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*Research Article*

# Business Environment in Kosovo

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**_Abstract_**

*The environment as a term implies natural, social space and the infrastructure in general. It is widely acknowledged and accepted that the improvement of a business environment - including financial, regulatory, legal, and institutional aspects - has a positive impact on the overall development of the private sector. In this paper we tried to identify the challenges and their impact on business in Kosovo and to present an actual survey of this significant economic activity. We have developed this study based on three following methods: the method of collecting analysis and information of professional character, the comparative method and the quantitative method. Also the aim of this analysis of challenges that refer to business environment in general, strengths and weaknesses, the opportunities and risks that can occur during the process of transition and the role of government will be analyzed in relation to the stimulation of decreasing negative barriers to improve the overall environment.*

***Keywords:*** *challenges of SMEs, business environment, economic expansion, barriers in doing business, employment, macroecomic factors, international trade*

## Introduction

The impact of private sector development on improving the socio-economic wellbeing of a country is unequivocal. This sector performs efficiently in both small and large scale production, it creates conditions for innovative solutions to technical and operational barriers, and it fosters technological innovation and knowledge transfer.

The private sector has been essential to achieving meaningful development outcomes around the world. This sector constitutes the greatest share of GDP in many developing countries. It is also responsible for around 90 percent of the jobs in the world (World Bank, 2012), and carries the heaviest weight in achieving the first Millennium Development Goal (MDG) of halving the proportion of people living on less than 1 dollar per day by 2015 (CIDA, 2003). Additionally, in many countries the private sector generates a large portion of tax revenues necessary to provide health care, education, and other important public services. Put differently, the private sector represents the main source of economic growth, job creation, poverty alleviation, and government revenues in many developed and developing countries.

Although Kosovo's economic growth has outperformed its neighbors and been largely inclusive, it has not been sufficient to reduce high rates of unemployment; provide formal jobs, particularly for women and youth; and reverse the trend of large-scale outmigration. With negative domestic savings, the current growth model relies heavily on remittances and aid, which have been important for growth and poverty reduction. This dependency, together with Kosovo's structural characteristics (small size, past legacies, fragility, eurobased economy), is also putting pressure on competitiveness and productivity, limiting job creation and business expansion in the tradable sector.

Central to private sector developments are considerable efforts to further develop and prepare young Kosovars for high-skilled employment. Nearly a quarter (23 percent) of firms state that an inadequately educated workforce is a "major constraint" to their business. This requires more regular, consistent, and strategic consultations with the private sector so as to (i) improve job placement programs (alignment with market demand); (ii) develop business and management know how; (iii) facilitate a more significant transfer of skills and information, research, and development; and (iv) improve the overall access and quality of formal education, from early childhood to tertiary education

With per capita GDP estimates of close to €3,000, Kosovo is one of the poorest countries in Europe. Average per capita income is about one-tenth that of EU levels, and the incidence of poverty remains high. Standardized poverty lines used by the World Bank—

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defined by a threshold of US$5 per person per day (at purchasing power parities)—lead to poverty rates of about 80 percent. Using the domestic poverty line of €1.72 per day (2011 data) as defined by the Kosovo Agency of Statistics, 29.7 percent of its population of 1.8 million are considered poor. Kosovo has a relatively low Gini index and flat consumption distribution, with poverty rates declining gradually. No significant differences exist between urban and rural poverty, but there are notable regional differences. Extreme poverty is disproportionately high among children, the elderly, households with disabled members, female-headed households, and certain ethnic minority households (especially in the Roma, Ashkali, and Egyptian communities). As in many other countries, there is a strong negative correlation between education and poverty.

**Kosovo at a glance**

Kosovo is a relatively small country located in the South-East Europe. It has a population of approximately 1.8 million, with 50.55 percent male and 49.45 percent female, and 61 percent of people living in rural areas. There are 163.2 residents per square kilometer and approximately 297,090 households with 5.9 people each, on average.

In the postwar period, Kosovo has implemented numerous reforms that in one way or another were aimed to have an effect on the economic development of the country, and ultimately pave country's path towards the European Union integration. These reforms included improvements in the doing business environment through improvement of national legislation, fiscal policies, and fighting corruption. However, regardless of all the work that has been done in narrowing the gap between Kosovo and other regional countries with regards to doing business, unfortunately this gap is still very much evident, and Kosovo businesses still face challenges and problems of different nature. In this context, the American Chamber of Commerce in Kosovo has conducted a Study on the Opportunities and Challenges of Doing Business in Kosovo, with the aim of conducting a comprehensive analysis of the state of businesses, and then based on the findings of the study, the appropriate recommendations can be offered to respective institutions, that are responsible for tackling of potential problems that the private sector faces.

