experience in a specific country makes investors seek local partners (Chang, et al., 2012). The level of diversified portfolio a firm has could also determine the entry choice. More diversified firms have sophisticated control and organizational systems and established experience regarding negotiations and how to integrate acquired units. Such firms prefer joint ventures as the expertise they have enables them to reduce the incremental costs occurring with other entry modes. Table 9 presents the motives of foreign firms to choose a particular entry mode in the host market.

Table 9. Motives of Foreign Firms in Choosing an Entry Mode

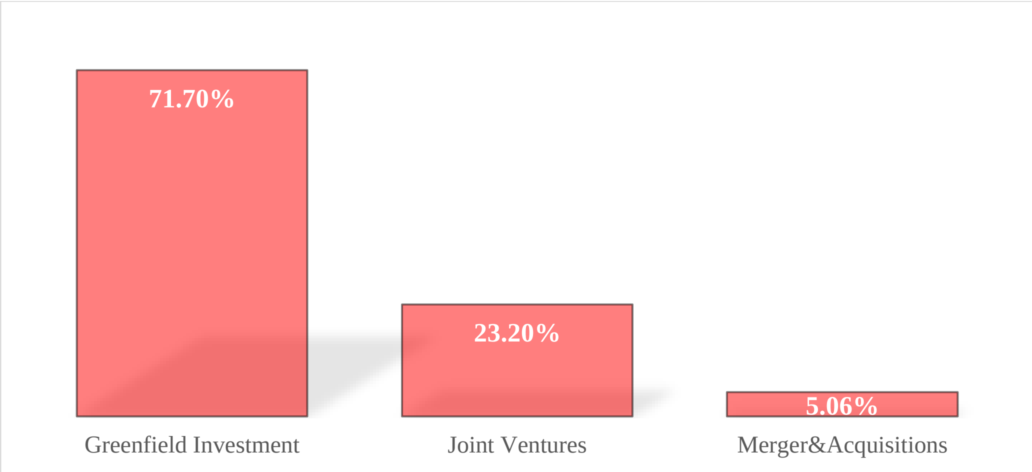
	Greenfield Investment	Merger & Acquisitions	Joint Ventures
Motives			
Diversified Firms		√	√
Differentiated Products	√		
Firm's Experience Abroad	√		
Lack of Contract Enforcement	√		
Small Local Market	√	√	√
Lack of Experience Abroad		√	√
Small Firms			√
Technological Advantages	√		
Institutional Efficiency		√	√
Export-oriented Firms	√		
Local Market - oriented Firms		√	√
Incentive Packages and Tax Policies	√		
Cheap Labor Force	√		
Qualified Labor Force		√	√
Cultural Distance	√	√	√
Firms of Larger Size	√	√	√

4.2 The Preferred Foreign Direct Investment Entry Mode in Kosovo

The number of foreign firms in Kosovo was 4510, in 2018. The quantity of foreign firms registered in Kosovo varies according to the flow of FDI inwards. From the total number of active firms in Kosovo (165,268), firms with foreign capital comprise only 2.72%. According to (Kosovo Agency of Statistics, 2019), the most preferred activities of local firms operating in the second quarter of 2019 were: trade (22.2%), production (18.04%), and services (13.52%). The year 2018 was characterized by similar statistics, while in 2017, as trade remains the preferable activity, production is ranked as the least preferred. This indicates that for three years in a row, there has been an improvement in the business environment, and the increase of investments in the production sector is a signal of enhanced stable economic growth. According to our survey, 35.2% of respondent firms were engaged in the trade sector, 33.6% in service activities, and 31.2% in the production sector. Hence, it can be concluded that there is no significant difference among local and foreign firms in terms of the economic activity they pursue. (Kosovo Agency of Statistics,

2019) ranks Pristina, Prizren, Ferizaj, and Gjilan as the cities' local firms are focused on while our survey comprises foreign firms operating widely in Pristina, Ferizaj, and Mitrovica. This indicates that Pristina District is the most favorable for foreign investors, probably influenced by the market size, better business opportunities and infrastructure. Figure 18 shows the preferable entry mode of foreign firms in Kosovo.

Figure 18. Entry Mode of Foreign Firms in Kosovo



From Fig 18, there is a plain result regarding the entry mode choice of foreign investors in Kosovo, where 71.7% of them preferred Greenfield investments, while joint ventures were preferred by only 23.2% and a symbolic 5.06% for M&A. In the literature review discussion, table 9, we attempted to aggregate several factors for why firms would choose an entry mode in a foreign market. Regarding the reasons for foreign firms to undertake Greenfield investments in Kosovo, the motives could be classified into three categories. As explained in part 2.2 of this thesis, Kosovo`s tax policies and incentive packages are similar to, or lag behind those of the region. Regarding differentiated products, there is no data about this factor in our survey; hence these two factors mentioned above could be considered of less importance on attracting Greenfield investments in our country. The second category includes: firms of larger size, the experience of investing firms abroad, and market size. The motive of large firms experienced internationally in investing in small markets, such as Kosovo, lies in the rationale of global strategic positioning of MNEs. (Example: ZARA). The third category involves factors of stronger influence for Greenfield investments in Kosovo:

