# FOREIGN DIRECT INVESTMENT IN KOSOVA
## Policy Environment and Promotional Strategy

Research Report

**September 19, 2002**

**This Report is prepared as part of the project 'Promoting Economic Development Through Civil Society', which is implemented by the Riinvest Institute for Development Research in partnership with the Center for International Private Enterprise (CIPE), Washington, D.C. with the support of the United States Agency for International Development (USAID).**

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## EXECUTIVE SUMMARY

This Report addresses key issues related to the role and promotion of Foreign Direct Investment (FDI) in Kosova. It is prepared under the joint project entitled "Promoting Economic Development through Civil Society" carried out by the Riinvest Institute for Development Research in partnership with the Center for International Private Enterprise (CIPE) from Washington D.C., and supported by the United States Agency for International Development (USAID). This project focuses on promoting economic reform through improving the quality and raising the level of Kosova's economic policy debate. This report will be presented in the seventh session of the International Roundtable Forum (IRTF) scheduled in September 2002 and it is the last module of IRTF in this two-year project.

1) The objectives of both the Report and the session of International Roundtable Forum are to raise public awareness on the present state of FDI and its significance, to launch a broad debate on the problems facing FDI in Kosova, and to recommend policy measures within a unified and consistent promotional strategy that could re-brand Kosova as an attractive FDI destination.
2) In the 1990s FDI grew more steadily in developing countries relative to other financial instruments of capital inflows. This has greatly contributed to economic development. A positive correlation has been observed between FDI and GDP growth. Though the developed countries are the main providers and also the recipients of FDI, there is a growing trend of FDI flowing towards the developing countries. Several factors contribute to rendering a country attractive for FDI, including a stable financial environment, liberalization and restructuring, free and fair competition, a favorable tax policy, infrastructure development, property rights protection, export potential and freedom to repatriate profits.
3) While a 2001 regulation on Foreign Investment in Kosova provides a solid modern framework for FDI, other positive regulations, laws and policies have not yet been implemented. Post-war Kosova needs substantial investment that could be largely met through FDI. Moreover, FDI in the form of risk capital is an alternative to interest-bearing banking credits in addition to their importance for filling the gap in the investments needed for Kosova. Several factors influence the level and destination of FDI in Kosova, most importantly the undefined international status of Kosova, absence of financial markets and stock exchange and the need to support the privatization process through private investment.
4) As is the case in other economic fields, a lack of data and information impose a major constraint in analyzing the current volume and the structure of FDI and the trends and problems that accompany the FDI phenomenon in Kosova. Existing data are at best incomplete and at worst unreliable. In order to get additional information on the elementary characteristics of the current FDI in Kosova and to gauge the investors' perceptions on the business environment, Riinvest surveyed 38 businesses that have received foreign investment in some form (joint ventures). Some of the main findings based on this survey are:

(i) The foreign partners' share in the total investment of € 23 million in the 38 surveyed companies is around 51%. The average foreign investment per company surveyed is € 307,023.

(ii) About 53% of foreign capital in the surveyed companies is in the form of joint venture and technology transfer, followed by 39% in the form of direct investment and remaining 8% in other forms.

(iii) Financial Services sector was identified as being the most popular FDI destination in Kosova, followed by wood processing, construction material, chemical, plastics and rubber industry. The Banking and insurance services have absorbed € 19.3 million of foreign investment. For these investments Kosova is the main target market, although the importance of the regional market is also factored in to these investment decisions.

(iv) Turkey, Italy and Germany were identified by the surveyed businesses as the largest investors.

(v) Businesses generally identify their partners through use of personal contacts or through visits and recommendations of friends due to lack of existence and access to necessary official information.

(vi) Businessmen support equal treatment of foreign and domestic investors, which is legislated in the Regulation on Foreign Investment. However, survey results indicate foreign investors' insecurity in being protected by the existing legislation, with 37% respondents who felt insecure and 34% who felt only moderately protected.

(vii) Riinvest surveys of SMEs in Kosova indicate high SME interest in partnering with foreign investors. Though the data on current status shows that only 34% of surveyed SMEs have successfully established contacts with foreign partners, mainly in trade relations.

(viii) High capital potential is presented by the Kosovar Diaspora, which currently represents about 25% of Kosova's population. Its level of annual inward remittances is about € 400 to 500 million to Kosova. The surveyed entrepreneurs considered the Diaspora capital as an important potential source of finance. Other Riinvest surveys of families indicated that a major part of these remittances is used for current consumption and for investments in improvement to current family dwellings or construction of new houses and about 9% of remittances have been invested in production businesses. There are still no effective mechanisms created for mobilizing the Diaspora capital for better economic use.

5) Of the 14 barriers to foreign investment that the 38 surveyed companies were asked to rank, corruption and lack of investment guarantee were considered the biggest obstacles (see graph 1). Though in terms of intensity of barriers the difference between the highest intensity of 10.4 and the lowest intensity of 4.7 is not very significant it does point to the need that the policy makers should address all the obstacles giving priority to the obstacles with high intensity.

6) In addition to obstacles in Kosova for FDI, it is acknowledged that the region lags behind in promoting an FDI-friendly environment. South East Europe (SEE) is considerably behind Central Europe (CE) in fostering an investment-friendly environment that includes economic and institutional reform, establishment of democratic institutions and creation of an efficient and attractive macroeconomic environment. Moreover, intra-regional trade in SEE comprises no more than only 6-10% of the total trade of any country with other countries in the region to which only Kosova is an exception with 60% of its trade being with the countries in the region. Interestingly, infrastructure ranked as the highest obstacle for Kosova, but fifth in other countries. Customs problems ranked as the highest obstacle SEE countries, but second in Kosova. In addition, Kosova has specific problems in trade with Macedonia, Serbia and Montenegro such as lack of reciprocity in trade relations and specific taxes/charges for goods in transit.

7) The EU countries are the largest investors in the region. Croatia, Bulgaria and Romania have received more FDI than Albania, Bosnia and Herzegovina, FRY and FYROM. (Annex 3). In an attempt to form a stable, transparent and uniform framework for private sector investment, the SEE Governments, jointly with their Stability Pact partners, are pursuing the implementation of 'The Compact for Reform, Investment, Integrity and Growth' – the Investment Compact. – that outlines agenda of reform to establish fair and non-discriminatory treatment of domestic and foreign investors with full protection of their of property rights through administrative implementation and judicial enforcement. Kosova Government and UNMIK should make necessary efforts to join the countries in the Investment Compact.

8) The current policy environment and macroeconomic framework inadequately addresses FDI issues. First, there are significant gaps between: (i) GDP and consumption, (ii) savings and domestically financed investments, (iii) public investments needs and budget capacities, (iv) export and import levels, and (v) unemployment and productive private investment. International finance donations have mitigated these gaps to some extent, though funding from these sources is expected to decrease in the coming years. Efforts should be directed toward reducing these gaps, which negatively impact growth. Increasing exports and reducing fiscal evasion are among the priority measures. The Macroeconomic Analysis Unit within the CFA/Ministry of Economy and Finance is meeting an important need for information for foreign investors on current economic indicators in Kosova. Much remains to be done in order to create a modern national accounting system and support an efficient statistical information base, with significant contribution by the Statistical Office of Kosova (SOK).

Another possible venue to attract FDI is to implement privatization of SOEs and reform of public utilities based on Kosova Trust Agency (KTA) Regulation. Privatization models and programs should be aggressively promoted to private foreign and domestic investors. Success of privatization would raise FDI inflow and other private investment**.** Especially, for attracting FDI, there is a need to create favorable conditions for building of public private partnership in the process of restructuring and development of infrastructure and public utilities.

Liberalization of Kosova's foreign trade has resulted in competition from imports to domestic businesses. Distortions are created due to asymmetric fiscal relations with neighboring countries affecting Kosovar competitiveness in domestic and foreign market.

Kosova's undefined status as a trade entity has major implications for creating a supportive environment for FDI. Pending solution to this issue, bilateral agreements could be signed with some countries and with international financial and non-financial institutions. Enhancing Kosova's status vis-à-vis international institutions within Resolution 1244 and Constitutional Framework would enable it to accelerate international economic cooperation.

Modern fiscal and taxation systems are currently being constructed. However, the main complaints of businesses are related to tariffs and the implementation of the VAT as it relates to imports of capital goods. These are viewed as a significant becoming an obstacle for investment growth.

A considerable part of the approved commercial law and the Regulation on Foreign Investments meets market economy standards, a prerequisite for investment. However, the package of commercial and other laws has not yet been completed and is not implemented consequently. Therefore, the missing synergetic effects are not fully realizing these advantages of the legal system in Kosova.

9) Several actors are involved in promotion activities for FDI: the Government, Kosova Chamber of Commerce, USAID-KBS, Euro Info Center, Swisscontact, offices of foreign countries etc. However, currently there is a lack of coordination among different actors, lack of organizations for coordination and lack of promotion strategy. It is necessary to address this situation in the near future together with promotion of Kosova advantages and creating a new image and brand of Kosova. An institutional campaign should be formed to stress the advantages of Kosova in competition with the alternative destinations in the Balkans and Central Europe, such as:

   a. Central geographic location
   b. Abundance of natural resources at competitive prices
   c. European hinterland
   d. Links with many European countries and the US through the Diaspora
   e. Relatively high level of educated young population,
   f. Good technical skills
   g. Motivated workforce
   h. Relatively cheap and abundant workforce available,
   i. Low internal taxation
   j. Stable currency (Euro) and low inflation
   k. Export exempted from VAT and customs duties
   l. Free Trade with the EU for almost all goods under the Stabilization and Association Process
   m. High purchasing power through remittances

## RECOMMENDATIONS

Stakeholders should assume a more active role in creating an FDI-friendly environment in Kosova by establishing good practices and coordinating efforts to address the following areas:

(1) International practices and experience should serve as a basis for creating a more investment-friendly environment. In order to do this successfully, the Government and UNMIK should focus on the following activities:

- Systematically improve political stability and security conditions
- Increase awareness within business community and public opinion that when the private sector plays an important role in fostering economic progress and the creation of a free market economy;
- Protect fair competition by reducing fiscal evasion and continuity of the systematic anticorruption measures;
- Adjust tax policy to offer more investment incentives by lowering tariffs on capital goods and raw material imports;
- Further improvements for more investor-friendly application of VAT;
- Facilitate export by establishing Kosova's trade identity and set up agreements with neighboring and other countries to eliminate administrative barriers, such as recognition of Kosovar certificate of origin and respect reciprocity in trade relations;
- Undertake all necessary steps to meet standards and criteria required by Investment Compact within Stability Pact (box in page 30) in order to establish a stable, transparent and uniform framework for private sector investment;
- Promote a privatization program to potential investors, develop and publish a reference guide to operational policy procedures and build transparent practices for implementation of KTA Regulation that would encourage foreign and local investors;
- Promote FDI in public sector through private sector participation;
- Accomplish a legal framework by approving pending laws and regulations on Privatization/long-term use of land, Mortgage Law, Bankruptcy Law, Law on Protection of Competition, Law on Foreign Trade, Law on Financial Market and Stock Exchange and Law on Property Rights. Laws that are already adopted should be implemented and enforced judicially thereby enforcing rule of law;
- Follow the example of the agreement with OPIC to reach similar arrangements with agencies in Europe and other regions.

(2) Policy measures should be directed toward creating a sound banking system to offer

- More incentives and better interest rates for savings in the form of long term deposits that would facilitate long term loans
- Increase further competition and introduce guarantee instruments to stimulate reduced interest rates for investment credits
- Advanced banking practices that facilitate trade e.g. – Letter of Credit and banking guarantees

(3) There should be solid support for urban and spatial planning activities under the jurisdiction of the Ministry of Environment and Spatial Planning and of the municipalities to provide an urban environment conducive to easy access to business locations. This also includes simplifying administrative procedures and reducing costs for different permits/licenses required for new construction activities;

(4) Create a system of institutional contacts with Kosovar Diaspora and, avoiding its fragmentation that may arise as a consequence of political orientations. This organizational form with Kosovar and Municipal attributes should aim at mobilizing the Diaspora's financial and human capital for investment in Kosova. Elaborate the concept of investment funds with the Diaspora's financial capital and promote them as a potential investment vehicle in cooperation with governments and banks in corresponding countries;

(5) Encourage different stakeholders in FDI promotion for creating within a government or respective ministry a coordination body for more efficient and sustainable promotional activities directed to re-brand Kosova as an investment destination. It is necessary to achieve more coordination and effects in different activities that are indicated in chapter 7 of this report. Also establishment of specialized Agency for FDI promotion could be considered;

(6) Development of information system and adequate statistics for following and analyzing FDI trends is one of the important activities for Government and especially the Statistical Office of Kosova.

# 1. INTRODUCTION

This Report addresses key issues related to the importance and promotion of foreign direct investment (FDI) in Kosova. It has been written as a part of the joint project entitled “Promoting Economic Development through Civil Society” carried out by the Riinvest Institute for Development Research in partnership with the Center for International Private Enterprise (CIPE) from Washington D.C., and supported by the United States Agency for International Development (USAID). This project focuses on promoting economic reform through improving the quality and raising the level of Kosova’s economic policy debate. To date, the project has addressed the following aspects: (i) Privatization of Socially Owned Enterprises, (ii) Taxation Policy, (iii) SME Financing and Development, (iv) Pension System Reform, (v) Local Economic Development, (vi) International Conference on Privatization of Socially Owned Enterprises and the Reform of Public Utilities. This report will be presented in the seventh session of the International Roundtable Forum (IRTF) scheduled in September 2002 and it is the last module of IRTF in this two-year project.