Kosovo's economic profile does not look very healthy. Kosovo continues to struggle with high rates of unemployment. The Kosovo 2016 Labour Force Survey results (2016) show that around 1.2 million, or two-thirds of the total population, form the working age group (people aged 15-64). Of the total working age group, only 41.3 percent are active in the labour force (491,260 people). From the total number of active people in the labour force, 71.3 percent (350,489 people) are employed and 28.7 percent are unemployed (140,771 people). The same source states that unemployment is much higher for women than it is for men, at 40.0 percent compared to 28.1 percent, respectively. The most discouraging figure is the youth unemployment rate (aged 15-24), which is the highest among all age groups at 52.2 percent . Around 64.9 percent of young females and 47.0 percent of young males in the labour force are unemployed. The high rate of unemployment among the youth population might have affected to some extent their self-confidence, as they have not been provided an opportunity to demonstrate their skills and talents. As a result, many of them are discouraged and seek to work outside Kosovo. The general high rate of unemployment, moreover, has led to a high poverty rate. In Kosovo, around 30 percent of the population lives in poverty, and around 11.1 percent lives in extreme poverty with less than €1 per day. The main reason behind these discouraging figures is linked to weak private sector development and low capital investments. The majority of Kosovo businesses provide jobs that require only low-level skills – this also has some effect on the motivation of workers to pursue proper education. Additionally, the few businesses that need advanced skills report that the universities and colleges in Kosovo do not link their curriculum effectively with the skills needed by the market; therefore, students equipped with diplomas from these institutions do not meet their demands.

Kosovo has recorded an average GDP growth rate of 3.3% over the last few years, marking one of the few countries in the region to have positive growth despite the Euro zone crisis. At the end of 2013, the country successfully concluded a two-year Stand-by-Arrangement with the International Monetary Fund (IMF) that helped guard the sustainability of public finance. With an estimated 2014 GDP of €5.4 billion, Kosovo is planning no budget growth with its 2014 budget of €1.5 billion. Its 9% of GDP public debt is well below international standards. The economy relies heavily on imports; exports cover only about 11% of its trading activities. Diaspora transfers at 12% of GDP account for a substantial part of the economy, with risks of decreases if the effects of the Euro zone crisis persist. The informal economy is estimated at 40% of GDP. While the official unemployment rate is 30.9%, it is believed to be closer to 45%. In addition, a high level of perceived and actual corruption in the government and weak rule of law have taken their toll in attracting Foreign Direct Investment (FDI) and slowed the country's general economic development.

During 2013, Kosovo's economy is estimated to have grown at a rate of 2.5 percent with a GDP of €5.15 billion in nominal value and €2,794 GDP per capita (IMF, 2013). Compared to neighbouring countries, Kosovo's economic performance is not at a satisfactory level, as the GDP per capita is the lowest among them. According to the World Bank (2014), in 2012 the highest GDP per capita was recorded by Montenegro (€5,275), followed by Serbia (€3,930), Macedonia (€3,545), Bosnia and Herzegovina (€3,429), Albania (€3,091) and the last one with the lowest GDP per capita is Kosovo (€2,708). As a result of the low growth rate, which has been unable to satisfy the country's development needs and to improve citizens' living standards, Kosovo remains the poorest country in the region, and Europe as well.

Similar to previous years, with slight increase with 3.8% , in 2016 Kosovo's economy has continued to face high current account deficit, which is mainly caused by high trade deficit. According to Kosovo Customs (2014), the trade deficit in 2013 is €2.1 billion, recording a decrease from €2.2 billion in 2012. Some of the main trade partners are Italy, Turkey, Albania, Macedonia, India, Germany, Montenegro, and Serbia2 . During 2013, Kosovo has exported mostly to Italy, with around 25 percent of the total share of exports, and imported mostly from Serbia with 12 percent share of total imports. Apart from geographical proximity and historical factors, an additional reason why Kosovo has mainly engaged in trade with neighbouring countries is the Central European Free Trade Agreement (CEFTA) which was signed in 2006 among Kosovo (with UNMIK as signatory), Albania, Bosnia and Herzegovina, Croatia, Macedonia, Moldova, Montenegro, and Serbia (CEFTA, 2014).

In 2015, the balance of FDIs was euro 287.3 million, which represents a high increase compared to the value of euro 123.8 million in the previous year. Foreign Direct Investments (FDIs) received in Kosovo during 2015 amount to euro 324.4 million (euro 151.2 million in 2014). Within the structure of FDIs, both forms of FDIs were characterized with an increase of the value, including the capital and fund of investments in shares, as well as investments in debt instruments. The capital and the fund of investments in shares, which represent around 71.0 percent of total FDIs, amounted to euro 243.7 million or 109.1 percent more than in the previous year. Higher increase rate (133.2 percent) was marked by FDIs in the form of debt instruments, which amounted to euro 80.7 million in 2015 . One of the reasons for the significant decline during the 2008-2010 period can be attributed to the global financial crisis. It is also important to note that the privatization of public enterprises usually brings the largest amounts of FDI; therefore, the decline can be attributed also to end of the largest waves of privatization in the country. However, the same cannot be stated for the 2011-2013 period. The main reasons for FDI decline can mainly be traced to the bad image of Kosovo created by the high level of corruption (Corruption Perception Index ranks Kosovo in the 95th place out of 176 positions with a 36/100 score), extortion, organized crime and bureaucracy, and other similar problems. Regarding the origin of FDI, European Union (EU) countries continue to be the main investors in Kosovo.

**Private sector development**

As stated in the beginning of this report, private sector development is of critical importance as it creates enterprises leading to more jobs and empowerment, brings new technology and innovation, and increases the income of the country as a result. Indeed, in many developing countries, the private sector is considered the primary engine of economic growth. Despite its important role, the figures about this sector in Kosovo are not very encouraging, especially when compared with neighbouring countries.