- Lack of contract enforcement – The rule of law remains a major problem of Kosovar society. The rationale behind Greenfield investments, which involves full control by the parent firm, stems from the uncertainty of contract enforcement; thus, foreign firms become hesitant to engage with local partner firms.
- Technological advantages – This also could be an influential factor behind Greenfield investment. Considering the origin of foreign investments, the majority stems from

much more developed countries, it is assumed that foreign firms have more advanced technology, creating a competitive advantage in the country.

- Export-oriented firms – 40% of foreign investors declared export as their main activity in Kosovo, implying that export could be a key factor for greenfield-investments.
- Cheap labor force – Kosovo has the highest unemployment rate in Europe and the youngest population. Considered an important asset of the country for further economic development, the Kosovo labor force is of low cost, and, if not adequately qualified, it possesses a high potential of skills improvement considering the young age of unemployed people.
- Cultural closeness – This factor was assessed as an important motive to invest in Kosovo by 54.5% of foreign firms. As there is no great geographic distance between Kosovo and investing countries, important determinants of foreign investments and particularly Greenfield entry mode are personal contacts or previous business relations. These two factors contributed to the building of mutual trust, hence increasing the certainty of foreign investors to invest in Kosovo in a form that is associated with more control but more risks also.

CONCSLUSION

Concerning FDI in Kosovo, political parties may frequently be heard blaming each other for the failure of Kosovo to attract foreign investors. Currently, there is a lack of detailed empirical research regarding the fields in which foreign investors can invest, - and as such the challenges, motives, and the advantages that come with those investments are not identified. The fact that, since the adoption of the Law on Strategic Foreign Investment, Kosovo has managed to attract only one foreign investment indicates the lack of a strategy of the Government of Kosovo that would affect the attraction of investors. In the four sections of this thesis, based on literature research, reports, and analyses, and in a survey conducted on foreign investors in Kosovo, we extracted their motivations to invest in Kosovo and identified some of the most important challenges which they face.

Regarding the motives of foreign firms to invest in Kosovo, they are mainly low labor costs, geographical proximity, economic stability, personal contacts, or prior business connections. Investors who have invested in Kosovo's neighboring countries have had similar motives based on previous empirical research we have encountered. Foreign firms in Kosovo are looking for efficiency and resources. This implies that they require the implementation of their activities with high efficiency in an environment with favorable government policies, economic stability, and low cost. In terms of human capital, the low cost of labor, the young age of the population, and the educated labor force have been considered to be the advantages of Kosovo. So a young workforce with the potential to learn foreign languages and use technology could attract foreign investors. Political stability is the pillar that enables the creation of an appropriate business environment and the undertaking of reforms. Non-recognition by Serbia and the chain of problems it causes, by trying to undermine Kosovo's statehood is one of the biggest challenges foreign investors have encountered in Kosovo. In the economic context, this is due to the impediment in the movement of goods and the disregarding of free trade agreements concerning Kosovo. Whether relations with Serbia can improve depends little on Kosovo, so this remains a long-term challenge. But another pillar that has been ranked as Kosovo's biggest disadvantage is the lack of the rule of law and the high level of corruption. The problems that most foreign firms face in terms of human capital are the lack of free movement in the EU, migration, and lack of workforce quality.

Kosovo's economic growth in recent years has been largely based on consumption and public investment. Foreign investment would be a driver of sustainable economic development in Kosovo, reducing unemployment and transferring positive effects such as technology and good management practices. Therefore, the development of the private sector and the attraction of foreign investment are indispensable for sustainable economic development and the reduction of unemployment. Improving the legal framework and investments in education are the country`s immediate needs that would enhance the country`s FDI attractiveness index.

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APPENDICES

LIST OF APPENDICIES

Appendix A: Abstract (Povzetek)