The objectives of both the Report and the session of International Roundtable Forum are:

(i) To raise public awareness on the present state of FDI and its significance.
(ii) To launch a broad based debate on the problems currently faced by FDI inflows to Kosova and on policy measures to overcome them.
(iii) To recommend a unified and consistent promotional strategy aimed at increasing Kosova´s businesses ability to attract foreign investment from private sources and at encouraging foreign private investors to participate in development programs for Kosova.

This report attempts to address the following areas:

- Analyze specific issues on foreign investment in Kosova after the war,
- Identify barriers to foreign investment (regional, institutional and administrative),
- Identify essential strategic elements for attracting foreign investment (legal framework, institutions for promotion),
- Recommend economic policy measures,
- Present international experiences in attracting foreign investment.

Prior to preparing this report, Riinvest conducted the following three activities:

(i) Communication and working sessions with key policy makers involved in FDI in Kosova
(ii) Survey of 38 Kosovar registered joint ventures in a variety of sectors of activity
(iii) Study tours in the region

(i) Communication and working sessions with key policy makers involved in FDI in Kosova

Riinvest conducted meetings, discussions and consultations with representatives of numerous governmental institutions, United Nations Mission in Kosova (UNMIK) and segments of civil society that are involved in reconstruction and monitoring of economic policy reforms. The meetings addressed the various aspects of current conditions affecting foreign investment and opportunities to create a more favorable investment climate by using experiences of other countries. Meetings with the following institutions proved to be most useful (specific topic of interest in parentheses):

- UNMIK Pillar IV, Central Fiscal Authority (CFA) and Kosova Trust Agency (KTA) (General guidelines, fiscal reform, privatization program, completion of the legal framework for Trade and Investment)
- Ministry of Economy and Finance (Macroeconomic aspects)
- Ministry of Trade and Industry (Economic policies)
- Ministry of Labor and Social Affairs (Employment, Labor law)
- Ministry of Environment and Space Planning (Urban preconditions)
- Banking and Payment Authority (Foreign investment in financial sector and banking system capacity)
- Kosova Chamber of Commerce (Promotion)
- USAID – Kosova Business Support (KBS) (Promotion of export and foreign investments)
- The Euro Info Correspondent Centre (EICC) (Promotion)
- Kosova Reconstruction Equity Fund (KREF) (Carrying out of concrete projects)
- Dialogue with a number of Kosovar companies that are recipients of FDI and with Kosovar businessmen in Diaspora destinations. The perspective of Diaspora related potential investor on what actually prevents them from investing in Kosova was most clarifying.

In June 2002, Riinvest organized the International Conference on Privatization of SOEs and the Reform of Public Utilities. The attendance and topics discussed at this conference reflected the increased interest of Kosovars to attract foreign investment as a precondition for effective privatization of SOEs via the "Spin-off" model. The results of this conference were also relevant to this research report, especially to propose recommendations on economic policies

(ii) Survey of 38 Kosovar registered companies with the share of foreign capital in a variety of sectors of activity

In order to support the research presented in this report, analyze the current conditions and identify barriers to foreign investment in Kosova, Riinvest surveyed companies that have some form of foreign participation in their capital structure. The sample included 60 companies out of the 318 registered businesses with foreign investment participation (as of August 2002, SOK), or 12% of these companies. However, while conducting the survey, 22 of these companies could not be contacted (probably due to cessation of operations), though the data provided count for 38 companies.

The questionnaire focused on the following topics:

- Amount of foreign investment
- Investors' communication channels
- Profile of existing foreign investments
- Reasons for investment
- Foreign investment by sector
- Barriers to foreign investment
- Market conditions
- Legislative environment

(iii) Riinvest visited Macedonia (FYROM), Montenegro, Croatia and Bosnia and Herzegovina. Discussions with numerous representatives of state institutions in these countries revealed that little is done to attract foreign investment. Perhaps this is because of their lackluster economic image and limited progress in carrying out economic reforms. Lessons learnt from the experience of other countries relating to implementation of policies to attract foreign investment and facilitation of investor access to Kosova's economy are particularly relevant to the efforts of UNMIK and the Government of Kosova to create a better image and climate for FDI in Kosova. In order to better illustrate international experiences, Riinvest contacted its partnering institutes in the region. Their contributions are presented in the annexes of this report.

The visits and discussions for DELTA project that Riinvest is implementing with the support of the International Finance Corporation (IFC) and Open Society Institute (OSI), also proved relevant for this research. This project aims to prepare municipal government officials in Kosova in strategy design for SME development in their municipalities. These visits are used to analyze activities undertaken at municipal levels concerning current investment climate and the state of infrastructure and public utilities in this phase of development.

Throughout the activities of this project, the project team established cooperation with the media. An advocacy campaign on the issues related to attracting foreign investment was created through comments, interviews, analysis and presentation of the preliminary results in the media. The seventh session of IRTF is an opportunity for the media to send promotional messages based on the report recommendations and discussions by participants in the Forum.

In developing research activities, Riinvest enjoyed substantial support from USAID – Kosova mission, and CIPE in Washington D.C. In this report, Riinvest cooperated with Ms. Carmen Victor, a CIPE-contracted expert, whose contribution was important in realizing the activities. A report prepared by Ms. Victor is used mainly in the promotion strategy section of the report.

We take this opportunity to thank all the partners and discussants for their contribution in preparing this report.

## 2. SPECIFIC IMPORTANCE OF FOREIGN DIRECT INVESTMENT IN KOSOVA

Several sets of circumstances of economic and political nature are relevant to FDI in Kosova:

- Difficulty in accessing loans from international finance institutions due to ambiguity regarding final status of Kosova,
- Significant reduction is expected after 2003 in donations for capital investment,
- Inability of the banking system to foster long-term loans in amounts that could support more serious investments. It is not offering advance payment facilities and guarantees for import and export international transactions and instruments like letters of credit,
- Absence of a financial market and a stock exchange,
- Implementing the privatization process, as outlined be the Regulation on KTA, will significantly depend on FDI,
- Remittances of Kosovar emigrants from Western Europe and the U.S.A. are expected to decrease,
- Lack of investment in public infrastructures and other sectors,
- High unemployment.

It is obvious that Kosova is facing limited resources for investment financing, at the time when it is confronted with pressure and imminent need to resolve the unemployment problem (unemployment rate is estimated range as high as 45-50%) and improve public infrastructure. Power generation, telecommunications and road transport can be considered as limiting factors to development. Private businesses in the post war period have generated new jobs and economic growth. However, recession signs are also emerging as average turnover declines and employment stagnates (Riinvest: SME survey 1999, 2000, 2002).

Under these conditions, policy makers are challenged to encourage new investment. Creating a friendly and adequate business and institutional environment to attract FDI is one of the most important priorities for economic policy and reform since there is not enough investment capacity in Kosova to ensure sustainable growth. It is known that FDI alone cannot accelerate investment activities and promotion of FDI is more difficult in Kosova than in many competing destinations due to the circumstances specific to Kosova. For these reasons, the aim of FDI promotion needs to be combined with the provision of alternative financing instruments and guarantees in which the FDI component could be increasingly important. Though FDI alone cannot accelerate investment activities, it is quite necessary. FDI should become an important source to complement other financing sources.

Experiences of economic development in the last decade, particularly those of developing countries, indicate that private FDI is important because:

- There is a positive correlation between FDI and GDP growth, increased opportunities for export and, stimulation effects of local businesses and competition improvement,

- FDI as risk-capital offers better prospects for sustainable development than interest-bearing credits,
- FDI stimulates social and human capital development through transfer of technology, know how and training
- FDI improves budget revenues as a result of tax revenue increase, hence decreasing the need for subsidies of public utilities

For all these reasons, it is clear that Kosova needs an active policy aimed at improving promotion of opportunities for cooperation with foreign investors, increasing competitiveness in the FDI market and cultivating absorptive capacities for partnership and joint ventures.

## 3. AN OVERVIEW ON GENERAL TRENDS OF FDI

Continuous global FDI growth in the 1990s has been apparently more stable compared with other financing instruments (capital flows) in developing countries (International Financial Market, loans between the countries, banking credits, government bonds and investment portfolios). FDI in developing countries increased from $1 billion to about $12 billion in 1998 (Private Capital Flows to Developing Countries - ECOSOC 2000).

FDI trends in selected regions are presented in Table 1.

Table 1: Regional presentation of FDI (in billion $)

| Region | Investment inflows | Investment outflows |
|---|---|---|
| Latin America | 71 | 15 |
| Asia & Pacific | 85 | 36 |
| Central and Eastern Europe | 19 | 2 |
| Africa | 8 | 0,5 |
| North America | 193 | 110 |
| Western Europe | 237 | 406 |

Source: Foreign Direct Investment: A Lead Driver for Sustainable Development, Toward Earth Summit 2002, Economic Briefing Series No.1)

Table 1 illustrates that the biggest profiteers of net FDI inflow are: Latin America, Asia and Pacific, North America and Eastern Europe, while net outflow of FDI is recorded in Western Europe, which invests more in other regions than it receives. In general, we can ascertain that 92% of investment originates from developed countries and 72% of them return to these countries (UNCTAD 1999).

The most attractive sectors for FDI in developing and transition countries are: mines, minerals, metals, food production and traditional sectors of industry, public infrastructure and services (especially power generation and telecommunications).

Experts believe that when FDI makes up such a large share of overall investment in a developing country, it is a sign that other investment sources and financing instruments (financial market, credit market, etc.) are underdeveloped and have smaller potentials (Finance and Development, June 2001, IMF). Therefore, the main suggestion for developing and transition countries is that they should focus on improving general conditions and the business environment for investment. Experiences have also shown that FDI effects are greater in countries with a higher level of education, which determines the absorptive capacity for FDI.

**IRELAND - A SUCCESS STORY**

Economic development of Ireland has been very successful. Annual GDP growth rates in the period 1993-2001 have been three times higher than the rest of Europe. Behind this success is long term sustainable policy and consistency which contains: low corporation tax, priority for industrial promotion, expansion of education, EU accession, fiscal rigor, social contract. Other advantages also contributed to this progress: English speaking population, favorable climate for investment, well developed public administration, welcoming public opinion, bribery almost unknown, low social costs in comparisons with continental EU countries. The share of foreign firms in total number of firms is 49,2 % (30,1% from US) .The exports have more than doubled in the period 1995-2000 while also being able to maintain a trade surplus. (Based on Dr. Garret FitzGerald, former Prime Minister of Ireland presentation at the USAID Conference: Building Competitive Advantage in Nations – Increasing Transparency, Combating Corruption and Improving Corporate Governance, Budapest, March 26-28, 2002.)

A fundamental recommendation based on years of experience and research is that a sound development strategy must focus on promoting long-term investment that provides higher rates of return on investment (ROI). The ability of certain countries to attract FDI depends on legislation that should provide a level playing field in the market, safeguard security, have non-discriminatory character and promote transparent investment practices.

Other necessary elements for creating an appropriate environment include:

- political stability
- market potentials and opportunities for access to the markets
- repatriation and disposal of profit
- infrastructure development
- facilitation of in currency exchange
- privatization and deregulation
- fair competition
- investment security

Lord Griffiths of Fofrestfach, Vice Chairman of Goldman Sachs Europe, presents additional recommendations for successful attraction of FDI. Based on his extensive experience in designing and advocating sound business development strategies, he suggests three main elements that are crucial for attracting foreign investors:

- stable financial environment (low inflation, low fiscal deficit, monetary policy aimed at preventing credit expansion)

- liberalization and restructuring (free up markets, including labor markets, transparency in macroeconomic policy and statistics)
- freedom to repatriate profits

Lord Griffits also thinks that creating a good trading environment is of special importance, which means abolishing import controls, removing export subsidies and trade restrictions, allowing free prices, privatization, and providing international accounting standards which make the companies transparent. The government's sustainability and commitment to implement its policies also play a vital role (CIPE, Washington D.C.: Economic Reform Today, no. 4, 1997, interview).

The U.S. Chamber of Commerce summarized its experiences on "What goes into a U.S company to invest overseas?" Here it lists similar attributes that attract FDI to a developing country, such as market size and free access and competition, possibilities to export in nearby markets are important, than quality of labor force, propriety rights protection, regulatory burden and costs, taxation, low political risk, Predictable Macroeconomic Management, Reliable Infrastructure support. (More details in Annex 2).

## 4. FOREIGN DIRECT INVESTMENT IN POST WAR KOSOVA

In the aftermath of war and during the emergency phase of reconstruction of Kosova, the interest of potential businessmen and investors was evident by their frequent visits. They observed the progress of economic recovery and sought opportunities to conduct business under the existing circumstances, with a specific interest in construction, construction material and food items. Another motive was to investigate potential opportunities for more serious business in connection with FDI. There was strong contact with members of Kosova's Diaspora, who envisioned the creation of joint ventures with domestic companies.