Kosovo has a very low number of newly created businesses, and many of those fail shortly after their establishment. To be more specific, Kosovo's new business density in 2012 (new registrations per 1,000 people ages 15-64) was 4.27. It is noteworthy to mention that 92 percent of Kosovo businesses are micro-enterprises (1-9 employees), mostly family-owned businesses, thus having limited potential for innovation and to reach beneficial economies of scale. The geographic distribution of Kosovo businesses, moreover, is highly unequal. The overwhelming majority (one third of them) are concentrated around Prishtina, leaving other parts of Kosovo less developed. Similarly, the performance of Kosovo businesses does not appear to be satisfactory. A Riinvest Institute survey (2013) reveals that, compared to the previous year, an average of 54 percent of the existing Kosovo businesses stated that their sales have decreased (a decrease of 34 percent), 21 percent stated that the sales increased (an increase of 22 percent), and 25 percent of them claimed that their sales recorded no changes. Furthermore, the survey reveals that businesses in Kosovo make the bulk of their sales within the country. On average, 89 percent of the total sales are made in Kosovo, whereas the remaining 11 percent are made outside Kosovo.

A range of different obstacles contribute to the unfavorable picture of the private sector. Barriers associated mostly with the unsatisfactory level of law enforcement constitute the major barriers hindering the creation and development of new firms in the private sector. More specifically, Riinvest Institute (2013) reveals that barriers such as unfair competition (driven by tax evasion and informality in general), corruption, organized crime, and a non-functioning court system are perceived as the most serious obstacles by businesses. It is worth noting here that, due to the sluggish performance of the judiciary system, 62 percent of Kosovo businesses, according to the Riinvest survey, claimed that they do not trust courts at all. Other barriers commonly faced by businesses include limited access to finance, high cost of finance (the Kosovo Chamber of Commerce, 2013; MTI 2013), and fiscal barriers.

Shortly, based on this picture, it appears that Kosovo is struggling to create a favourable businesses climate that would create the preconditions for a healthy and sustainable private sector, which in turn would lead to new competitive businesses, new jobs, and an improvement in the overall socio-economic wellbeing of the people.

**Doing Business in Kosovo: A view on the key policy implications**

Business is an important tool for economic development and stability. The establishment of an enabling business environment has been broadly acknowledged as an essential precondition for the private sector response that leads to dynamic growth, and ultimately employment and income generation. The Government, therefore, has the main role in creating an enabling business environment. For this reason, it is of immense importance to design rules and regulations that stimulate the growth of enterprises. Recently, policy makers and multinational organizations have increasingly focused on a sound investment environment as a strategy for economic development. Various reports from international organizations link the need to reform the business environment with attracting foreign investors, the key developments that would smooth the country's economic progress and social stability.

Kosovo's laws do not discriminate against foreign investors. The GoK – specifically the Prime Minister's Office, Ministry of Trade and Industry (MTI), Kosovo Investment and Enterprise Support Agency (KIESA), Ministry of Finance (MOF), and Ministry of Economic Development (MED) – actively promotes foreign investment and welcomes the expansion of the private sector. However, the lack of a single GoK organization empowered and responsible for coordinating all foreign investment opportunities is a hurdle to some projects. While the Kosovo economy continues to transition from socialism to capitalism, some public distrust of the private sector remains.

Strengthening the business environment in Kosovo is a mechanism that would support an increase of foreign direct investments and would accelerate the institutionalization of competitive conditions for both domestic business growth and external businesses' investments in Kosovo. Moreover, the development of a more attractive business environment would in turn improve Kosovo's attractiveness in the region and for the whole of Europe. However, despite its importance, there has not been any significant improvement in the business environment of Kosovo over the past two years. Numerous shortcomings have been identified by several reports. Being in a fairly early stage of the transition process and also an early stage of state building, Kosovo is encountering severe challenges in creating an enabling business environment. Due to the lack of seriousness and maturity of policy-makers regarding this issue, Kosovo, together with Bosnia-Herzegovina, today ranks as the least attractive business environment in the SEE region. This lack of commitment from policy-makers and unsatisfactory business climate sends negative signals to foreign investors in regard to the possibilities for doing business in Kosovo. Based on the World Bank's Doing Business indicators, Kosovo ranked 60th out of 183 countries in both 2017, while the indicators for starting a business, dealing with construction permits, protecting minority investors, and enforcing contracts ranked Kosovo even lower (see Table 1).

Kosovo is continuing efforts to transform its socialist legacy to a market-oriented economy, and the GoK is working to strengthen the legal environment necessary to attract and retain foreign investment. Corruption, practiced and perceived, and a lack of contract enforcement create high barriers to foreign investment. According to the World Bank, Kosovo's economy is characterized by: limited integration into the global economy; the success of its Diaspora in foreign labor markets, resulting in a steady stream of remittances; pro-growth budgetary priorities; and continued international financial support. Vocal political opposition to the government's privatization policies, corruption, political or self-interested interference by government officials, disagreements over asset ownership between Kosovo and Serbia, and unreliable energy supply increase the risk and cost of investments in Kosovo.