Tuje neposredne naložbe so pomembne za gospodarstva v prehodu in razvoju. Pojav globalizacije je v zadnjih dveh desetletjih vplival na rast tujih neposrednih naložb. Tuja neposredna naložba predstavlja naložbo, s strani rezidentov druge države, v novo ali obstoječe podjetje v drugi državi z namenom nadzora proizvodnje, distribucije in drugih dejavnosti podjetja. Države tekmujejo pri uporabi najbolj privlačnih politik za pridobitev tujih investitorjev. Namen tega magistrskega dela je razložiti strukturo in glavne značilnosti tujih neposrednih naložb v gospodarstvu Kosova. Zahodni Balkan je majhen trg, odmaknjen od naprednih gospodarstev. Kosovo je z razvojnega vidika zaostalo tudi v regiji. Od razglasitve neodvisnosti države leta 2008 je bil največji obseg tujih naložb dosežen leta 2011. V preteklih letih ni bila dosežena bistvena rast kljub določenim pozitivnim gibanjem. Na podlagi izvedene raziskave je Kosovo privlačno za podjetja, ki želijo doseči učinkovitost z nižjimi stroški ter hitro vstopiti na evropski trg. Politična nestabilnost se, z vsemi svojimi komponentami, kaže kot ovirajoč dejavnik za razvoj nove države. Prebivalstvo z najmlajšo povprečno starostjo v Evropi predstavlja dragoceno prednost pri pridobivanju tujih investitorjev. Po drugi strani pa imajo migracije in izolacija države negativen učinek na človeški kapital Kosova. Investicije od začetka so najbolj priljubljena oblika vstopa na Kosovski trg s strani tujih investitorjev.

Appendix B: List of Abbreviations

FDI – Foreign Direct Investment;
UNCTAD – United Nations Conference on Trade and Development;
WW2 – Second World War;
GDP – Gross Domestic Product;
EEC – European Economic Community;
IMF – International Monetary Fund;
UN – United Nations;
ECJ – European Court of Justice;
ECB – European Central Bank;
EU – European Union;
MNE – Multinational Enterprise;
OLI – Ownership, Location, Internalization;
NATO – North Atlantic Treaty Organization;
EBRD – European Bank for Reconstruction and Development;
SSA – Stabilization and Association Agreement;
CEFTA – Central European Free Trade Agreement;
VAT – Value Added Tax;
GNP – Gross National Product;
WTO – World Trade Organization;
PTA – Preferential Trade Agreement;
UNMIK – The United Nations Interim Administration Mission in Kosovo;
KIESA – Kosovo Investment and Entrepreneurship Support Agency;
KFOR – The Kosovo Force
OECD – The Organization for Economic Co-operation and Development;
PISA – Programme for International Student Assessment;

Appendix C: Questionnaire

Firm Name:	
Address/City:	
Phone number/ E-mail:	

Founding period:	a) Prior 1999
	b) 1999-2007
	c) 2008-2018

Type of activity:	a) Manufacturing
	b) Services
	c) Trade

Which were the motives of your firm to invest in Kosovo?

Local Market	1	2	3	4	5
Regional/Continental Market	1	2	3	4	5
Export Base	1	2	3	4	5
Low Labor Costs	1	2	3	4	5
Economic Stability	1	2	3	4	5
Cultural Closeness	1	2	3	4	5
Geographic Proximity	1	2	3	4	5
Previous Business Relations	1	2	3	4	5
EU Perspective	1	2	3	4	5
Double Taxation Treaties	1	2	3	4	5
Local Suppliers	1	2	3	4	5
Incentive Packages	1	2	3	4	5
Quality of Infrastructure	1	2	3	4	5

Which political problems discourage foreign firms to invest in Kosovo according to your perception?

Government stability (Efficiency, longevity)	1	2	3	4	5
Legal Framework	1	2	3	4	5
Ethnic Tensions	1	2	3	4	5
Religious Tensions (ex. radicalization)	1	2	3	4	5
Corruption	1	2	3	4	5
Conflicts with Neighbor Countries (non-recognition of the Kosovo statehood by Serbia, control over local Serbs, lobbying against Kosovo Independence etc.)	1	2	3	4	5
Investor Treatment	1	2	3	4	5
Socio-economic Conditions (unemployment, poverty, welfare)	1	2	3	4	5
Physical Security	1	2	3	4	5
Trade Barriers (Import tariffs, protectionist policies) (Ex. 100% tariff barriers with Serbia)	1	2	3	4	5

Which features of human capital are mostly important for foreign investors in Kosovo?

Young Age of Population	1	2	3	4	5
Bachelor Degree	1	2	3	4	5
MSc/MBA Degree	1	2	3	4	5
Craft Qualifications	1	2	3	4	5
Work Experience	1	2	3	4	5
Low wages	1	2	3	4	5

Which are the challenges a foreign firm faces regarding to human capital in Kosovo?

Lack of Qualified Workers	1	2	3	4	5
Weak Quality of Education	1	2	3	4	5
Migration	1	2	3	4	5
Isolation (Lack of free movement / long and exhausting procedures to send employees in trainings outside Kosovo)	1	2	3	4	5

Thank You for Your Contribution!