Unfortunately, Kosova was not prepared to respond to these initiatives. There were no well-established institutions, a weak rule of law, difficult channels of communication with administrative authorities within the state institutions, great difficulties in public utilities, and lack of any banking or financial system. Even though a modern Regulation/Law on Foreign Investment has been in place since 2001, the results and experiences are still modest (see Annex 1).

Even three years after the war, it is very difficult to estimate and analyze the current situation of FDI in Kosova. There is still no any specific evidence that would enable one to estimate the volume and the structure of FDI. The Statistical Office of Kosova (SOK) provides very poor information. This creates difficulty in analyzing trends and problems that accompany the FDI phenomenon in Kosova. According to SOK data, there are 318 registered joint ventures.

While preparing this Report, Riinvest surveyed 38 joint ventures. The survey was designed to obtain additional information on elementary characteristics of these investments and gauge investors' perceptions on the business environment.

**Conclusions based on this survey are as follows:**

**(1) Most companies with foreign partnership were registered in 2001.** More than half are sole proprietors (53%), joint stock companies (24%), and limited liability companies (21%). The others (2%) are representatives of foreign companies.

**(2) Volume and structure of investments in 38 surveyed companies:**

- Total investments include € 23.0 million,
- Share of foreign partners in investment: € 11.7 million, 51.0% respectively, though other estimates indicate that it is higher at 60%,
- Average foreign investment per company surveyed is €307,023,

Investments are made through these three main forms:

(i) Joint ventures, including technological transfer (53%),
(ii) Direct investment by foreign investor alone (39%),
(iii) Investments through other ways (8%).

Main business preferential sectors of the surveyed companies are focused on production, industry respectively (52%), where wood processing, construction material, chemical, plastic and rubber industry have the biggest share. Trade is represented by 16%, tourism and restaurants 8%, construction 5%, financial services 5%, transport 3%, agriculture 3%, consulting and others 8%.

The foreign capital originated in Turkey (10), Italy (7), Germany (6), Switzerland (3), Slovenia (2), Austria (2). Norway, U.S.A., Ireland, Macedonia, Albania and Bulgaria are presented by one case and some other cases of mixed capital from several countries.

**FOREIGN INVESTMENT IN BANKS AND INSURANCE COMPANIES**

Banking and insurance were one of the most attractive sectors for foreign investments in Kosova. These sectors absorbed € 30.6 million, out of which € 19.3 (63%) is the share of foreign capital comprising € 13 million in banking and € 6.3 million in insurance.

**(3) Lack of institutional mechanisms hinders investments**. Businesses use the following venues to identify investment opportunities:

- Personal contacts (63.2%)
- Recommendations from friends (21.1%)
- Internet (2.6%)
- Consulting organizations (2.6%)
- Other channels (10.5%)

Main incentives for investment are cited as market (48%) and cheap labor force (20%). Some other incentives though considered of lower intensity include penetration in the new markets (15%), resettlement to Kosova (9%) and other motives (8%). It is interesting to note that most of the investors indicated that 89% of their market was in Kosova, 6% in other Balkan countries and

5% in other countries. This can be explained by the fact that investments were modest and were made for serving the immediate and emerging demand in the Kosova market. Normally one should expect that more serious investment by all means would be made for serving the regional market since the size of Kosova's market is very small. Answers to open questions regarding the reasons for investing in Kosova indicated that they were mainly 'emergency needs of the market' and a 'favorable market'. Answers to open questions regarding the discovery of investment venue included personal contacts with friends who worked in the region (Bosnia and Albania) or those who have made personal contacts within Kosova after and during the war.

**(4) Perceptions on economic equality, legislation, judicial protection and institutional support:** Foreign investment legislation favors promoting equality between domestic and foreign investors in all aspects for access to privatization, market and information. Surveyed companies indicated their support to this policy measure as follows:

- 50% of respondents prefer 'completely the same status between domestic and foreign investors'
- 29% prefer more favorable status for foreign investors
- 13% think that domestic investors should enjoy more favorable status
- 8% did not respond to this question

Perceptions of levels of legal and institutional protection indicated considerable sense of insecurity of investment. Survey responses reflect that adequate protection for foreign investors and their capital has not yet been provided. Still, the survey indicates that Kosova's legislation is neither sustainable nor effective in protecting the interests of investment and businesses development. Majority of investors (67%) have some insecurity. The question 'how much do you consider yourself protected by existing legislation', received the following response:

- fully protected (2.6%)
- satisfactorily protected (21.1%)
- moderately protected (34.2%)
- felt insecure (36.8%)
- did not respond (5.3%)

Foreign investors consider efficiency of the courts and the confidence in judicial system to be very important. Respondents rated judicial protection of their rights much more positively. The question 'if your contract is to be called into question, would you enjoy protection from justice?' received the following answers: about 63% expressed confidence in Kosova's judicial system, 29% said they were skeptical towards this problem, and 8% did not respond.

Survey findings proved that institutional support for foreign investors is still very low. Only 7 out of 38 surveyed companies pointed out that they enjoyed any support provided by institutions, the support that is attributed to assistance in finding the investment venue, compared with two companies that reported their support as coming from consulting services and one case in facilitations to municipal taxes.

**(5) Orientations of SMEs in Kosova for partnership with foreign partners:** Private businesses in Kosova are quite interested in establishing partnerships with foreign investors. Findings from the survey of 619 private businesses (Riinvest, December 2001) indicated that SMEs have oriented their plans for investment in finding possible ways to seek financial resources from abroad. About 60% of the surveyed companies expressed that they were looking for foreign partners to implement their business plans. Furthermore, they expect partnership with foreign companies would be mainly oriented toward investments in new projects (35.3%), expanding existing capacities (42.6%) and increasing sales. Private businesses find it especially important to develop strategies for investing in new projects. An overwhelming majority of private businesses recognize the importance of investment needs and try to find ways to secure investment in spite of inadequate institutional support and other obstacles that face businesses in Kosova.

**PESTOVA**

Pestova, a private company near Vushtrri is producer of potatoes. They have imported potato seeds for years from the partner "Agrico" in Netherlands, acting also as their distributor. The owner of Pestova, an ambitious entrepreneur, has developed a project for processing of 3,500 tons of potatoes annually. He is in negotiations with his partner for a joint venture. Pestova will invest in land and equipment, while the partner will provide technical know how and potato seeds. According to the owner the foreign partner is hesitant, because of tariffs and taxes at 26% on imports of these inputs[1], similar to the imports of consumer goods. Foreign partner is not willing to invest in these conditions and both of them are waiting eventual changes.

On the other hand, the current situation is far away from these expectations. Only 34% of the surveyed companies have established contacts with foreign partners. Partnership for trading have a major share in economic cooperation (53.0%), while the share of other forms of cooperation (5.9%) is still insufficient (Riinvest, SME survey 2001).

Even in Socially Owned Enterprises (SOEs) the situation is unfavorable in terms of export performance and establishing partnerships with foreign companies. Hence, according to the Riinvest's report on SOEs of 2002, the share of export in overall turnover is 8% whereas foreign investment in the form of investment sources is 2%. Such a situation was triggered by the legal status of these enterprises and delays in their privatization. Activities of SOEs to build partnerships with foreign investors were mostly directed toward communication with special partners in order to attract their interest.

Riinvest research indicates that building partnerships between domestic SMEs and foreign investors is hindered by obstacles such as: political insecurity, lack of legislation and undeveloped infrastructure. Whereas the response of SMEs to the grading of obstacles provided a relatively balanced picture for all given options as follows:

- political insecurity (21.6%)
- lack of legislation (21.5%)
- undeveloped infrastructure (19.9%)
- insufficient level of information (18.5%)
- delays in the privatization process (18.4%)

[1] This includes 10% of customs duty, and 15% VAT. It seems that further improvements in reimbursement procedure for VAT credits are necessary.

From this data one can conclude that the respondents desire a serious commitment to address these problems.

**(6) Kosova Diaspora's capital mobilization:** The Kosovar Diaspora is estimated to comprise about 25% of Kosova's population and is considered to be an important potential source for investment. The estimations regarding remittances from Kosovar emigrants vary from € 400-500 million (Riinvest, Family survey 1999, CFA estimate). It is considered that most of these resources are dedicated to consumption and/or invested in construction of houses, very often irrational. There are still no economic policy mechanisms aimed at mobilizing the Diaspora's remittances and savings potentials and investing them in manufacturing, services and generating jobs. Based on the findings from the survey of family economies and businesses in 1999, only 9% of remittances has been invested in production.

**INTERING**

Intering Gmbh is a company established by Kosovar brothers named Shoshi, working in Germany since 1990 in construction industry, specializing in installations and thermo-isolations. It employs about 120 workers, half of them Kosovars. They are currently engaged in some repair operation at KEK and are very interested to be included in the privatization process. They gained relevant experience in privatization in East Germany and are especially interested in metal processing sector. Having in mind their experience gained in the German market, they do not see too many obstacles in having successful investment in Kosova. They would like to see more progress in taxation policy and elimination of trade barriers.

Kosovar entrepreneurs feel that mobilization of the Diaspora capital is of great importance for Kosova. Over 79% of the surveyed entrepreneurs consider the Diaspora's capital as very important, 17.1% thinks that this is moderately important and 3.8% say it is less important. However, Table 2 below illustrates that Kosovar entrepreneurs have had little contact with the Diaspora (Riinvest, SME survey 2001).

Table 2: Contacts of Kosovar entrepreneurs with Diaspora

| Forms of contact | % |
|---|---|
| 1. I have/had carried a joint project | 6.1 |
| 2. I use loans from friends and relatives who work abroad | 15.5 |
| 3. I am in the phase of setting preliminary contacts | 22.6 |
| 4. I have not made any contact at all | 54.8 |
| 5. No response | 1.0 |

Source: Riinvest, SME survey 2001

A fairly small number of the surveyed entrepreneurs have reported joint investment projects with financial resources of the Diaspora and 55% had no contact with the Diaspora. This reflects a lack of needed information and opportunities for contacts on both sides. This leads us to the suggestion that appropriate ways for joint projects and building partnerships should be fostered.

Over the period 1990 – 99, the Diaspora significantly contributed to the educational, health, social, cultural and scientific institutions. However, it was less involved in the support of economic and investment activities.

In the post-war period, more favorable circumstances emerged for the first time. Solidarity relations between the Diaspora and Kosova were replaced by mutual economic interests. This is very important when considering the Diaspora's human and financial potential and resources. In the beginning of emergency phase, the approach of Kosovars from Diaspora was accompanied with a doze of euphoria, but soon they started to realize the difficulties as well as true opportunities to engage their resources through investment in Kosova.

At this time, Diaspora initiatives are abundant, but they are far from being implemented. Recently, the Government of Kosova began the process of building new communication and cooperation bridges between the Diaspora and Kosova on the basis of investment projects. For this purpose, two conferences have been organized, one in Germany and the other in Switzerland, with the significant participation of Kosovars in those states. Another Conference is expected to take place in the U.S.A. in October.

These events, called "Conferences on Investment in Kosova," were successful, judging by the number of participants. They offered a forum for more organized and open discussion between Kosova's institutions and the Diaspora. Reports of these conferences indicate that the interest and concerns of the participants are identical to a large extent with those expressed by other investors: loans and credits to start up businesses, taxes, legal security, whom to contact, lack of assistance and orientation, lack of travel documents, infrastructure reconstruction, establishing of the liaison offices and other related concerns.

# 5. CURRENT BARRIERS AND LIMITATIONS TO FOREIGN INVESTMENTS IN KOSOVA

## 5.1. INTENSITY OF THE BARRIERS

Research conducted in preparation for this Report revealed many barriers to investment, as well as institutional and administrative obstacles hindering a favorable investment climate. Riinvest surveyed 38 companies on the extent of difficulty these barriers and obstacles pose to them and their ability to conduct business. They were asked to rate 14 barriers, as presented in Figure no.1.