Despite these challenges, Kosovo's relatively young population, low labor costs, and abundant natural resources have attracted foreign investment, with several international firms and franchises already present in the market. There are opportunities for U.S. businesses to invest, especially in the food, IT, infrastructure, and energy sectors. The newly-elected government is seeking to further improve the business climate through the adoption of a multi-year development program focused on providing incentives for economic growth. These include amendments to tax and foreign investment legislation. The banking sector in Kosovo is stable and liquid, but high interest rates stifle commercial endeavors, prompting the government to enter into credit-guarantee arrangements with international donors to improve access to credit for businesses.

**Table 1** Rank of indicators in 2016 and 2017

| Indicator | Rank in 2017 | Rank in 2016 | Change in rank |
|---|---|---|---|
| Overall | 60 | 64 | ↑4 |
| Starting Business | 13 | 27 | ↑14 |
| Dealing with construction permits | 129 | 125 | ↓4 |
| Getting Electricity | 114 | 111 | ↓3 |
| Registering Property | 33 | 33 | - |
| Getting Credit | 20 | 19 | ↓1 |
| Protecting Minority Investors | 63 | 62 | ↓1 |
| Paying Taxes | 43 | 77 | ↑34 |
| Trading accros Borders | 51 | 59 | ↑8 |
| Enforcing Contracts | 44 | 43 | ↓1 |
| Resolvin Insolvency | 163 | 164 | ↑1 |

Source: World Bank Doing Business Report 2017

The position of business environment in Kosovo: challenges and their impact in business

Since 1999, Kosovo Economy has been mainly built on international donor assistance, public sector expenditures and remittances from Kosovo Diaspora

(WB, 2010). Until now, the role of the private sector, in particular of SMEs, has been relatively weak. Kosovo is passing through an early transitional stage where entrepreneurship is still a new concept and small businesses struggle with both internal and external constraints. Still, the SME sector in Kosovo represents the majority of employment and output, and it is on the development path towards business stabilisation.

Since the second quarter of 2011, Kosovo has made significant progress on strengthening its basic legal framework and institutional structures, with a view to reinforcing the necessary foundations for a functioning market economy. These reforms (partially supported by World Bank–financed projects and a multi-donor, World Bank–led budget support operation) have begun to be reflected in improved rule of law and business climate indicators, and Kosovo's ranking in the most recent Doing Business survey improved by 40 positions in two years. Several features in the overall business environment compare favorably to those of Kosovo's neighbors (such as flexible labor markets, an open trade regime, and a healthy banking sector); however, weak institutional capacity, unclear property rights, and a complicated and fragmented licensing and inspection regime continue to create disincentives for formal private sector activities.

From mid-2011 until end-2013, Kosovo's economy was managed well, but risks have been increasing. Kosovo is one of only four countries in Europe that has recorded positive growth rates in every year of the post-crisis period since 2008. The average growth of 3.5 percent during 2011–14 contrasted favorably to the region but was slightly below the global average. The growth outlook over the medium term remains moderately buoyant, as it recovered in 2015 to 3.6 percent from only 1.2 percent in 2014, according to Kosovo's Statistics Agency. The growth in 2015 is estimated at 3.6 percent, largely reflecting the solid increase in contributions from private investments by 4.2 percentage points and the positive contribution of consumption of 0.9 percentage points, fueled by foreign direct investment (FDI) and workers remittances.

Kosovo's laws do not discriminate against foreign investors. The GoK – specifically the Prime Minister's Office, Ministry of Trade and Industry (MTI), Kosovo Investment and Enterprise Support Agency (KIESA), Ministry of Finance (MOF), and Ministry of Economic Development (MED) – actively promotes foreign investment and welcomes the expansion of the private sector. However, the lack of a single GoK organization empowered and responsible for coordinating all foreign investment opportunities is a hurdle to some projects. While the Kosovo economy continues to transition from socialism to capitalism, some public distrust of the private sector remains.

**Box 1: Reforms in Doing Business in Kosovo** (Source: Ministry of Trade and Industry)

Aiming to enhance the capacity for conducting business in Kosovo and improve the ranking in the World Bank Doing Business Report, the Government of Kosovo has commenced a reform agenda. To date, several reforms have taken place:

1. The requirement of obtaining a work permits in order to start-up a business has been eliminated, and the procedure for registering a business has been simplified.
2. The business registration fee has been eliminated. Prior to this reform, it cost € 24 to register a LLC business
3. The required deposit of main assets for businesses of the Joint Stock Companies has been reduced from €25.000 to €10.000.While of the required rate of deposit for LLC businesses was formerly €1.000,this required deposit of businesses' main assets has been removed.
4. The declarations on conflicts of interest have been advanced for directors and relevant officers. Also, the competent courts can easily annul transactions that violate the rules on conflicts of interest.
5. In order to export or import goods to or from Kosovo, businesses have been required to submit eight (8) different documents. Now the exporting and importing companies are not obliged to obtain export/import certificates. Yet, despite this reform, businesses still face several challenges due to the inefficient functioning of 'One Stop Shops'.[6]

Reforms in Kosovo aim at increasing domestic productivity and trade. Kosovo wants to shift its growth model from one driven by remittances and consumption to one driven by investment and the tradable sector. The resilience that Kosovo's economy has exhibited during the crisis period since 2008 has reflected (i) its limited integration into the global economy; (ii) the success of its diaspora, resulting in a steady influx of remittances; (iii) a pro-growth composition of the budget; and (iv) the steady inflow of donor support. In the absence of fiscal and monetary policy tools, key challenges continue to be the need for reforms aimed at strengthening public administration to increase the quality of, and access to, public services, reinforcing the business climate, and upgrading public infrastructure. These reforms, closely embedded in the EU integration process, are key policy instruments to attract direct investments of the scale, scope, and quality needed to increase productivity in key sectors of the economy, generate "catch up" growth, and ultimately, reduce the high rates of unemployment and poverty.