Appendix D: List of Survey Respondents

Nr.	Company Name	City		Nr.	Company Name	City
Q1	Orbico Kosova	Prishtine		**Q41**	Rehau Branch	Prishtine
Q2	Bitex	F.Kosove		**Q42**	Rumuz LLC	F.Kosove
Q3	KEDS	Prishtine		**Q43**	Jub Kosova	Prishtine
Q4	Qumeshtorja Kabi	Ferizaj		**Q44**	Divani	Ferizaj
Q5	Hymeri Kleeman	Prishtine		**Q45**	Laqi	Ferizaj
Q6	Gjirafa	Prishtine		**Q46**	L Occitane	Prishtine
Q7	Ati Kosova	Prishtine		**Q47**	Tefik Canga	Ferizaj
Q8	Italy Recycling	Obiliq		**Q48**	Tisso	Prishtine
Q9	Thai Restaurant	Prishtine		**Q49**	Top Shop	Prishtine
Q10	Grawe	Prishtine		**Q50**	Kivo LLC	Kacanik
Q11	G Group	Prishtine		**Q51**	Renova	Ferizaj
Q12	Unioni Financiar	Prishtine		**Q52**	Dauti Commerce	Ferizaj
Q13	Hirano Mushroom	Prishtine		**Q53**	Beo LLC	Ferizaj
Q14	Alteco	Gjilan		**Q54**	Parket Mont	Ferizaj
Q15	CNC Noll	F.Kosove		**Q55**	Bahceci	Prishtine
Q16	Universal Food	F.Kosove		**Q56**	Zirat Bankasi	Prishtine
Q17	Prima Tobacco	Prishtine		**Q57**	Goetz Enterprises	Prishtine
Q18	Intermed Shpk	Prishtine		**Q58**	IMG Const	Prishtine
Q19	Pandora	Prishtine		**Q59**	Knauf Shpk	Prishtine
Q20	Jaha Solars	Prishtine		**Q60**	Rsm Company	Prishtine
Q21	Koba Shpk	Prishtine		**Q61**	Back Garden	Prishtine
Q22	Green House LLC	Prishtine		**Q62**	Jumbo	F.Kosove
Q23	Sabaja Craftberry	Prishtine		**Q63**	Tokyo Restaurant	Prishtine
Q24	Hert	Prishtine		**Q64**	Agromarket Ks	Prishtine
Q25	Trofta	Istog		**Q65**	IQ to Link	Prishtine
Q26	Banka Ekonomike	Prishtine		**Q66**	Go Shipping Albania	Prishtine
Q27	Max	Prishtine		**Q67**	Deloitte	Prishtine
Q28	Mango	Prishtine		**Q68**	Intertex Leather	Gjakove
Q29	PoFix	Lipjan		**Q69**	KosovaTex	Prishtine
Q30	Arkos	Drenas		**Q70**	Eser Shpk	Ferizaj
Q31	Petrol Oti Slovenja	F.Kosove		**Q71**	Premium Trade	Prishtine
Q32	Eox Balkan	Ferizaj		**Q72**	Jaha Company	Prishtine
Q33	Impact Shpk	F.Kosove		**Q73**	Kospak	Prishtine
Q34	Tregi Kosovo	Prishtine		**Q74**	Brighten Group	Prishtine

(Table continues)

(Continued)

Nr.	Company Name	City		Nr.	Company Name	City
Q35	Eco Higjiena	Gjilan		**Q75**	Hotel Gracanica	Gracanice
Q36	Ricom	Gjilan		**Q76**	Royal Medical	Prishtine
Q37	ABC Design	Gjilan		**Q77**	Grand Thorton	Prishtine
Q38	Mabco Construction	Prishtine		**Q78**	M Sora	Drenas
Q39	Quipu Shpk	Prishtine		**Q79**	Fashin Ave	Prishtine
Q40	EcologInternational	Prishtine		**Q80**	Ipko	Prishtine
Q81	Baruti Shpk	Prishtine		**Q121**	Adria Inspek	F.Kosove
Q82	Nuha Gmbh	Ferizaj		**Q122**	Nik Group	Prishtine
Q83	Dukes Shpk	Prishtine		**Q123**	Original Marine	Prishtine
Q84	Shoedazz	Prishtine		**Q124**	Interex Sagl	Prishtine
Q85	Vali Ranch	Gjilan		**Q125**	Safe Life	Prishtine
Q86	Face&Lace	Prishtine		**Q126**	Banka per Biznes	Prishtine
Q87	Kamila	Prizren		**Q127**	Heinze Shpk	Gjakove
Q88	Elumatec Maschine	Vushtri		**Q128**	Euroenergie	Prishtine
Q89	Turkiye Is Banka	Prishtine		**Q129**	Kelkos	Decan
Q90	TNT Shpk	Prishtine		**Q130**	Hydro BG Gmbh	Prishtine
Q91	NLB	Prishtine		**Q131**	Aura	Prishtine
Q92	Homme	Prishtine		**Q132**	Central Shpk	Prishtine
Q93	Okaid	Prishtine		**Q133**	German Color	Gjakove
Q94	Ask Tec M San Grupa	Prishtine		**Q134**	Newko Balkan Shpk	Suhareke
Q95	Emirate General Trase	Prishtine		**Q135**	Hydroline	Prishtine
Q96	Koton	Prishtine		**Q136**	Auto Pasion	F.Kosove
Q97	Fox Marble	Prishtine		**Q137**	DirectDebit Limit	Prishtine
Q98	Chelsea Point	Prishtine		**Q138**	Turkish Airlines	Prishtine
Q99	RaiffeisenBank	Prishtine		**Q139**	VBH	F.Kosove
Q100	Gap	Gjilan		**Q140**	Ekol Canta	Prizren
Q101	Istikbal	Gjilan		**Q141**	D Med	Prishtine
Q102	Ledo	Milosheve		**Q142**	Time Company	Prishtine
Q103	KTL	Han Elez		**Q143**	Kadiu Shpk	F.Kosove
Q104	Euroterm AG	Gjakove		**Q144**	Ekofiks LLC	Drenas
Q105	Top Channel	Prishtine		**Q145**	PI (Qendra Estet)	Prishtine