The survey exposed specific barriers that also affect domestic private SMEs. The largest barriers facing SMEs are lack of laws and unfair competition. Companies established by foreign investments are most affected by corruption and the lack of investment guarantee. The survey reveals that the highest barriers to foreign investment in Kosova are:

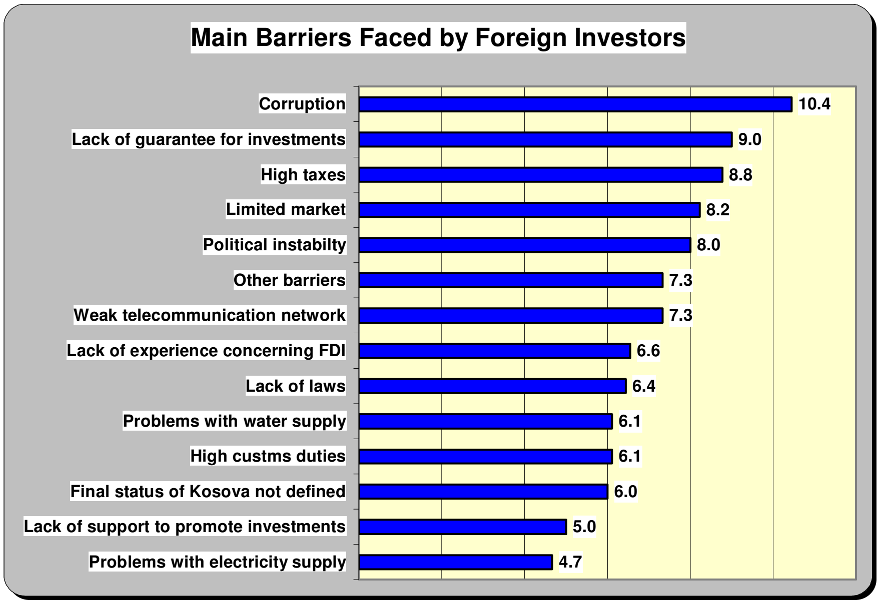
- Corruption
- Lack of guarantee for investments
- High taxes
- Limited market
- Political instability
- Weak telecommunication network

Some of the lowest barriers include:

- Lack of experience to carry out FDI
- Lack of laws
- High customs duties
- Final status of Kosova not defined
- Lack of support to promote investments

Such a ranking of barriers is relatively surprising because it ignores barriers relating to the final status of Kosova (6%), promotion (5%) and electricity restrictions (the lowest intensity barrier). For investors currently operating in Kosova, its final status does not seem to be a barrier. A careful analysis indicates that though in terms of intensity of barriers the difference between the highest intensity of 10.4 and the lowest intensity of 4.7 is not very significant, it does point to the need that the policy makers should address all the obstacles giving priority to the obstacles with high intensity. To conclude, all the barriers listed and considered relevant by the respondents are important and deserve attention by policy makers.

Figure 1: Barriers to foreign investments




### (i) Corruption

The timing of this survey coincided with a period when the attention of the public and institutions in Kosova was directed toward corruption and economic crimes as an acute problem and that probably had a bearing on the answers of the respondents. It was being considered as a major barrier to creating healthy business environment. While in the SME survey this barrier was ranked seventh indicating medium intensity. About 70% of the respondents consider corruption is a barrier of high intensity and 30% believe corruption is either a low intensity barrier or is not a barrier. It is necessary to develop adequate policy measures to combat corruption with institutions taking responsibility for systematic activities and widespread participation of civil society with supportive public opinion. The survey of 38 companies did not seek information about particular reasons of corruption. Some indications in this barrier can be derived from the survey of 1,100 households conducted by Riinvest also in August 2002 (Early Warning Report, 2002). According to the findings of this survey, corruption is ranked at the third place after the issues of uncertainty about the final status of Kosova and unemployment and before the issues of poverty, crime, high prices etc. About 50% of the respondents agreed that there is corruption in customs, 32% in health institutions, followed by 28% in local administration, 20% in central administration, 20% in courts and 10% in police service.

### (ii) Lack of guarantee for investments

The lack of legal status for Kosova as a subject of international law hinders its membership in international financial institutions, including organizations that guarantee investments, such as MIGA (Multilateral Investment Guarantee Agreements). MIGA, an institution within the World Bank group, has 157 member countries. It ensures investors against non-commercial risks. This is very important for the countries that came out of war because it characterizes them with geopolitical instability. Such institutions are crucially needed for post-war countries like Kosova. For a more determined orientation of foreign investors to establish their companies or get involved in other forms, it is indispensable to insure the guarantee of investments from political risk and distortions of the national market caused by retroactive impacts of economic policies. MIGA is now more present in our region in Bosnia and Herzegovina, Albania and Macedonia, (MIGA, Annual Report 2002).

Lack of investment guarantees was ranked by 45% respondents as a high intensity barrier, while 34% indicated it to be a medium intensity barrier and the rest did not consider it as a barrier.

Potential investors would like to see a strategy that incorporates additional guarantees. One such example is the agreement signed by Overseas Private Investment Corporation (OPIC) of USA with UNMIK (Annex 4). OPIC provides specific political risk guarantees/reinsurances. Other investment guarantee agreements with other state agencies should follow. For strategic investment to come to Kosova a higher involvement by the public sector is required, if only to provide additional guarantees. A mechanism to provide reinsurance against political risk could have a multiplying effect on the expressions of interest already shown by potential investors.

**(iii) High taxes**

Taxation instruments often have vital impact for foreign investor decisions concerning destination. Kosova is currently in the phase of establishing policies and institutions necessary for a market economy. The current level of taxation serves more to create a consolidated and sustainable budget rather than ensuring preferential treatments of potential investors. The survey illustrated that 42.1% of the companies see high taxes as a high intensity barrier, 24% respondents see it as a medium intensity barrier and 31.6% say it is either a low intensity barrier or poses no problem at all.

**RENOFIX**

Renofix is a company established by investor from Tetova (Macedonia) and is an example of 100% foreign investment. The overall investment is about € 4 million. The company has recently commenced operations and manufactures paints employing 20 workers. This company would serve the regional market. During the interview, the owner narrated several problems he faced such as:

- Difficulties in getting licenses for construction of building, power connection etc. The compliance with procedures and other costs amounted to over € 13,000 and it took about a year to get all required licenses for buildings (€ 8,500), power connection, forest tax, change of use for land from agricultural to industry, fire protection equipment etc.
- The administrative rules were not clear, he never knew who was the designated authority and the administration was not supportive.
- Taxation – tariffs and VAT on equipment and raw materials are less favorable compared to Macedonia. The rules allow payment of VAT on equipment after six months while he was forced to pay the entire VAT at the point of entry of equipment and no one explained why.
- The owner considered that he should have been allowed to purchase private land in his own name.

As far as the taxation system and its instruments in Kosova are concerned, the tax burden in Kosova cannot be considered high, compared with other countries in the region. In general, the share of tax revenue in GDP is also not high. However, the business community has raised serious concerns about the structure of taxes, claiming that the current tax regime does not encourage investments. For instance, equipment and raw material do not enjoy adequate treatment in taxation policy, while some neighboring countries offer tax incentives for these categories, and enjoy trade preferences in exporting to Kosova. That enables them to gain competitive advantages, distort the market and harden Kosova's position to potential export markets.

**(iv) The market**

Over the last three years, there has been an emerging market characterized by excessive demand to provide food, shelter displaced people and reconstruct houses, provide public utilities and provide general infrastructure. The transition from reconstruction phase to sustainable development will influence market restructuring. Kosova's trade regime is completely liberalized without constraints on import and export, but is also without encouragement to exports. All these conditions are relevant to potential investors. Nevertheless, the survey found that 37% of companies see 'limited market' as a very high barrier, 24% regard it as a medium barrier and the rest see it as a small barrier.

When we consider the market size of Kosova, then it is obvious that expansion of business necessarily would lead investors to penetrate the regional market and beyond. However, in parallel with the modest volume and structure of products and services to export, a number of serious barriers to export have emerged. First, FYROM, Montenegro and Serbia are not providing equal treatment to Kosovar exporters, who are paying all tariffs and taxes for their export, while Kosova applies zero tariff rates to these countries. In addition, Kosovar importers are paying a specific transit tax when using the territory of neighboring countries (in FYROM € 100 per truck, in Montenegro 3% from the value of import and, in Serbia 5%).

**(v) Political instability**

A country's political situation carries significant importance to a foreign investor. Kosova is in a phase of building its institutions based on free and democratic elections at both central and local levels. Institutions are in the process of consolidation and in the future they will become sustainable, their credibility and responsibility for managing the economic development of the country will increase proportionally to the transfer of competencies from UNMIK. Security has shown an improving trend, which can be explained by decreasing of political crimes and crimes that endanger life and property. Although Kosova is no longer frequently in headlines in the world news, improvement in stability has not yet achieved appropriate sustainability. We are witnessing lately a rise in tensions manifested through protests, which sometimes take a violent form. Insufficient integration of minorities, especially Serbs and their enclaves within institutional life and economic system of Kosova, generates instability.

In spite of this, the survey indicated that nearly 2/3$^{rd}$ of the interviewed valued the level of political instability as a high or medium barrier, signaling that more work should be done to increase the efficiency of institutions in order to control neuralgic points that affect the trends of political sustainability. In addition, it is indispensable to raise public consciousness on the importance of political stability and security for creating a positive image of Kosova in the world and to foreign investors.

Because Kosova is still considered to have a business environment with political risk, various forms of private-public partnerships need to be established. Investment Guarantee Funds need to be available not only for big public utility projects but also for business projects deriving for instance from the privatization of SOEs.

Commercial risk/payment default by customers in Kosova is lowest in the region. Better coordination among banks in the region is required not only to allow for the different payment instruments for sales transactions (i.e., a letter of credit), but also to improve general investment friendliness.

Having investment-related institutions within the administrative structure will contribute to the goal of improving the perception of political will for investment facilitation and to make it clear that this goal has a high priority.

**a. Lack of laws**

Although 'incomplete legislation' was ranked as a barrier of medium importance in this survey, it is interesting to point out that in the SME survey, the same barrier was ranked as the most intense in the last two years. The lack of legislation and low capacities to implement the regulations/laws in place, are causing delays in building market economy institutions,. Law enforcement mechanisms often do not support implementation (e.g. Regulation on Business Registration, Regulation on KTA). Some essential Regulations are ready for approval (e.g. Mortgage, Bankruptcy). Nonetheless, an important part of legislation is in place. The ten enforced regulations address the following laws:

- **Sales contracts (Reg. 2000/68)**
    - Reflects the basics of the UN Convention on the International Sale of goods
    - Applies only to movable property
    - Exempts ships, vessels, aircrafts and electricity
    - Its applicability can be excluded or derogated
    - Supersedes local law on contracts and torts

- **Foreign investment (Reg. 2001/3)**
    - Grants national treatment to foreign investment
    - Establishes the filing requirements
    - Restricts military products
    - Protects against takings
    - Protects intellectual property
    - Provides rights of information

- **Pledges (Reg. 2001/5)**
    - Pledges and liens as collateral

- Filing of pledges
- Ordinary course of business sales
- Regulation 2001/32 on the establishment of a pledge filing office
- Provide for system of public information
- Access through international computer links

- **Business organizations (Reg. 2001/6)**
  - Company Law
  - Partnerships and limited partnerships

- **Insurance regulation and supervision (Reg. 2001/25)**

- **Payment transactions (Reg. 2001/26)**

- **Essential Labor Law (Reg. 2001/27)**
  - Labor contracts
  - For definite or indefinite times
  - Basics about the parties and work
  - Termination of Labor contracts: a) unsatisfactory performance, serious misconduct, due to structural, economic or technological changes.
  - Severance payments, minimum wage.

- **Standards for financial reporting (Reg. 2001/30)**
  - Establishment of the Kosova Board on Standards for financial reporting and a regime for financial reporting of business organizations.
  - Qualifications for accountants and licensing of auditors
  - Financial reporting obligations for business organizations
  - Audit requirements over 250 K Euro

- **Establishment of a pledge filing office (Reg. 2001/32)**

A Regulation on Land use rights now under preparation will complete this provision. It is designed to improve the title and to guarantee the use to those who buy the company's assets.

Such regulation - a law in fact on removing the current limitations on the scope and transferability of the right to use Socially Owned property- would definitely remove one of the remnants from the socialist era, the "right of use" that companies had over construction land.

For non-Socially Owned land a law on the establishment of a procedure for resolving claims and determining rights in Real property ranking also very high on the agenda aims at creating a procedure that requires persons having claims to a piece of non-residential property to formally file such claims within a specific period of time and then to present supporting evidence.

**(vii) Public infrastructure**

In the post-war period, donors made large investments in public infrastructure resulting in considerable improvements in their condition and working. AER, USAID, DFID, GTZ and other international organizations significantly contributed through their investments in infrastructure. However, Kosova had inherited an undeveloped infrastructure that was severely damaged during the decade prior to the war. The current state of the infrastructure is incapable of supporting foreign investment and business development.

Investors are faced with the problem of providing the land and the planned buildings with connectivity to water supply, sewage and waste disposal, electricity, telecommunication and road networks. Private investors in Kosova have somehow managed this access to infrastructure networks and often financed it from their own resources. It is estimated that these costs usually result in increasing the project costs by 20 to 30% and requiring higher investment. Shipment of goods through neighboring countries is also very expensive and is accompanied by several barriers and bad roads and nonfunctional railway. The demand of both business sector and consumers for public services is rising while the state of infrastructure and public utilities can be regarded as the biggest limitations for investors.

The long-awaited reform of Kosova's public utilities sector remains mired in debate and conceptualization. A strong legal foundation could be expected to cause a restructuring of the incumbent monopoly, KEK and to facilitate market liberalization. These, in turn, would facilitate private sector participation and foreign direct investment. At this stage it is known that KTA will administer publicly owned enterprises of Kosova, including the public utilities. Under its legislative mandate, KTA can be expected to undertake to restructure those existing enterprises. However, this is only one of many steps that must be taken to attract FDI in Kosova. Throughout Europe, strong, legally established independent regulatory authorities applying strong laws have driven power sector restructuring. The same is true for Kosova. Only legislative pressure in the form of strong public utilities laws and a strong regulatory presence can effectuate a change in the sector's dismal condition. Nevertheless, the structure and mandate of an independent regulator remains undetermined. Much also remains unclear regarding the way that competencies and responsibilities to deliver public utility services should be shared and coordinated between the central and local administration. There has been no substantial or open debate on these issues, and until they are resolved, no investment in any of the public utility sectors can be anticipated.