Strengthening of domestic demand in the euro area in 2015 was positively reflected on the economic developments in the Western Balkans. During this period, economic activity in this region was characterized by growth, mainly driven by the increase of domestic demand and strengthening of the external demand. In 2015, real GDP growth rate in the Western Balkans is estimated to have been around 2.4 percent, while for 2016, the IMF forecasts show an average acceleration growth of GDP of 3.2 percent.

Developments within the private business registry in the first nine months of 2015 were characterized with an increase of new enterprise number and also an increase of closed businesses. The number of total new enterprises until September 2015 was 7.353 compared to 7.230 as it was in the same period of the previous year. The number of total closed enterprises until September 2015 reached 1.235 compared to 1.224 closed businesses as it was in the same period of 2014 (figure 26). In in the first nine months of 2015, the ratio of closed enterprise to new ones was 16.7 percent (17.1 percent in the same period of the previous year).

The structure of GDP in Kosovo is dominated by the services sector 3, which have a share of around 50 percent to total structure of GDP. Within the total GDP, public administration has a share of 13.4 percent, followed by the trade and agriculture sector, which have a share of 12.2 and 11.3 percent, respectively, to total GDP. Considerable share have also the sectors of the processing industry (9.7 percent) and the real estate business (8.8 percent)

Until September 2015 industrial manufacturing in the country appears to have marked a decline in its circulation in the extractive industries with an average of 22 percent. At the same period, a circulation decline was marked also in supply with electricity, gas, steam and conditioned air and water supply, the activities of management and treatment of garbage (with an average of 3 and 10 percent, respectively) (figure 25). On the other hand, industrial production resulted to have marked a circulation growth in the sector of processing industry (around 11 percent of an average until September 2015).

**Effect of corruption and informality on doing business**

Informality is a central driver of unfair business practices, including corruption and tax evasion. Riinvest's own assessments estimate that the informal sector in Kosovo is responsible for approximately 25 percent of GDP.

In 2011, a survey conducted by Riinvest and UNDP showed that Kosovan businesses perceive unfair competition – driven by tax evasion and informality – as the top barrier in a list of 22 other barriers. This was the very first time where "unfair competition" topped the list of barriers, following a set of studies from previous years that introduced corruption and/ or electricity supply as the main barriers in doing business.

Kosovo is at an early stage/has some level of preparation in the fight against corruption. Kosovo has strengthened its institutional capacities to fight corruption and organised crime, with the establishment of multi-disciplinary investigative teams, the set-up of a tracking mechanism for high level corruption and organised crime cases, as well as the fostering of serious crime department of basic courts. This has led to an increased number of high-level cases being investigated and prosecuted. However, corruption remains prevalent in many areas and continues to be a very serious problem. A stronger political will to tackle this in a comprehensive manner is necessary.

Kosovo has enacted strong legislation to combat corruption, but the government has thus far been unsuccessful in efforts to investigate, prosecute, confiscate the assets of, and jail corrupt individuals. The Anti-Corruption Agency and the Office of Auditor General are government agencies mandated to fight corruption. The Law on Prevention of Conflict of Interest and Discharge in Public Function, as well as the Law on Declaration, Origin, and Control of Property of Public Officials, are intended to combat nepotism. They require senior public officials and their family members to disclose their property and its origins. The Criminal Code also punishes bribery and corruption; however, corruption is widespread.

Informality-related barriers turn out to be among the most serious issues faced by the surveyed businesses. Of the three barriers of this group, 'corruption' and 'unfair competition' are ranked among the top five most severe barriers. Their significantly negative impact on the ease of doing business has remained almost unchanged compared to 2009. The situation seems to be quite similar in all economic regions. Both of them are substantially harmful to businesses as they negatively affect operating costs, increase risk and impede the healthy competitiveness of the market. Over the next four years, these two barriers are expected to decline, albeit not to a level that can be considered not harmful to businesses. On the other hand, despite people's perceptions that extortion is a wide spread phenomenon in Kosovo, businesses in general perceived that it was not a very pressing issue in any of the periods. However, unlike businesses of other regions, businesses of Region West appear to be confronted by this informal practice far more frequently.