(Table continues)

(Continued)

Nr.	Company Name	City		Nr.	Company Name	City
Q106	Kotex	Vushtri		**Q146**	Defence Control	Ferizaj
Q107	Blaue Blume	Prishtine		**Q147**	Fama	Ferizaj
Q108	Don Bosko	Prishtine		**Q148**	Vier Pfoten Ks	Prishtine
Q109	Bonus Shpk	Prishtine		**Q149**	Flogen Tech Inc	Prishtine
Q110	Nor Invest	Gjakove		**Q150**	JYSK	F.Kosove
Q111	Luxsoltex	Gjakove		**Q151**	Unitas Energy	Ferizaj
Q112	Safran&Ko	Gjakove		**Q152**	Pro Tech	Prishtine
Q113	Agrico Kosova	Vushtri		**Q153**	Farm Line	Prishtine
Q114	Adria Airways	Prishtine		**Q154**	Medcargo LLC	Prishtine
Q115	ORS Ortopedika	F.Kosove		**Q155**	Rema Tex	Dragash
Q116	Croatia Group	Prishtine		**Q156**	Fluidi Shpk	Gjilan
Q117	Vila Germia	Prishtine		**Q157**	Ags Movers	Prishtine
Q118	Trepca Shpk	Peje		**Q158**	ProCredit	Prishtine
Q119	Training GC	Decan		**Q159**	Lexalko Shpk	F.Kosove
Q120	Kosova Steel Group	Peje		**Q160**	Swiss Pelete	Prizren
Q161	Swiss Pelete	Prizren		**Q201**	Gentli	Prishtine
Q162	AMSCA	Prishtine		**Q202**	Crimson Finance Fund LLC	Prishtine
Q163	Oli Shpk	Prishtine		**Q203**	Apollonia	Podujeve
Q164	Zepter	Prishtine		**Q204**	Thermo Shpk	Ferizaj
Q165	Samsonite	Prishtine		**Q205**	Kosova Raisen	Prishtine
Q166	Kalo&Associates	Prishtine		**Q206**	World Plast	Ferizaj
Q167	Capital Ring	Prishtine		**Q207**	Aqua Aluminyum	Ferizaj
Q168	Cosedil SPA	Prishtine		**Q208**	Tobacco Holding	Prishtine
Q169	Sigma	Prishtine		**Q209**	Egi Bau	Prizren
Q170	Green Sol Kosova	Prizren		**Q210**	Europalete	Junik
Q171	Galvazink	Prizren		**Q211**	Setteguti SA	Viti
Q172	Sls Group	Prishtine		**Q212**	Peugeot	Prishtine
Q173	American Exploration and Mining	Prishtine		**Q213**	Concept Studio	Prishtine
Q174	Sinalco	Istog		**Q214**	MKC	GJakove
Q175	Lely Shpk	Prishtine		**Q215**	Reco Windows	Kacanik
Q176	Boulevard Shpk	Prishtine		**Q216**	Treciklo	Mitrovice

(Table continues)

(Continued)