A brief overview of the most difficult sectors is required, specifically the power, telecommunications and municipal public utilities sectors (for more information refer to "Local Economic Development in Kosova", Riinvest, April 2002, "Some Problems of Restructuring of Public Utilities in Kosova," and "The Restructuring and Privatization of Utilities and Large Companies in Kosova," by Iraj Hashi, presented at the "International Conference on Privatization of SOEs and the Reform of Public Utilities," Riinvest, June 2002).

**(a) Power generation** problems continue to pose a significant obstacle to foreign direct investment in Kosova. Frequent load shedding results in power outages that severely hamper economic development. Securing alternative supplies of power is wasteful and costly. The "sunk costs" required to import power is money lost to improve the sector. Despite the substantial investments made during the past three years, Kosova's power system is today unstable, unreliable and expensive. The damage sustained by the Kosova B power station in July significantly worsened an already bad situation. KEK's assets are technologically obsolete and functionally decrepit. Existing power stations cannot be expected to provide a stable or sufficient supply of electricity. Management of KEK remains unsatisfactory. The level of consumer billing is currently at 53% and bill collection, currently running at 65% must increase significantly. On the positive side, KEK's increased billing and collections can be expected to improve its capacity to finance the import of electricity during the rehabilitation of Kosova B station. That work should be concluded by the end of 2002.

It is axiomatic that substantial economic development cannot occur in the absence of a steady supply of power. The situation will not be improved in the absence of sector restructuring and market opening to foreign direct investment. If investors will come, they will do so only with clear picture of what the power sector is and what it will be implementing strategies to attract FDI. Today in Kosova, the current power monopoly, KEK, has neither the incentive nor the legal mandate to restructure itself. However, restructuring the power sector of Kosova is not simply a matter of restructuring KEK. International experience also reflects that where the introduction foreign direct investment is subordinated to the restructuring of an incumbent monopoly, sector restructuring will fail. It will also fail if it is left to the industry itself or to administrative authorities. If restructuring is to succeed in Kosova, political commitments taken at the highest possible level must be embodied in the power law and in the establishment of a strong regulatory body. Given the declining amount of development aid and the substantial amount of investments that are immediately required to fuel the growth of the Kosovar economy, restructuring is critical. Successful restructuring of the power sector will create a climate that encourages new market entries in the form of independent power producers and suppliers. The result will be increased competition, enhanced market choice and an improved quality of service for all consumers. Kosova must be prepared in the immediate future to attract funding from international investors.

Although power sector reform should take into account long-term strategies and policies to improve the operation and management of KEK and to open up the power sector generally, reformers must not loose sight of the sector's immediate and critical need for substantial investment. In that regard, international experience provides numerous models that may be relevant for Kosova in its current state of development. Some models involve only partial market liberilization and partial private ownership or power sector assets. There are also plenty of examples of how "not to do it". International experience is replete with examples of countries have failed to effectively restructure or to attract foreign direct investment into their power sectors. This is particularly true where the political will to take the necessary steps fails. When this is the case, sector development is subordinated to short-term political interests, and regulators "captured" by the powerful and connected find themselves unable to protect public interests. On the other hand, where the process goes well, governmental agencies and independent regulators applying objective laws in a transparent manner often succeed in creating with strategic investors a virtuous cycle of predictability and fair treatment that ultimately results in continued investment.

In summary, FDI inflows would be hampered in the absence of a steady supply of electricity. It will be impossible to get the initial FDI to "prime the pump" for future investment until the sector is restructured and there is private sector participation. This in turn will require a strong power law and the oversight of a strong independent regulator. Kosova's efforts to improve the energy sector should focus on the establishment of a strong legal framework that sends all the appropriate signals to investors that Kosova is a good place for FDI.

**(b) Telecommunications** made progress in increasing its volume of services after the war, but quality of the services is very poor and prices are very high. This is because Post and Telecom of Kosova (PTK) is the monopoly public company providing these services in Kosova. However, PTK increased its profit and invested in reconstructing damage done by war. It now provides cable and mobile telephone services, Internet (DardaNet) and the traditional postal services. Despite these investments, the quality of PTK services remains unsatisfactory and they are provided at very high prices. It is estimated that these prices are the highest in region and these higher costs impact the cost of investment in new and existing businesses.

Riinvest's survey of 38 joint ventures shows that the level of telecommunications during this phase of reconstruction and economic development is acting as a limiting factor to decision-making by potential investors. Hence, 70% of the companies consider the weak telecommunication network as a high or moderate intensity barrier. PTK should be restructured and the market should be liberalized allowing new service providers and encouraging privatization that would increase competition in this sector. The pressure of competition would force PTK to improve its structure and management for better performance and quality of services and to lower the prices. The experience of other countries in transition has shown that telecommunications is an exciting domain for foreign investors. Existing research (Iraj Hashi 2002) shows that Great Britain, Finland, Germany, Spain and Sweden have privatized their telecommunications sector and have achieved high level of liberalization and opening of the market to allow new entrants in mobile telephone services.

**(c) Role of Local Administration in promoting private investment** is very important. Development of level of public utilities, urban development and regulation of location and terrain in municipalities is also very important, especially in promoting a friendly environment to encourage foreign investment. In this regard, special attention should be paid to the Urban Planning function that should create new urbanistic opportunities for the development of local and international businesses that can receive investment, especially in Greenfield Projects in the construction sector. To date, no local administration has taken on the role of building a system of measures to encourage local business development and joint ventures. Previous research conducted by Riinvest on Local Economic Development (Riinvest, 2002) identified several areas that should receive greater attention at the local government level:

- lowering of administrative costs for business establishment and registration
- facilitating access to capital, consulting and training
- promoting appropriate urban planning policy in municipalities, which facilitates location efficiency in business (by ensuring locations for infrastructure facilities, entrepreneurship zone, - urban marketing)
- establishing some transparency in development and respecting rules of the game (competition) on the occasion of organizing tenders for public investment

- encouraging a partnership between publicly and privately owned enterprises
- developing transparent market oriented mechanisms to link bank financing and local infrastructure financing.

Responses obtained by the SME survey (the table below: Riinvest, 2001) reflect a very critical evaluation on the quality of public utilities at the local administration level.

Table 3: How do you evaluate the support provided by local administration? (%)

| | % (bad) | % (unsatisfied) | % (good) |
|---|---|---|---|
| Electricity supply | 95.3 | 2.6 | 2.1 |
| Water supply | 51.1 | 32.0 | 16.8 |
| Telecommunications | 32.3 | 38.3 | 29.4 |
| Roads | 37.4 | 43.9 | 18.8 |
| Garbage collection | 50.6 | 35.7 | 13.7 |
| Education and health | 22.1 | 57.8 | 20.0 |

Source: Riinvest's survey of private SMEs, 2001

All the public utilities and services in Table 3 are important to encourage foreign investors. We can observe two kinds of barriers with negative impact to promote investment in the municipalities of Kosova: (i) administrative barriers, and (ii) infrastructure barriers. Administrative barriers are mostly bureaucratic and influence the country's image. To address this, the municipal and central legislation should incorporate advanced experiences and simplified models of business registration and bankruptcy, as well as strategy for entry in and exit from the market.

## 5.2. REGIONAL/GEOGRAPHICAL LIMITS TO FDI ATTRACTION

Ongoing delays in implementing institutional reform or establishing functioning democratic institutions, along with the presence of corruption, and the lack of efficient macroeconomic management in Southern and Eastern European (SEE) countries, has significantly limited foreign investment. This entire region is lagging well behind Central European (CE) countries in terms of FDI, and Kosova is no exception. The barriers to FDI specific to Kosova must be resolved at the local level, however regional reforms should not be ignored and Kosova stands to benefit from its central location in the region. Regional trade for many countries is about 6% to 10% with few joint ventures within the region, but in Kosova regional trade is over 60% of total imports.

**REGIONAL INVESTMENT LEVEL (1990- 2001)**

(i) FYROM (from Greece, Turkey, Croatia, Bulgaria, "FRY", B&H, Albania).___34.6%
(ii) Romania (from Turkey, Greece, "FRY", Bulgaria) ______________________8.0%
(iii) Bulgaria (from Turkey, Greece) __________________________________14.9%
(iv) Bosnia and Herzegovina (from Croatia, Turkey) ______________________14.4%
(v) Albania (from Greece, Italy, Bulgaria, Kosova, FYROM)_________________85.6%

The largest foreign investors in the region are EU countries with a considerable share of total foreign investment in: Bulgaria (60.0%), Romania (57.0 %), Croatia (61.2%), FYROM (42.5%) and Bosnia and Herzegovina (30.4%). Investments from the U.S.A. are highest in Croatia making up 27.5% of all foreign investment.

Throughout the region a more serious commitment to attracting foreign investors is developing, especially with regard to manufacturing and privatization of state-owned enterprises.

Table 4: Overview of FDI indicators (1990- 2001)

| Countries | FDI in million $ | FDI per capita in $ | Level of FDI per capita; average 100 |
|---|---|---|---|
| 1. Albania | 800 | 233 | 50.1 |
| 2. B & H | 470 | 125 | 26.9 |
| 3. Bulgaria | 3,997 | 504 | 108.4 |
| 4. Croatia | 6,703 | 1,530 | 328.4 |
| 5. FYROM | 824 | 403 | 86.7 |
| 6. Romania | 7,698 | 343 | 73.7 |
| | 20,492 -Total | 466 - Average | |

Source: Economic Strategy for South Eastern Europe (V. Gligorov). Wienna Institute for International Economic Studies, 2001 and: Building Peace in SEE: Macroeconomic Policies and Structural Reforms Since the Kosova Conflict, IMF/WB, 2001.

According to indicators of foreign investment per capita in Table 4, Croatia is in a better position (328.4%) than Bulgaria (108.4%). **T**hat is an indication of the linkage between the level of economic development and FDI. Countries that have higher GDP per capita also have higher investments per capita. FDI per capita in CE countries is significantly higher: Hungary ($2,311), Czech Republic ($2,604), Slovenia ($1,709) and, Poland ($1,010).

In general, FDI was concentrated in industry, trade, and repair of trucks and engines. As may be seen in Table 5, Industry received the highest share of investment in FYROM (84.5%), Croatia (46.5%), Bulgaria (54.2%), and Bosnia and Herzegovina (42.8%).

Problems in the development, restructuring and privatization of the agricultural industry have discouraged foreign investors in this sector. These problems combined with the need for substantial infrastructure development have also limited investment in mines, as well as power, water, and gas utilities.

Table 5: FDI in some regional countries by sector (mil.$)

| Sectors | Bulgaria | Romania | Croatia | B & H | FYROM |
|---|---|---|---|---|---|
| Agriculture | 0.3 | 3.0 | 0.0 | - | - |
| Mines | - | - | 3.4 | - | - |
| **Industry** | **54.2** | **43.8** | **46.5** | **42.8** | **84.5** |
| Electricity, gas, water supply | - | - | 0.8 | - | - |
| Construction | 1.0 | 2.3 | 1.3 | 5.4 | 1.1 |
| Trade, repair of trucks and engines | 19.5 | 24.1 | 4.1 | 3.1 | 6.0 |
| Hotels and restaurants | 5.1 | 0.8 | 1.0 | - | - |
| Transport and communication | 4.5 | 2.3 | 30.0 | - | 1.2 |
| Financial intermediaries | 11.7 | 23.7 | 12.5 | 13.1 | 2.8 |
| Real estate, rent and business activities | - | - | 0.4 | 31.5 | - |
| Others | 3.7 | 0.0 | 0.0 | 4.1 | 4.4 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Foreign Direct Investment in South East Europe: Implementing Best Policy Practices. Wienna, 2000

Regional Economic Cooperation and trade also face many obstacles. An evaluation by a network of five regional think tanks in Albania, Bulgaria, Kosova, Macedonia and Montenegro, "Obstacles to Trade, Growth, Investment and Competitiveness" (Chesapeake Association, 2001), sampled 25 companies from each country and ranked the main obstacles to investment.

Table 6: Rank of obstacles for trade and cooperation from company perspective

| Description | Kosova | Other Countries |
|---|---|---|
| Custom related problems | 2 | 1 |
| Taxes | 7 | 2 |
| Contracts and payments | 4 | 3 |
| Lack of information | 5 | 4 |
| Infrastructure (telecomm., energy, roads…) | 1 | 5 |
| Administrative procedures | 6 | 6 |
| Banking System | 3 | 7 |
| Political Risk | 8 | 8 |

Source: Obstacles to Trade, Growth, Investment and Competitiveness (Chesapeake Association, 2001),

Problems related to the Customs administration were the most severe for all countries in the region except Kosova, in which it was ranked second. Instead, the low level of infrastructure development was considered as the main obstacle in Kosova. Kosova is also experiencing more serious problems with its banking system than the other countries. All surveyed companies in the region cited Kosova as their most important market, a reflection of the post-war reconstruction needs. Administrative cost for establishing companies in the region is also very high as a result of the level of corruption and the poor quality of governance and transparency.