Among informality-related barriers, 'corruption' has been considered as the most severe barrier over the last four years. The results of the survey indicate that this obstacle is rated with 82 intensity points for the period of 2009. The interviewed businesses considered that this barrier has not lessened much, as they indicated only 0.8 points decrease for the present period. The future seems to be encouraging in this respect. Specifically, business responses suggest that the impact of 'corruption' on SME's in 2017 will be lower compared to the present period for roughly 13 percent. Running a company is essentially a private sector activity oriented towards suppliers and customers, but business activities also require frequent interactions with public officials for various purposes such as customs clearing, building permits, tax and labour inspection etc. The afore-mentioned figures reveal that over the last four years, businesses have been confronted with corrupt public officials and/or inefficient regulations that have made bribery an inevitable act necessary to get things done. In other words, these scores imply that businesses have to set aside a large portion of their resources to pay direct private benefits to public officials in order to secure certain government services. These bribes can be considered an additional 'unofficial tax' to businesses, and consequently an additional burden that prevents them from growing. It is noteworthy to mention that corruption is acknowledged as a widespread phenomenon by every credible source, not only by those capturing the perceptions of businesses. For instance, in 2016 Kosovo scored a Corruption Perception Index (CPI) of 36 (0 – most corrupt; 100 – least corrupt) and was ranked 95h in the rankings of 177 countries released by Transparency International – that is worse than Macedonia which is ranked 90th, Montenegro 64th, and Albania 83nd.

**Fiscal barriers on doing business**

The state budget during 2015 experienced an increase of revenue and expenses. Revenue increased by 9.3% to EUR 1.46 billion. Revenues collected at the borders continue to dominate the structure of budget revenues, and represented 65% of the total revenues in 2015. Revenues collected from border taxes reached EUR 944.9 million, marking an annual increase of 18.8% in comparison to 2014. Non-tax revenues amounted to EUR 188.1 million or 9.8% higher than the previous year. Budget expenditure in 2015, not including designated donor grants and trust funds, stood at EUR 1.57 billion and recorded an annual growth of 6.2%. Capital expenditures in 2015 absorbed 25.8% of the total expenditure reaching EUR 404 million, which represents a decrease of 1.8% from the previous year. Most of the capital expenditure in 2014 and 2015 was intended for infrastructure investments, which largely consisted of the construction of the Pristina-Hani i Elezit highway, which began in July 2014. According to the Central Bank of Kosovo, during 2015 Kosovo's budget recorded a primary deficit of EUR 110.2 million, compared with the deficit budget balance of EUR 143 million in 2014. In the same period, general government debt amounted to EUR 748.9 million, or 12.98% of GDP (10.63% in 2014). This increase in public debt in 2015 is mainly accounted for by the growth of domestic debt of 47.3% which reached EUR 378 million, while the external debt increased significantly by 13.7%, reaching EUR 371 million. While in previous years public debt was dominated by external debt, at the end of 2015 domestic debt had a higher share (50.4%) of the total public debt.

Fiscal barriers are thought to be moderately challenging by the interviewed firms. Apart from 'high tax rates', which is ranked 6th in the general ranking of barriers, 'high customs tariffs and heavy trade regulation' and 'inefficient tax administration' ended up in the middle places (1lth and 15th, respectively) of the list. Region Centre stands, to some extent, better vis-à-vis other regions. The three fiscal barriers are believed to be of a lesser intensity four years from now. Only businesses of Region South make a distinction in this regards, especially when it comes to 'high tax rates' and 'inefficient tax administration'; they appear to be not so optimistic about the future of these barriers compared to other regions.

Kosovo has adopted various constitutional and legal stipulations to prevent public debt from rising to unsustainable levels. They include (i) a public debt law that sets the maximum public debt-toGDP ratio at 40 percent (which was reduced to 30 percent of GDP in a recent amendment of the fiscal rule); (ii) a constitutional stipulation, according to which external borrowing by the Government, including for highly concessional International Development Association (IDA) credits, would require parliamentary ratification with a qualified majority; (iii) a law on public financial management and accountability that requires any supplementary budget to be "deficit neutral"; and (iv) a fiscal rule aimed at limiting overall budgetary deficits, with few exceptions, to 2 percent of GDP (as agreed with the International Monetary Fund [IMF]).

'High tax rates' tops the list of fiscal constraints in all the periods taken into account in this study. This fiscal obstacle received an intensity score of 76.3 for the period of 2009, dropping slightly to 74.8 in the next period (2013). This marginal decrease might be partially associated with the reforms implemented at the end of 2009 that halved taxation on profits – but not sufficiently enough to improve perception as several other taxes have increased during this period (amongst others VAT). For 2017, the businesses expect, though ambitiously, that this barrier will further decrease by roughly 14 percent, receiving an intensity score of 64.4. The high intensity scores appearing on the survey results are in part due to the arbitrary interpretation of obscure tax regulations, selective tax levies and associated extortion by the tax administration. These "dishonest" practices were increasingly present, especially over the recent years as the Government has felt pressure to meet its revenue forecasts in order to be able to bear the heavy involvement in capital investments.

A breakdown of the data for 'high tax rates' by regions reveals that for 2009 the intensity scores varied from 70.1 in Region Centre to 82.9 in Region South. Region North leans more towards the lower value with 72.5; whereas Region East (79.8) and Region West (78.9) leans towards the upper value. Four years after (in 2013), it appears that the severity of this barrier has not lowered as the intensity scores decreased negligibly; not more than 2 points in each economic region, indicating that it is still a major challenge obstructing the development of firms. In 2017, however, the severity of this barrier is forecasted to lessen in four economic regions, besides Region South (for visual representation, see Figure 13). The pessimistic expectations of the businesses of Region South suggest that the unfair practices resulting in indirect taxes are sort of deeply embedded phenomena which cannot be eradicated very easily. Although the tax administration is thought to be rather inefficient in general, the listed barrier of 'inefficient tax administration' is considered not so serious from the perspective of businesses for all periods. The intensity scores reveal that, in 2009, it was deemed to have stood at 54.6, followed by a decrease of 52.2 in 2013. Four years from now, it is anticipated to decrease further, receiving an intensity of 47 points.