Nr.	Company Name	City		Nr.	Company Name	City
Q177	Atlas Banka	Prishtine		**Q217**	Roplasto	Ferizaj
Q178	Taffmed	Prishtine		**Q218**	Cynthia Invest	Drenas
Q179	Spirit	Kacanik		**Q219**	Ecomex	Mitrovice
Q180	Mecatyp Ks	Ferizaj		**Q220**	Niart	Peje
Q181	Bechtel Enka	Prishtine		**Q221**	Candaroglu	Mitrovice
Q182	Virtuo	Prishtine		**Q222**	Jens Distribution	Prizren
Q183	NTP Amici	Prishtine		**Q223**	Magra Shpk	Peje
Q184	MA Communication	Vushtri		**Q224**	Multivac Albania	Prizren
Q185	All Business Brigade	Vushtri		**Q225**	Kag Asphalt	Prizren
Q186	BDS	Prishtine		**Q226**	Wurth Kosova	Prishtine
Q187	KBI ESSE	Prishtine		**Q227**	Alvogen Pharma	Prishtine
Q188	Garda Sh	Prishtine		**Q228**	Euro Assets	Prishtine
Q189	Thule	Prishtine		**Q229**	CMC Ekocon	Prishtine
Q190	Toyota	Prishtine		**Q230**	Beson AG	Viti
Q191	Avis	Prishtine		**Q231**	Travel Kosova	Prishtine
Q192	Illyria	Prishtine		**Q232**	Jeta e Re	Istog
Q193	Swiss Diamond	Prishtine		**Q233**	Vd Products	Prishtine
Q194	Baron	Prishtine		**Q234**	Hyundai Auto	Prishtine
Q195	M Solution	Prishtine		**Q235**	Relux	Prishtine
Q196	Vlera Shpk	Shtime		**Q236**	Solid	Llapllaselle
Q197	Bkt	Prishtine		**Q237**	Blum	Prishtine
Q198	Neptun	Prishtine		**Q238**	Blum Blazic	Prishtine
Q199	Biotek	Prishtine		**Q239**	Seyntex	Prishtine
Q200	Stone Castle	Rahovec		**Q240**	Springs	Prishtine
Q241	Llap Com	F.Kosove		**Q247**	Himalayan Gorkha	Prishtine
Q242	Llap Com Kreaton	F.Kosove		**Q248**	Mamidoil	Prishtine
Q243	Everest	Prishtine		**Q249**	Hotel Union	Prishtine
Q244	Doner Kosova	Llapushnik		**Q250**	Sol K	Prishtine
Q245	Fair Shpk	Partesh				
Q246	Rexhi Gmbh	Gjilan				

Appendix E: Statistical Calculations

PAIRED SAMPLES T-TEST

Hypothesis I

Paired Samples Statistics

		Mean	N	Std.Deviation	Std.Error Mean
Pair 1	Mean: Low Labor Cost	3.518	197	1.3949	.0994
	Mean: Geographical Proximity	3.086	197	1.1055	.0788

Paired Samples Correlations

		N	Correlation	Sig.
Pair 1	Mean of paired samples	197	.941	.000

Paired Samples Test

Paired differences									
Pair 1	Paired Samples	Mean	Std.Deviation	Std.Error	Lower	Upper	T	df	Sig (two-tailed)
		.4315	.5167	.0368	.3589	.5041	11.72	196	.000

Hypothesis II

Paired Samples Statistics

		Mean	N	Std.Deviation	Std.Error Mean
Pair 1	Mean: Corruption prior 2008	3.662	68	1.2046	.1461
	Mean: Corruption in and after 2008	3.191	68	1.0546	.1279

Paired Samples Correlations

		N	Correlation	Sig.
Pair 1	Mean of paired samples	68	.909	.000

Paired Samples Test

Paired differences									
Pair 1	Paired Samples	Mean	Std.Deviation	Std.Error	Lower	Upper	t	df	Sig (two-tailed)
		.4706	.5028	.0610	.3489	.5923	7.717	67	.000

Hypothesis III

Paired Samples Statistics

		Mean	N	Std.Deviation	Std.Error Mean
Pair 1	Mean: Migration	4.075	199	1.1500	.0815
	Mean: Weak Quality of Education	3.764	199	1.0729	.0761

Paired Samples Correlations

		N	Correlation	Sig.
Pair 1	Mean of paired samples	199	.886	.000

Paired Samples Test

Paired differences									
Pair 1	Paired Samples	Mean	Std.Deviation	Std.Error	Lower	Upper	t	df	Sig (two-tailed)
		.3116	.5351	.0379	.2368	.3864	8.21	198	.000

FREQUENCY TABLES

Economic Stability					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	21	10.3	10.6	10.6
	2	36	17.6	18.1	28.6
	3	37	18.1	18.6	47.2
	4	62	30.4	31.2	78.4
	5	43	21.1	21.6	100.0
	Total	199	97.5	100.0	
Missing	System	5	2.5		
Total	204	100.0			

Regional/Continental Market					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	37	18.1	19.8	19.8
	2	35	17.2	18.7	38.5
	3	64	31.4	34.2	72.7
	4	22	10.8	11.8	84.5
	5	29	14.2	15.5	100.0
	Total	187	91.7	100.0	
Missing	System	17	8.3		
Total	204	100.0			

Geographical Proximity					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	22	10.8	10.8	10.8
	2	32	15.7	15.7	26.5
	3	64	31.4	31.4	57.8
	4	65	31.9	31.9	89.7
	5	21	10.3	10.2	100.0
	Total	204	100.0	100.0	
Missing	System	17	8.3		
Total	204	100.0			