A number of activities are being undertaken in coordination with the international community to overcome the problems presented here. The measures within the Stability Pact, or "Investment Compact for SEE Countries," are of particular importance.

**THE INVESTMENT COMPACT FOR THE SEE REGION**

Governments throughout the region must do much more to create the conditions under which the private sector will invest. With the objective to establish a stable, transparent and uniform framework for private sector investment, the Governments of the region, in collaboration with their partners in the Stability Pact, decided pursue the implementation of the **Compact for Reform, Investment, Integrity and Growth** (referred to as the Investment Compact). The Investment Compact outlines a very ambitious agenda of legal, regulatory and institutional reforms, to establish fair and non-discriminatory treatment of domestic and foreign investors, with full protection of their property rights, not only by the letter of the law but also by its administrative implementation and judicial enforcement. The specific policy areas covered by the Investment Compact include; banking; capital markets; corporate governance; policies and promoting strategies for foreign direct investment; commercial law, including business licensing and formation; administrative efficiency and bureaucratic obstacles for private sector initiative; competition law and policy; fighting bribery and corruption; the system of justice; SME support; privatization; fiscal reform and taxes; and accounting regimes and practices.
The commitment of the Governments of South Eastern Europe to the introduction and implementation of the Investment Compact will be supported by Governments outside the region, international institutions and other donors. Following the finalization and approval of the Investment Compact by the Government of South Eastern Europe, technical support and assistance to strengthen institutional capacity to implement it will need to be mobilized.
*Source: World Bank: The Road to Stability and Prosperity in SEE – Regional Strategy Paper, 2002.*

# 6. POLICY MEASURES FOR FDI ATTRACTION

The current situation of economic development and the problems described concerning FDI highlight the need to complete the economic, legislative and institutional reform in Kosova to foster a more business and investment friendly environment. Of course, these policies should be equally addressed for all investors, foreign and domestic. In this part of the report, we will briefly address some of the issues that are relevant to creating such an environment.

## 6.1. BUILDING UP OF MACROECONOMIC STABILITY

The completion of emergency reconstruction after the war, as well as financial and technical assistance by the international community has helped generate the fast growth of GDP as shown in the table below. However, within this growth, there are great disparities that can hinder sustainable economic growth and macroeconomic stability. These gaps consist mainly of:

- gaps between GDP, consumption, savings and investments,
- gaps between capital investment needs and budget capacities,
- gaps between import and export,
- unemployment and investment level.

Some of these disparities can be illustrated by the data below:

Table 7: Macroeconomic Indicators (2001):

| | |
|---|---|
| GDP: | €1.8 bn (est.) |
| GNP: | €2.5 bn (est.) |
| Disposable income: | €4.3 bn (est.) |
| Consumption: | €2.5 bn (est.) |
| Savings: | €0.3 bn (est.) |
| Investment: | €1.5 bn (est.) |
| Imports (goods): | €2.5 bn (est.) |
| Exports (goods): | €0.4 mil (est.) |
| Kosova Consolidated Budget: | €0.4 bn (est.) |
| Capital Investment: | €1.7 bn |
| Bank deposits(31.12.2001): | €0.5 bn |
| Remittances: | €0.6 bn (est.) |
| Inflation rate (CPI): | 11% |

Source: CFA estimations

Many of these disparities are being managed currently due to international financial assistance and remittances from Diaspora. But the most difficult challenges are how to increase income and job creation in the face of decreasing foreign financial assistance. Careful management of this transition phase is very important to avoid a significant slow down in growth as a result of the sharp reduction of aid also known from the experience of other countries as a ‘shock’ to the economies that were based on aid or high financial infusion from abroad (as has happened in Bosnia). In order to counter the recession, next two years are crucial for improving public infrastructure through the donor support that would stimulate business activities, income generation and employment.

Table 8: GDP growth estimations

| | | Index |
|---|---|---|
| GDP mill. USD 2000 | 1,352 | 100 |
| GDP mill. USD 2001 | 1,679 | 124 |
| GDP per capita 2000 | 764 | 100 |
| GDP per capita 2001 | 904 | 118 |

(Based on CFA estimations, March 2002)

The rate of inflation of around 11% in 2001 is expected to decline. The new European currency is expected to aid FDI because it allows investors to avoid the problem created in currency exchange or depreciation of the domestic currency as a consequence of inflation or expansionist monetary policies. Stable currency and low level of inflation is objectively an advantage of Kosova compared to the neighboring countries.

Kosova's consolidated budget, which was only 50% self-financed in 2000, increased to the level of 82% of self-finance in 2001, while by 2002 it is expected to be covered by tax revenues up to about 93%. GDP is also expected to grow by 24% (13% in real terms) in 2001, and 14% (7% in real terms) in 2002, eventually tapering off to a 6% to 7% growth rate by 2005. The share of Budget to GDP is set to increase from 14% during 2001 to around 20% after 2005 (CFA estimations).

Another area of concern is the imbalance between exports and imports. Exports are currently at a very low level due to production and infrastructure obstacles. Current policies seek to reduce account deficits in both directions by decreasing imports of humanitarian aid and emergency reconstruction assistance and increasing exports of goods. Remittances will likely continue to be very important in managing these deficits and currently account for over €400 – 500 million. (Riinvest estimates, Household survey, 1999).

Adequate macroeconomic management and regulation as a precondition of economic stability is also key to attracting FDI. Special attention should be paid to increasing exports, investment in public infrastructure, increasing budget revenues from taxes, and increasing employment. This requires a further increase in capacities of public administration as well as building transparent macroeconomic budget indicators. Support for the Macroeconomic Analysis Unit at CFA/Ministry of Economy and Finance, which publishes monthly reports on macroeconomic indicators and a quarterly Outlook on macroeconomic trends with Riinvest, should continue. Investors demand a clear picture of the macroeconomic situation and enriching the statistical base of macroeconomic indicators should be a priority.

## 6.2. PRIVATIZATION AND THE REFORM OF PUBLIC UTILITIES

Approval of the regulation on KTA is a step forward for commencing of the privatization process. Registration of the new subsidiary companies from existing SOEs and selling of their assets to foreign and domestic investors, without taking into consideration debts inherited from the past and other problems related to SOEs, seems to be a well-thought out model oriented towards attracting foreign investors and other investors. At the same time additional, including efforts are needed for operating procedures to implement the Regulation and creating a program of activities to carry out the privatization process and link it with economic policies and complementary legislation. Furthermore, it is necessary to undertake an aggressive activity to promote the privatization model and program to private foreign and domestic investors. It is clear that the success of privatization of large and medium SOEs via "Spin-off" model will crucially depend on the involvement of foreign and domestic investors with adequate financial capacities.

Having in mind that public infrastructure, in particular telecommunications, power generation and some utilities can be attractive to foreign investors, the openness of reforming processes within public enterprises is essentially important. International Conference on Privatization of Socially Owned Enterprises and the Reform of Public Utilities (Riinvest, June 2002) shed light on the dilemmas in this area. Nevertheless, the main concerns within public enterprises are daily problems of operation, and less of restructuring, liberalization and indispensable reforms, by which their position would change significantly.

Virtually all sectors of public infrastructure and utilities need substantial investment. It is, therefore, imperative to take innovative approach for attracting investors and create necessary legal framework for realizing the investment. Some of the possible approaches are mentioned below.

There are different options available for private sector participation according to differences in how responsibility for asset ownership between the public and the private sector is shared. Other than complete privatization (divestiture) the main intermediate options for private participation are management contracts, leasing, concessions and operator models like BOT (Build, Operate, Transfer), BOO (Build, Own, Operate) and others. These options are briefly explained below.

- Under a **lease arrangement,** a private firm leases the assets of a utility from the government and takes on the responsibility for operating and maintaining them. The lessor assumes the commercial risk of the operation and correspondingly buys the rights to the income stream. The profitability clearly depends on how much the lessor is able to decrease the costs while still meeting the quality standards so it has the incentives to improve operating efficiency.

- A **concession** gives the private investor not only responsibility for operation and maintenance of a utility assets but also for new investments. However asset ownership remains with the Government and full use rights to all assets including those created by the private partner revert to the Government when the contract ends. The main advantage is the transfer of full responsibility for operation and investments to the private sector and the creation of incentives for efficiency in all the utility activities. This is therefore an attractive option where large investments are needed.

- In a typical **BOT project** the investor undertakes an investment, operates the facility for a number of years and at the end of the contract passes on all rights to the facility to the public utility. If the facility remains in the ownership of the investor it is a **BOO arrangement.**

### 6.3. MARKET REGULATION AND FAIR COMPETITION

As stated earlier the foreign trade regime in the Kosovar market is liberalized. As a result domestic businesses face competition from imports, the market is distorted and fair competition leading to economic stability and rational market signals do not exist. The 2000 and 2001 Riinvest Small and Medium Enterprise (SME) surveys indicate that, out of fourteen barriers to doing business in Kosova, unfair competition ranks only behind the lack of appropriate enabling legislation as the most serious barrier. These reasons should be presented as shortcomings in the regulation of the market and economic policies that create room for fiscal evasion. This principally results from asymmetric tariff regime and customs enforcement that discourage Kosovar producer and reduce their competitiveness in domestic and foreign markets.

Kosova's absence of international standing as a trade entity negatively effects its regional and international trading position. This, in turn, inhibits the development of businesses and the strengthening of sustainable economic growth. Kosova's international relations and trading policies are reserved for the Special Representative of the Secretary General (SRSG). The establishment of these policies and relations represent an immediate need in order to create the preconditions for the significant involvement of Kosovar businesses in the regional and wider international market.

From the perspective of private direct investments, improvement in trading conditions requires taking effective measures as following:

- Active policy making in regard to Kosova's international status as trade entity in order to foster fair competition
- Implementation of reciprocity instruments
- Compensating for the negative effects caused by the trade agreement between Kosova and Serbia/Montenegro
- Regulation of these trade relations by means of the trade agreement
- Addressing asymmetrical special and discriminatory transit taxes faced by Kosovar importers in Montenegro and Serbia
- Addressing the barriers and difficulties faced by Kosova in export of products to neighboring countries due to the implementation of non-reciprocal instruments, administrative barriers, arbitrary customs duties, and problems associated with the official certification of Kosovar products.

### 6.4. FURTHER IMPROVEMENTS IN TAXATION POLICY

Modern fiscal and taxation systems currently are being constructed. Tax revenues as share of GDP rose from **around 8% in 2000 to around 17% in 2002** in an environment of strong GDP growth. A further improvement of tariff structure and customs procedures in major trading sector would encourage investment. Such a change would benefit Kosova in three ways:

- Increase the competitiveness of Foreign Direct Investment (FDI)
- Lower effective tax rates on investment goods.

### 6.5. DEVELOPMENT OF FINANCIAL AND CREDIT SYSTEMS

Considerable progress has been made in the banking sector. The establishment of a credit market, improved competition, and increased bank deposits and transactions are elements of a stable financial system that encourages investment. Deposits and savings are increasing due to an efficient banking system and increasing banking client confidence. Deposit levels actually surpassed predictions and serve as an indicator of financial and credit stability. At the end of 2001 deposits amounted to Euros 467 million, and in 2002 stabilized at Euros 350-380 million.

Business credits from banks have also increased. All licensed Kosovar banks are implementing credit and business support programs. To date banks have provided 53 million Euros in loans to domestic businesses – 49.6% of loans have been to trade companies, 16.9% to manufacturing companies, 19.5% to service companies, and 13.9% to other companies. In the current phase of reconstruction, however, this amount of support is inadequate, especially for manufacturing businesses, because of the loan terms and conditions (high interest rates, the absence of grace periods, and short-term loans). Non-banking institutions play a role as financial intermediaries. They have provided Kosovar entrepreneurs with over 13,000 micro credits totaling Euros 29.1 million.

Structural disparities remain an issue, especially regarding deposit quality and structure. In addition, the ratio between loans and deposits is extremely unfavorable. Economic policies should be able to correct these disparities, in particular by encouraging term-deposits and long-term savings. Higher interest rates may offer one solution. A better relation between passive and active interest rates could lead to a solution for long-term credits and an increased credit supply. In addition, further improvements in competition could help lower interest rates.

The above-mentioned recommendations are essential to creating an appropriate environment for investments and privatization. However, investments are only one element of a financial system. The broader functioning of the capital market, seemingly neglected until now, should quickly be added to the economic policy agenda of policy makers and designers of the Kosova economic system.

The establishment of investment funds using the capital of the Kosovar Diaspora in the countries where it is concentrated (Germany, Switzerland, U.S.A., Scandinavia, Great Britain, and other countries) is also key to economic development. The capital in those funds could connect

Kosovar and foreign banks and be guaranteed by bilateral investment agreements, e.g. Overseas Private Investment Council (OPIC). It would be beneficial to create a more detailed proposal as soon as possible in order to discuss it with the Kosovar Diaspora and the relevant governments. The Swiss government and Swisscontact are preparing one concrete example.

The banking system does not issue the usual instruments of payment for international transactions (import/export). Banks in Kosova are not yet coordinated enough with correspondent banks elsewhere in the region to allow for letters of credit. Regional trade facilitation and regional economic integration requires this level of coordination to be in place.