**Effect of Public Procurement on Doing Business**

Historically, public procurement has been an area that has triggered a lot of negative attention from the entire society in Kosovo, especially in terms of the perceived presence of corruption. The number of companies whose existence is largely dependent on tenders is relatively high, and at the same time, given that the public sector is the largest buyer of products and services in the country.

The corruptive behavior of the public sector hugely affects the certainty and efficacy of the business environment. Therefore, it is important to note that the public procurement market in Kosovo is estimated to amount to around 800 million euro, thus representing roughly 14% of the country's GDP.16 In addition, a large proportion of firms in Kosovo are directly dependent on public tenders or public expenditures due to the inefficiency and scarcity of the market machine to provide means for the growth of the private sector. This situation breeds corruption and control from partisan offices. Public tendering, therefore, represents a key issue, whereby firms become vulnerable to the partisan control and accordingly politicized; this politicization seriously hinders the market opportunities and the private sector's self-regulating growth. This corruptive linkage, nowadays a very common determinant in Kosovo's public procurement market, not only hinders the efficiency of the business environment but also demises the concept of a market economy wherein competition is the determining indicator for a firm's success. The criteria for awarding public tenders are observed to be unreliable and uncertain. The public tendering officers often introduce artificial criteria concerning the eligibility and qualification process in favor of certain (or a group of) economic operators. This has hindered the ability of many qualified economic operators to be eligible for participation in the bidding process. Moreover, the assessment of the merit of the bidders is based in unspecific and immeasurable criterion, which paves the way for misuse of authority and the awarding of certain tenders who exist within their preferred partisan firms. This practice clearly disrespects the rules of awarding tenders based on merit. This raises several concerns regarding the pervasiveness of practices of favoritism and regarding the links between businesses and procurement offices.

**Legal barriers**

Besides 'inefficiency of courts system' which is deemed to be a very problematic barrier (5th in the list of general barriers),'unfavourable labour law' and 'contract violations by customers or suppliers' are perceived to be less serious by businesses (apart from those of Region West), thus ending up in the lower part of the general ranking. Despite the fact that the intensities of these barriers have not changed much over the last four years, in 2017 the three barriers in all regions besides Region South are projected to receive lower intensity scores; in other words, they are expected to be less pressing issues. The court system is perceived to be unreliable and unsatisfactory. The results of the survey suggest that 'non-functioning court system' tops the list of legal barriers with an intensity score of 77.8 for the period of 2009 and a slight improvement, less than 2 percent, for the period of 2013. This score indicates that Kosovo courts are not functional enough to ensure the security of property and the enforcement of contracts, which are of a crucial importance for investment, trade, and the overall growth of the private sector. To be more specific, the Commercial Court is to be blamed primarily, considering that it is the primary institution responsible for resolving economic and commercial disputes between legal entities. A report conducted by the US Department of State (2013) confirms this weaknesses prevailing in the Kosovo court system. According to this report, one of the main constraints to dispute resolution is the backlog in the entire court system. Compared to the current period, the expectations of the interviewed businesses about this barrier in the next four years appear to be much more positive (67.9 intensity points). This is in part due to the fact that recently established commercial arbitration has started to be widely used by businesses as a substitute for courts.

**Institutional barriers**

The two institutional barriers are rated as such so that they end up at two opposite poles of the general ranking list: on the one hand, 'unavailability of state subsidies' is perceived to be amongst the most serious barriers, whereas 'inefficient business licensing and business permits' among the least serious ones. The former improved somewhat moderately since 2009 and it is expected to improve considerably in 2017, apart from Region South, where projections of businesses are not so optimistic. The positive change of the latter over the three periods of the study is of a similar magnitude, with no major differences across regions. The results of the survey suggest that 'unavailability of state subsidies' was perceived to be a very severe obstacle for Kosovan SMEs in 2009. The intensity score for this barrier resulted in 82.3 points in this period. In addition, the results reveal that the severity of this barrier has not decreased notably since that time. It receives a score of 81.1. When asked about the severity of this barrier four years from now, the interviewed firms appear to more enthusiastic compared to now. According to their responses, the intensity is expected to decline to 70.1. The high intensity of this barrier indicates that Kosovo firms need to receive some support from the state as they are not competitive enough to compete with firms exporting to Kosovo – which in many cases benefit from state subsidies. As a matter of fact, the ratio of imports to exports in Kosovo is around 10:1 (Kosovo Agency of Statistic, 2013). Note that this barrier might be overrated, bearing in mind the tendency of businesses to have higher expectations for subsidies. Unavailability of state subsidies' is perceived to be amongst the most serious barriers.