Incentive Packages					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	116	56.9	79.5	79.5
	2	13	6.4	8.9	88.4
	3	10	4.9	6.8	95.2
	4	5	2.5	3.4	98.6
	5	2	1.0	1.4	100.0
	Total	146	71.6	100.0	
Missing	System	58	28.4		
Total	204	100.0			

Cultural Closeness					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	32	15.7	18.9	18.9
	2	45	22.1	26.6	45.6
	3	22	10.8	13.0	58.6
	4	44	21.6	26.1	84.6
	5	26	12.7	15.4	100.0
	Total	169	82.8	100.0	
Missing	System	35	17.2		
Total	204	100.0			

Previous Business Relations					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	41	20.1	20.1	20.1
	2	24	11.8	11.8	31.9
	3	50	24.5	24.5	56.4
	4	40	19.6	19.6	76.0
	5	49	24.0	24.0	100.0
	Total	204	100.0	100.0	
Missing	System	41	20.1	20.1	20.1
Total	245	24	11.8	11.8	31.9

Quality of Infrastructure					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	22	10.8	12.2	12.2
	2	28	13.7	15.5	27.6
	3	44	21.6	24.3	51.9
	4	43	21.1	23.8	75.7
	5	44	21.6	24.3	100.0
	Total	181	88.7	100.0	
Missing	System	23	11.3		
Total	204	100.0			

Local Market					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	47	23.0	24.7	24.7
	2	34	16.7	17.9	42.6
	3	45	22.1	23.7	66.3
	4	43	21.1	22.6	88.9
	5	21	10.3	11.1	100.0
	Total	190	93.1	100.0	
Missing	System	14	6.9		
Total	204	100.0			

Local Suppliers					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	76	37.3	47.5	47.5
	2	35	17.2	21.9	69.4
	3	22	10.8	13.8	83.1
	4	19	9.3	11.8	95.0
	5	8	3.9	5.0	100.0
	Total	160	78.4	100.0	
Missing	System	44	21.6		
Total	204	100.0			

Taxes					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	53	26.0	31.0	31.0
	2	25	12.3	14.6	45.6
	3	31	15.2	18.2	63.7
	4	44	21.6	25.7	89.5
	5	18	8.8	10.5	100.0
	Total	171	83.8	100.0	
Missing	System	33	16.2		
Total	204	100.0			

Low Labor Costs					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	24	11.8	12.2	12.2
	2	26	12.7	13.2	25.4
	3	39	19.1	19.8	45.2
	4	40	19.6	20.3	65.5
	5	68	33.3	34.5	100.0
	Total	197	96.6	100.0	
Missing	System	7	3.4		
Total	204	100.0			

EU Perspective					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	37	18.1	19.5	19.5
	2	50	24.5	26.3	45.8
	3	48	23.5	25.3	71.1
	4	28	13.7	14.7	85.8
	5	27	13.2	14.2	100.0
	Total	190	93.1	100.0	
Missing	System	14	6.9		
Total	204	100.0			

Export					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	52	25.5	27.8	27.8
	2	30	14.7	16.0	43.9
	3	29	14.2	15.5	59.4
	4	36	17.6	19.3	78.6
	5	40	19.6	21.4	100.0
	Total	187	91.7	100.0	
Missing	System	17	8.3		
Total	204	100.0			

Ethnic Tensions					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	36	17.6	18.8	18.8
	2	42	20.6	21.9	40.6
	3	61	29.9	31.8	72.4
	4	33	16.2	17.2	89.6
	5	20	9.8	10.4	100.0
	Total	192	94.1	100.0	
Missing	System	12	5.9		
Total	204	100.0			

Government Stability					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	29	14.2	15.7	15.7
	2	43	21.1	23.2	38.9
	3	75	36.8	40.5	79.5
	4	32	15.7	17.3	96.8
	5	6	2.9	3.2	100.0
	Total	185	90.7	100.0	
Missing	System	19	9.3		
Total	204	100.0			

Religious Tensions					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	57	27.9	31.8	31.8
	2	46	22.5	25.7	57.5
	3	36	17.6	20.1	77.7
	4	25	12.3	14.0	91.6
	5	15	7.4	8.4	100.0
	Total	179	87.7	100.0	
Missing	System	25	12.3		
Total	204	100.0			

Corruption					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	18	8.8	8.8	8.8
	2	17	8.3	8.3	17.2
	3	31	15.2	15.2	32.4
	4	88	43.1	43.1	75.5
	5	50	24.5	24.5	100.0
	Total	204	100.0	100.0	

Socio-Economic Conditions					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	12	5.9	6.1	6.1
	2	32	15.7	16.2	22.3
	3	77	37.7	39.1	61.4
	4	57	27.9	28.9	90.4
	5	19	9.3	9.6	100.0
	Total	197	96.6	100.0	
Missing	System	7	3.4		
Total	204	100.0			