An agreement among the Agencies for Export Insurance from the Balkan countries is an idea to be considered. They may guarantee the realization of contracts whereas each Agency now takes the risk in refusing to execute the contracts by companies treated as residents in its own country. For these companies the local Agency has complete information, thus the risk premium due is minimized. One characteristic of the Balkan region is the high level of trade risk and therefore this proposed form of receipts guarantee would stimulate regional trade.

### 6.6. LEGISLATION

A considerable part of the approved commercial law and the Regulation on Foreign Investments meets market economy standards, a prerequisite for investment. However, the package of commercial and other laws has not yet been completed and is not implemented consequently. Therefore, the missing synergetic effects are not fully realizing these advantages of the legal system in Kosova. Incomplete legislation and the lack of enforcement mechanisms and principles of the rule of law hinder investments. The Parliament, the Government of Kosova, and UNMIK should focus their efforts on:

- Effective implementation of approved laws, especially the Law on Corporations
- Completion of the legal system through the addition of other necessary laws: Law on Privatization/long-term land usage, Bankruptcy Law, Law on the Protection of Competition, Law on Foreign Trade, Law on the Financial Market and Stock Exchange, and Law on Property Rights and Intellectual Property

### 6.7. ADVANCING KOSOVA'S STATUS IN INTERNATIONAL ECONOMIC RELATIONS

According to United Nations Security Council Resolution 1244 and the Kosovar Constitutional Framework for Provisional Self-Government, all aspects of international relations are the responsibility of the SRSG. Issues related to the strengthening of economic and trade relations of Kosova and foreign countries fall under UNMIK's auspices. Even though a basic legal framework for FDI exists, Kosova's exclusion from most important economic and financial institutions undermines its negotiating position when seeking bilateral agreements and discourages foreign investors. In order to overcome these problems, UNMIK and Kosovar institutions should work in the following areas:

- Signing of bilateral investment protection agreements and avoidance of double taxation on income and profits agreements with foreign governments,
- The regulation and institutionalization of Kosova's status vis-à-vis international financial institutions in order to ensure participation in their projects,
- Promoting Kosova's status within the Stability Pact from "Observer" to "Member" will ensure its substantial participation,
- Recognition of Kosova's status as an international trade and customs entity. This would facilitate trade and investment, and strengthen Kosova's negotiating position *vis-à-vis* international financial institutions, foreign countries, and potential investors.

## 7. FDI PROMOTION

### 7.1. CURRENT ACTIVITIES

An effective promotion strategy is the basis for attracting foreign direct investment in Kosova. In addition to local business associations and thinks tanks, the following institutions have started to promote foreign investment opportunities in Kosova:

- The Government of Kosova, through inter ministerial mechanisms
- The Kosova Chamber of Commerce
- USAID – Kosova Business Support Project
- The Euro Info Correspondent Centre (EICC)
- Swisscontact

Although the coordination among these institutions needs to improve, their efforts are an important step in the direction of FDI promotion. Following is a brief summary of their respective activities.

**(i) The Government of Kosova** is working with the Kosovar Diaspora to mobilize capital investment from outside the province by providing the Diaspora with relevant information about economic policy and legislative reform. Nevertheless, the Government of Kosova still does not have a platform for promoting and sustaining foreign investment.

The Trade and Investment section of the Former Department of Trade and Industry held contacts with some Investment promotion state agencies intended to lead to joint actions: The Swiss Office for facilitation of Investment (SOFI), The Instituto Español de Comercio Exterior (ICEX) or Istituto per il Comercio Estero (ICE) are among them.

**(ii) The Kosova Chamber of Commerce** has reestablished some business and economic relations with other countries, in particular the successor states of the former Yugoslavia. The Chamber has promoted opportunities for partnership with regional companies through visits of foreign businessmen, trade fairs, study tours, and training seminars and workshops for the local business community.

**(iii) USAID–Kosova Business Support Project (KBS)** focuses on the development of managerial capacities of Kosovar companies, particularly in the areas of trade promotion, financial resource management, and creation of contacts with foreign investors. Several promotion missions with various groups of investors, including the Kosovar Diaspora, have been organized to promote investment opportunities in Kosova. It is necessary to support the business associations, especially the **Kosova Export Association** that would contribute to promotion of trade and investment.

**(iv)The Euro Info Correspondent Centre (EICC),** located within the Kosova Chamber of Commerce, provides information resources to promote linkages between Kosovar and international businesses. The EICC has access to a network of 300 similar centers throughout Europe. Its promotion activities include: (i) providing information on the investment climate in Kosova, (ii) providing information on European regulatory policies, and (iii) setting up an IECC website to provide information on the business environment in Kosova and investment opportunities.

**(v) Swisscontact** focuses on three areas in Kosova: (i) management training, (ii) businesses services, and (iii) promoting the return of the Kosovar Diaspora. In terms of promoting foreign investment, Swisscontact is establishing the Kosovar-Swiss Investment Fund to mobilize and direct the capital of the Kosovar Diaspora to SMEs in Kosova.

An important element in promoting international investment is improving Kosovar integration within the broader regional economy. Commercial integration and investment are interrelated, in that the normalization and increase of trade flows and the enlargement of the internal market are preconditions for attracting investment. One possibility to improve commercial integration and increase investment is to promote the development of Kosova as a supply, distribution and manufacturing hub for the Balkans. This is based on Kosova’s central location and existing trade connections/routes used by Albanian minorities in the surrounding countries. The same principle could be applicable to external trade connections with ethnic minorities in Kosova. Development of a multiethnic trading network would provide security benefits beyond just commercial integration and capital investment.

## 7.2. ELEMENTS OF AN FDI PROMOTION STRATEGY

In addition to the developments in the legal, fiscal and financial fronts indicated earlier the appropriate strategy to promote FDI flows into Kosova should take into account, in the first place, the need to re-brand Kosova as an investment destination.

***(1) Institutional campaign*** to highlight the benefits of investing in Kosova. The UNMIK EU Pillar, USAID, and the Kosovar Government should be fully involved in the campaign, which should also be open to other donor organizations. With private sector involvement and promotion through the international economic press, Kosova is presented as an emerging market with attractive investment conditions:

- Central strategic position
- Abundance of natural resources at competitive prices
- Links with many European countries and the US through the Kosovar Diaspora
- Well-educated workforce with strong technical skills
- Highly motivated workforce
- Relatively inexpensive and abundant workforce
- Low taxes
- Stable currency
- Low rate of inflation
- Exports exempted from VAT and customs duties
- Free Trade with the EU for almost all goods under the Stabilization-and Association Process.
- Relatively high purchasing power through remittances

***(2) Investment missions by Kosovar businessmen.*** The former Department of Trade and Industry (DTI) organized several international investment missions. In one particularly successful mission, Kosovar mining representatives traveled to Canada where they met directly with international investors. Despite potential interest, the unresolved status of Kosova, combined with unclear ownership of SOEs prevented any serious bid. With privatization now underway in Kosova, investment potential should improve and international investment missions could be an effective promotion tool.

***(3) Utilization of liaison offices and foreign representatives in Kosova.*** International representatives in Pristina can contribute to investment promotion endeavors by reaching out to potential investors or investment promotion agencies in the states they are representing. They are valuable sources of information and investment promotion policies targeted at specific groups of investors like Diaspora. Identification of investment opportunities and mediating between investors in the host and destination countries are among their important functions.

***(4) Investment missions to Kosova.*** In conjunction with the liaison offices of foreign countries, the Trade and Investment section of the former DTI and Kosova Chamber of Commerce organized international visits to Kosova to assess investment opportunities and the broader business environment. Information sessions were held, and material such as the "Ten top tips for investors coming to Kosova", were provided by DTI to mission participants. Some deals involving joint ventures or limited liability companies resulted from the missions. Now, under more favorable conditions, these programs should be intensified.

***(5) Business-to-Business Forums*** have been organized by business support programs in Kosova for several years. The EICC and KBS conduct regular matchmaking sessions for sales contracts and for investment deals with positive results. Such Forums organized by the KBS have included broader Balkan participation, including representatives from Montenegro, Macedonia and Albania, and should be further expanded.

***(6) Participation in international trade fairs***. Business advisory services operating in Kosova such as KBS, EICC and the Kosova Chamber of Commerce are promoting the participation of local businesses in regional and pan-European trade fairs. Local producers need advice on what fairs are the most appropriate to attend, as well as technical support to facilitate their participation.

***(7) Presentation of Kosovar business opportunities at international investment forums***. A number of investment promotion events take place throughout Europe each year. A well-known forum, the CEEI (Central and Eastern European Initiative) in Trieste, Italy was attended by Kosovar delegates last year and other opportunities should be explored.

***(8) Publicity campaign.*** Relevant Kosovar publications on investment potential, economic sector profiles, and the business environment should be highlighted in the print and electronic media.

***(9) Establish and institutionalize contacts and communication with Kosovar Diaspora*** both at central and local level is necessary. The organization of Diaspora in other countries should overcome fragmentation caused by politicization and should move to interest based organization with Kosovar municipal attributes.

***(10) Elaborate Alternatives for Establishing an Investment Promotion Agency (IPA)***. The IPA could coordinate efforts of different Ministries and other actors, active in investment promotion. The purpose of IPA is also to coordinate investment promotion efforts throughout Kosova's regions in providing necessary information to investors and, provide technical assistance to investment promotion efforts in different sectors.

Internal organization of the IPA needs to be discussed and agreed upon by the sponsors and institutional partners in the Agency. International staff with the appropriate technical background and international relations experience is required for senior management positions.

The IPA's role inside the Government, or as an autonomous body (association) also needs to be discussed and decided. Similar investment promotion institutions are found in virtually all Kosova's neighboring states, and in many cases for sub-state territorial entities. As a basic institution of a market economy, an Investment Promotion Agency needs to be introduced in Kosova.

## ANNEX 1. FOREIGN INVESTMENTS REGULATION

The objective of this regulation is to provide legal framework that is necessary for Kosova in order to attract foreign investors. The guarantees that this regulation offers for foreign investors are the standards that they are present in the regulations of Western and transitional economies. The regulation puts the foreign investors in equal position to domestic ones, through ensuring that foreign investors have the same rights and obligations concerning taxes, customs etc. In other words, this regulation aims at equalizing foreign and domestic companies as much as possible.

According to definition of this regulation "a foreign investor" means a corporation which is at least 25% owned by a foreigner. On the other hand, the term "foreign investor" means: i) every physical person that is a citizen or resident in foreign country; ii) every judicial person founded and registered according to the legislation in foreign country or founded according to the legislation in power in Kosova, with a known address by the law and is doing economic activity in a foreign country or is it investing; iii) a foreign country or any of its administrative unit; iv) a judicial person founded by a treaty or intergovernmental agreement.

Main dispositions of this regulation are focused on some important principles which provide that:

- Foreign investments will be managed according to the principle of national treatment. That means that they will not be discouraged *vis-à-vis* domestic investors/companies. Management according to the national principle means that organizations dealing with economic activity are guaranteed the following:

    - To be organized in the same way as domestic ones;
    - To be a subject of ratification from the authority and domestic companies;
    - To have the right of transferring their assets, including licenses to other persons in the same way as to domestic persons;
    - To have the right to buy agricultural, residential or non-residential real estate as domestic companies;
    - To be protected in the same way as domestic shareholders if the do not own majority of shares in foreign investment;
    - Not to be taxed less favorably than any domestic company, etc.

- There are only two constraints on foreign investments. These constraints are sound almost in all countries. The first is that a foreign investor can own or control more than 49% of the property of commercial corporations that producers or distributors of the military products. The second is that the foreign investments that are present 5 km inside the border of Kosova should have an additional license from the authorities.

- Foreign investments are protected by arbitrary expropriations from the authorities. Expropriation of the foreign investment can be made only for public purposes, and that only in case if any important public objective can be achieved. In this case, expropriation should be carried out through a non-discriminatory procedure consistent with a regular legal process, and it should be associated with immediate, appropriate and effective compensation in favor of foreign investor.

- Foreign investments that can suffer damages as a result of the war or other military conflicts, extraordinary situations, civil demonstrations and other similar situations, have the legal right for protection as domestic commercial corporations.

- Foreign investors have unlimited right to use their legal investments and incomes. The profits from foreign investments can freely be transferred within and outside Kosova;

- Foreign investments are protected from the retroactive impacts of laws that will be approved in Kosova subject to them, though changes in the laws in Kosova, cannot exacerbate the operating condition of foreign investments, after the contract has been signed.

- Foreign investors are subject to the same set of laws regarding their activity as are domestic investors;

- Foreign investors will regulate their labor relations according to international standards. People employed by foreign investors in Kosova regardless their nationality, are subject to the legislation in power in Kosova. Foreign investors have the right to employ foreign workers.

**ANNEX 2.**

**U.S. Chamber of Commerce:**
**What Goes into a U.S. Company's Decision on Whether to Invest Overseas?**
**or the Twelve Commandments for International Investors**

The following factors are generally accepted as the principal criteria guiding a company's overseas decision:

1. **Internal Market** – the size and potential for growth of another country's domestic market, especially the purchasing power of its customer are key. You don't invest in a market where you have little potential to make a profit.

2. **Freedom of Access to the Market** – the strength of the competition as well as the degree of government (theirs and ours) inferences to entering a country's market. The freer the market, the more attractive it becomes as an investments opportunity.