**Labour force barriers**

The unemployment rate in Kosovo is estimated to be 32%, according to the latest available statistics from the Kosovo 2014 Labor Force Survey carried out by the Kosovo Agency of Statistics. Unemployment is higher among youth and women. The situation is not expected to improve quickly given that Kosovo has the youngest population in Europe and these individuals enter the labor market each year finding limited employment options. On the other hand, the labor market offers a work force with varied skills and levels of education and training. An important component of Kosovar life and the labor market is migration. Traditionally, migration has been very high, which in turn has alleviated some of the labor market pressures. Another positive influence from migration is the fact that returning migrants bring to the local market their experience and skills gained abroad.

Labour force barriers turn out to be among the least serious barriers in the current period. A notable feature of this group of barriers is that 'lack of labour motivation' worsened slightly from 2009 to 2013, instead of improving, as was the case with other groups of barriers. Projections of businesses are that these constraints will improve in all economic regions, especially in Region East.

Survey results indicate that businesses in Kosovo seem to have less concern with the 'lack of educated and skilled workers' in the labour market over the last years (intensity: 51.6 in 2009 and 47.7 in 2013). Four years from now, according to businesses, it will be even less of problem (40.6 in 2017). A slightly higher intensity appears when only corporates are taken into account. This difference was somewhat expected, considering that corporates are larger and require more sophisticated skills. Nevertheless, this barrier is generally perceived as less intense by the interviewed businesses. One might expect this barrier to be of a higher intensity, provided that our educational institutions are weak and consequently cannot prepare the new students; however, it seems that Kosovo businesses are still at the level where only low skill workers are needed. Labour force barriers turn out to be among the least serious barriers in the current period.

**Infrastructural barriers**

Infrastructural barriers are commonly perceived to be very minor obstacles to SMEs in Kosovo in the current period. A distinguishing feature of this group of barriers is that compared to 2009 'lack of power availability' and 'inadequate transportation infrastructure', in particular, have marked the greatest improvement. Four years from now, none of them is expected to be harmful to businesses. No major differences are found across regions. Infrastructural barriers are topped by 'problems related to parking vehicles'. The results of the survey, more specifically, indicate that, the intensity of this barrier for the past period turns out to be 69.8, followed by a very slight increase of 1 intensity point in the following period (2013). This score is not surprising given that an overwhelming majority of Kosovo businesses are both micro and concentrated in city centres, where there are severe parking shortages. When it comes to the future period, similarly with other barriers, the interviewed businesses projected it to be less intense obstacle to doing businesses – giving it an intensity of 62.8.

**Conclusion**

Based on the findings of the study, and comparing the secondary data from credible institutions, we present this conclusion:

- Business performance is assessed based on the turnover trend, net profit rate, number of workers, and salary trend collected via the survey. With regards to turnovers in the last four years, the findings of the survey suggest that roughly 56 percent of businesses claimed that their sales have either gone up or remained the same.
- Kosovo needs to maintain a focus on improving the business environment. The Government has taken measures to speed up business registration through the establishment of one-stop shops that have, among other measures, integrated business registration, value added tax (VAT), and the fiscal numbers into one document. Recently, the authorities adopted new fiscal reforms involving the differentiation of VAT from a flat 16 percent to 18 and 8 percent, with the reduced rate for a list of "basic" products (bread, water, oil, energy, and heating). The Government aims to shorten the VAT repayment period for those companies that pay their contributions regularly.
- In linking its vision to Europe, Kosovo is also committed to these goals. But it has a very long way to go. After decades of repression, poverty and conflict, it is hardly surprising that economic growth by any means possible now seems the only solution to Kosovo's ingrained socio-economic problems. However, unbalanced growth that fails to create decent jobs, that excludes large segments of society, that fails to unleash the full capacity of men and women, is not the end result that Kosovans truly seek.
- The findings of the survey at the national level reveal that 'high cost of finance' topped the list of perceived obstacles, followed by 'corruption', 'unavailability of state subsidies', 'unfair competition', and 'non-functioning court system'. The intensities scores reveal that these five barriers are very pressing for business entry and development. The same composition of barriers with the same ranking appears in 2009, though with higher intensity scores. The order of these barriers is projected to be the same in the near future; however, it is encouraging that their intensity scores are expected to plummet, which

means that they will become less impeding to the growth of businesses.

- A very notable feature of the general ranking of obstacles is that infrastructural barriers, namely 'lack of power availability', 'inadequate transportation infrastructure', and 'lack of telecommunication facilities' have improved the most over the last four years. Such improvement is a direct result of the orientation of government towards the infrastructure and energy sectors in Kosovo. Financial barriers, especially 'high cost of finance' and 'limited access to finance' are expected to mark the greatest improvement in the upcoming years. Infrastructural barriers, on the other hand, are believed to move down the least, which is understandable provided that they are already minor obstacles.
- Barriers to doing business were discussed in focus group discussions as well. With regards to labour-related barriers, an overwhelming majority of participants, regardless of region, expressed their concerns with the education and skill level of employees. According to them, people in the labour force are not qualified enough to meet the demands of the market. With regards to infrastructural barriers, nearly all participants have been appreciative of the government's investments in capital infrastructure over the recent years. When discussing financial barriers, the majority of participants acknowledged the fact that financial institutions do not issue loans that are convenient enough to help firms overcome their financial challenges. When asked to discuss the impact of the business obstacles associated with the judiciary system, a great number of focus group participants recognized the negative impact. However, based on some participants, the outlook seems encouraging as some initiatives have been undertaken to improve the system.

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