Problems with Serbia					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	16	7.8	8.6	8.6
	2	23	11.3	12.3	20.9
	3	52	25.5	27.8	48.7
	4	50	24.5	26.7	75.4
	5	46	22.5	24.6	100.0
	Total	187	91.7	100.0	
Missing	System	17	8.3		
Total	204	100.0			

Legal Framework					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	12	5.9	6.1	6.1
	2	9	4.4	4.6	10.7
	3	30	14.7	15.3	26.0
	4	53	26.0	27.0	53.1
	5	92	45.1	46.9	100.0
	Total	196	96.1	100.0	
Missing	System	8	3.9		
Total	204	100.0			

Trade Barriers					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	8	3.9	4.2	4.2
	2	38	18.6	19.9	24.1
	3	100	49.0	52.4	76.4
	4	29	14.2	15.2	91.6
	5	16	7.8	8.4	100.0
	Total	191	93.6	100.0	
Missing	System	13	6.4		
Total	204	100.0			

Physical Security					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	59	28.9	31.1	31.1
	2	47	23.0	24.7	55.8
	3	39	19.1	20.5	76.3
	4	30	14.7	15.8	92.1
	5	15	7.4	7.9	100.0
	Total	190	93.1	100.0	
Missing	System	14	6.9		
Total	204	100.0			

Investor Treatment					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	16	7.8	7.8	7.8
	2	9	4.4	4.4	12.3
	3	7	3.4	3.4	15.7
	4	47	23.0	23.0	38.7
	5	125	61.3	61.3	100.0
	Total	204	100.0	100.0	
Valid	1	16	7.8	7.8	7.8
Total	2	9	4.4	4.4	12.3

Young Age of Population					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	8	3.8	4.4	4.4
	2	19	9.1	10.4	14.8
	3	32	15.4	17.6	32.4
	4	91	43.8	50.0	82.4
	5	32	15.4	17.6	100.0
	Total	182	87.5	100.0	
Missing	System	26	12.5		
Total	208	100.0			

MSc/MBA Degree					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	7	3.4	4.0	4.0
	2	42	20.2	24.0	28.0
	3	35	16.8	20.0	48.0
	4	70	33.7	40.0	88.0
	5	21	10.1	12.0	100.0
	Total	175	84.1	100.0	
Missing	System	33	15.9		
Total	208	100.0			

Craft Qualification					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	15	7.2	7.2	7.2
	2	31	14.9	14.9	22.1
	3	46	22.1	22.1	44.2
	4	24	11.5	11.5	55.8
	5	92	44.2	44.2	100.0
	Total	208	100.0	100.0	
Valid	1	15	7.2	7.2	7.2
Total	2	31	14.9	14.9	22.1

Work Experience					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	15	7.2	7.7	7.7
	2	24	11.5	12.3	20.0
	3	47	22.6	24.1	44.1
	4	54	26.0	27.7	71.8
	5	55	26.4	28.2	100.0
	Total	195	93.8	100.0	
Missing	System	13	6.3		
Total	208	100.0			

Bachelor Degree					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	7	3.4	3.5	3.5
	2	27	13.0	13.4	16.9
	3	55	26.4	27.4	44.3
	4	64	30.8	31.8	76.1
	5	48	23.1	23.9	100.0
	Total	201	96.6	100.0	
Missing	System	7	3.4		
Total	208	100.0			

Low Wages					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	7	3.4	3.5	3.5
	2	21	10.1	10.6	14.1
	3	28	13.5	14.1	28.1
	4	85	40.9	42.7	70.9
	5	58	27.9	29.1	100.0
	Total	199	95.7	100.0	
Missing	System	9	4.3		
Total	208	100.0			

Isolation					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	7	3.4	3.4	3.4
	2	8	3.8	3.9	7.3
	3	14	6.7	6.5	14.1
	4	92	44.2	44.7	58.7
	5	85	40.9	41.3	100.0
	Total	206	99.0	100.0	
Missing	System	2	1.0		
Total	208	100.0			

Weak Quality of Education					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	7	3.4	3.5	3.5
	2	20	9.6	10.1	13.6
	3	41	19.7	20.6	34.2
	4	76	36.5	38.2	72.4
	5	55	26.4	27.6	100.0
	Total	199	95.7	100.0	
Missing	System	9	4.3		
Total	208	100.0			

Lack of Qualified Workers					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	7	3.4	3.5	3.5
	2	21	10.1	10.4	13.9
	3	35	16.8	17.4	31.3
	4	41	19.7	20.4	51.7
	5	97	46.6	48.3	100.0
	Total	201	96.6	100.0	
Missing	System	7	3.4		
Total	208	100.0			

Migration					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	9	4.3	4.5	4.5
	2	14	6.7	7.0	11.4
	3	28	13.5	13.9	25.4
	4	50	24.0	24.9	50.2
	5	100	48.1	49.8	100.0
	Total	201	96.6	100.0	
Missing	System	7	3.4		
Total	208	100.0			