3. **Labor Force and Raw Materials** – while the investors brings capital, technology and management to the table, the quality of the indigenous work force and the availability of in-country raw materials are also important ingredients in the recipe for success.

4. Protection from Currency Devaluation – simply stated, if you make an investment in dollars, and then the local assets (valuated in the local currency) are devaluated, you have lost part (or possibly all) of your original dollar-based investment.

5. **Remittance of Dividends, Interest, Royalties and Technical Assistance Payments** – if you can't get your money out of the country, then why invest?

6. **Property Rights Protection** – likelihood that a company's property, real or intangible (patents, copyrights, etc), will be stolen.

7. **Export Potential** – ability to source from an operating unit in one market to serve nearby markets or maximize a company's global efficiency by trading among its various operating entities in different countries to round out its products line.

8. **Regulatory Burdens** – the cost of government intervention on business (and profits) in a country.

9. **Favorable Taxation and Tax Incentives** – although tax incentives geared to attract initial investments are important, the final investment decision is usually based on how a country's taxation will affect the normal operating environment.

10. **Low Political Risk** – an investor's ability to rely upon the integrity of the host government and its ability to maintain local law and order is essential to any long-term investment.

11. **Predictable Macroeconomic Management** – confidential that the economy in which the investments takes place will be managed in a competent and predictable way. Simply stated, belief that the rules of the game will not change in the middle of a contest. Reliable Infrastructure Support – the ability to consummate transaction and get products and services to market is critical. Whether it is reliable transportation services, power generation, insurance and accounting services, a competent financial system, or other basic, investments cannot yield reliable returns without them.

12. **Reliable Infrastructure Support** – The ability to consummate transactions and get products and services to market is critical. Whether it is reliable transportation services, power generation, insurance and accounting services, a competent financial system, or other basics, investments cannot yield reliable returns without them.

## ANNEX 3. EXPERIENCES OF SOME COUNTRIES OF ATTRACTING FDI

### 1. BULGARIA

**FDI in Bulgaria (1991-2002): An Overview**[2]

**By Krassen Stanchev and Martin Dimitrov**

Openness to foreign investments

Bulgaria has one of the most liberal foreign investment laws in the Balkan region. Foreign investors may take the juridical form of any of the business organizations stipulated in the Commercial Code. The most common type of organization for foreign investors is a limited liability company. Other forms are: general partnership (unlimited partnership), limited partnership and sole traders. Foreign legal entities registered abroad may register branches as a part of the main company or representative office (marketing representation) on the local territory.

The problems most often cited by foreign investors are: government bureaucracy, poor infrastructure, poor regulation impact advance assessment as well as frequent changes in the legal framework, protracted privatization process and a relatively high tax burden[3].

Foreign companies are permitted to engage in various forms of business activity including the acquisition of shares in companies, with some restrictions. Foreign individuals cannot own land (this is a constitutional prohibition). The above restriction, do not concern Bulgarian companies with foreign participation, irrespective of the percentage of the foreign participation in the company.

Legal Guarantees for Foreign Investors

**National Treatment**

The Bulgarian Constitution and the Law on Foreign Investments provide national treatment to foreign investors which means that foreign investors are entitled to perform economic activity under the same provisions applicable to Bulgarian investors except where otherwise is provided by law. The national treatment to foreign investors includes the participation in the process of privatization and acquisition of shares, treasury bonds, and other kinds of securities.

[2] Additional materials on the issue are available on IME's web page: www.ime-bg.org
[3] For more information see: Bulgaria Country Commercial Guide FY 2001, http://www.tradeport.org/ts/countries/bulgaria/climate.html

*Legal Guaranties Against Adverse Changes in the Law*

The Law on Foreign Investments stipulates the principle that foreign investment made prior to the adoption of amendments in law imposing statutory restrictions only with regards to foreign investments, should not be affected by these restrictions. The sense of the law provides for that foreign investments shall be guaranteed against subsequent legislative changes.

*Expropriation and Compensation*

According to Article 26 of the Foreign Investment Law, property can be expropriated on the grounds of a law "for exceptionally important state purposes". Owners must be compensated with nearby property of equal value at current prices. Expropriation actions can be appealed to the Supreme Court with regard to the basis for the expropriation action, property appraisal and method of compensation. There have been no cases of expropriation action since the beginning of reform in Bulgaria in 1989.

<u>Transfer Policy</u>

Bulgarian citizens as well as foreigners may take Bulgarian levs and foreign currency of up to BGN 20,000 or its foreign exchange equivalent out of the country without documentation. However, the export of Levs and foreign currency between BGN 5,001 and BGN 20,000 or its foreign exchange equivalent should be declared at customs. Transfers larger than BGN 20,000 must have prior approval of the Bulgarian national Bank (BNB). Foreigners are permitted to export as much currency over the foreign currency equivalent of BGN 20,000 as they have imported into Bulgaria without prior approval.

Payments abroad made by businesses (or self-employed business people) may be executed only through bank transfers. Transfers over BGN 20,000 for current international payments (imports of goods and services, transportation, interest and principal payments, insurance, training, medical treatment and other purposes defined in Bulgarian regulations) must be supported by documentation showing the need and purpose of such payments.

This regulation does not fit with the understanding of liberal capital account and is to be considered as barrier to foreign investment and money transfers. However, in the context of EU accession liberalization is expected.

New amendment not yet come into force envisages declaration and not permission regime when transferring amounts larger than BGN 25,000. However, the transfer should be accompanied by documents testifying that money has legal origin and that the person/the business unit has paid all due taxes.

<u>Capital market</u>

Since October 1997, the Bulgarian Stock Exchange has operated under a license by the Securities and Exchange Commission. Despite different government attempts to develop Bulgarian Stock Market for the time being results are poor and unsatisfactory. The basic conclusion is that government cannot create interest where it does not exist or create business where entities are simply not attracted.

FDI inflows

The foreign direct investments in Bulgaria show an increasing trend for the last 9-10 years. The FDI flows in the country were barely USD 34 million in 1992 and rose to just above USD 1 billion in 2000. The biggest acceleration in the investment inflow was observed in 1997 when it increased by 2.5 times compared to 1996. The main reason for this increase was the momentum in the privatization process as the FDI through privatization were USD 421 million or more than 2/3 of the total FDI in 1997.

The introduction of the Currency Board in 1998 had a stabilization effect on business environment and created favorable conditions for Greenfield FDI (see the table bellow).

FDI inflows by years (million USD)

| Year | Privatization | Other* | Total |
|---|---|---|---|
| 1992 | - | 34.4 | 34.4 |
| 1993 | 22.0 | 80.4 | 102.4 |
| 1994 | 134.2 | 76.7 | 210.9 |
| 1995 | 26.0 | 136.6 | 162.6 |
| 1996 | 76.4 | 180.0 | 256.4 |
| 1997 | 421.4 | 214.8 | 636.2 |
| 1998 | 155.8 | 464.2 | 620.0 |
| 1999 | 226.7 | 592.1 | 818.8 |
| 2000 | 366.0 | 635.5 | 1001.5 |
| 2001 | 19.2 | 669.3 | 688.5 |
| 2002** | 300.0 | 400.0 | 700.0 |
| **Total without 2002 forecast** | **1447.7** | **3084.0** | **4531.7** |
| **Total with 2002 forecast** | | | **5231.7** |

* Greenfield investment + additional investment in companies with foreign participation + reinvestment + joint ventures
** Forecast of IME
Source: Bulgarian Foreign Investment Agency

## 2. BOSNIA AND HERZEGOVINA

**(i) The Progress:** Because of the difficulties in creating unified economic system, FDI results in Bosnia and Herzegovina (B & H) are modest. Since the end of military conflict, potential foreign inventors visit (B & H) to explore opportunities and often conclude that the investment climate is not very unfavorable. The largest share of FDI in B & H is from the following countries: Kuwait (19.0%), Germany (9.8%), the Netherlands (8.6%) and Austria (7.2%). Break down of these investments by sectors is as follows - manufacturing (65.5%), trade and services (18.7%), and banking (15.7%).

Over the six-year period of 1995 – 2001, FDI in Bosnia and Herzegovina (B & H) reached Convertible Mark (KM) 1.1 billion or 64.7% of investments in related projects. Investors in B&H were from 80 countries of which 35 investors were from European countries and their share in this investment was KM 760 million (69%) and KM 350 million (31%) was from 45 other countries. The composition of the investment was cash (58.9%), construction equipment (35.5%) and intangibles like patents and licenses (5.6%).

**(ii) Government Policies:** Development of economic policies is challenged by the problems like disintegration processes and interethnic relations (the Federation and Republika Srpska). The central government is not is a position to implement all the economic policy measures though government institutions have been created for legislative reform required to attract foreign investment. Currently, Foreign investment is exempt from payment of customs duties and other fiscal obligations and from profit tax for the first 5 years of the joint venture projects.

**(iii) Promotion:** The federal promotion agency has been set up to attract foreign that has focused on promoting B & H as an attractive destination, establishing an appropriate juridical environment, providing technical assistance in several sectors and services to facilitate securing licenses for project location and construction), identification of barriers and intermediation between local and potential foreign investors.

**(iv) Barriers:** The main barriers to investment as identified by the B & H Government include the following:

- Detrimental image of the country,
- Poor implementation of the laws,
- Bureaucratization of the state apparatus, corruption and inefficient judiciary,
- Complicated juridical system as a result of Dayton's Agreement, and
- Political instability.

## 3. CROATIA

**(i) The Progress:** Croatia is considered as a country at a higher level of economic development as compared to the SEE countries. Like most of the other successor states of former Yugoslavia, Croatia has gone through war and destruction in the process of become independent state. Due to the problems in the process of democratization, Croatia faced some limitations for cooperation with international community that proved to be a major barrier for attracting foreign investment. After 2000, some foreign investors started taking a more serious look at the investment opportunities in Croatia.

FDI in Croatia

| Year | Amount in million $ |
|---|---|
| 1993 | 120.3 |
| 1994 | 117.4 |
| 1995 | 120.8 |
| 1996 | 515.8 |
| 1997 | 550.7 |
| 1998 | 1,013.5 |
| 1999 | 1,635.0 |
| 2000 | 1,125.8 |
| 2001 | 1,445.3 |
| **Total** | **6,644.8** |

Estimated by sectors, the foreign investment is mainly in telecommunications (29.7%), financial sector 17.3%), pharmaceutical products (15.4%), cement (5.0%), and others (32.6%). The investment originated mainly from the following countries: Austria (27.2%), Germany (25.8%), U.S.A. (18.2%), Luxembourg (5.6%), and other countries (23.2%). of this, 13% investments was in new Green field projects in breweries, cement and construction material. Generally investment has been made to serve the domestic market.

**(ii) Government Policies:** The Government guarantees the foreign investment in Croatia. It has signed bilateral agreements with 40 countries to protect foreign investment and with 25 countries to avoid double taxation. Preferential treatment is given for customs duties on imported equipment for the joint venture investment projects. The Government is making efforts to lower the administrative cost and shorten the time required for business registration procedures and working on creating a 'One Stop Shop Agency' for all such procedures. Çakovec municipality has created very favorable conditions for land availability and providing infrastructure and has developed efficient procedures for licenses to both domestic and foreign investors and it is considered as model for other municipalities in Croatia.

**(iii) Promotion:** Croatia has developed a sustainable promotion policy to attract foreign investment. An example of successful promotion of investment opportunities is the foreign investment secured in tourism sector and particularly in the beach resorts and hotels on the seashore in which a coordinated effort of the Government, Croatia Chamber of Commerce and some private agencies played an important role. The main avenues for promotional activities have been organization of international fairs in Croatia, mounting investment promotion missions, promotional material in print and on compact discs, and technical support to business and project development.

**(iv) Barriers:** For identifying barriers to foreign investment the focus is more on the regional aspects and developing policies to position Croatia as a more attractive investment destination. The barriers in terms of domestic policies and functioning of state institutions are also addressed efficiently. The main barriers to investment in Croatia include the following -

- Long administrative procedures,
- Ambiguities on land cadastral and ownership,
- Lack of cheap capital in the region,
- Unfavorable environment for investment,
- Inadequate decentralization of powers,
- Until 2000, detrimental image of the country due to political isolation and slow pace of democratization.

## 4. HUNGARY

In the initial phase foreign capital was attracted in Hungary through the privatization process and to some greenfield projects whereas the driving force for the new decade will be the enlargement and deepening of the productive base of big firms already established in Hungary. This process requires a new strategy and specially a new and closer cooperation both from the big firms established in Hungary and the smaller and medium sized local firms. In other words, while capital flows were first based on an internal distribution of labor between the foreign parent company and the hungarian branch in the new decade the dominant distributiuon of labor will take place between the big new firms  and the small and medium sized local firms.

The Szechenyi plan embodies the economic conditions whereby a large scale economic development project for the medium term is laid out.

- At the beginning of the new Milennium Hungary has initiated a durable  growth trend.
- The economic harmonization process with the EU has already started.
- The Hungarian economy has become a leading target for activ foreign investment at the central-eastern European scale.
- Growth is now based on offensive exports and the dominance of more advanced sectors.
- Macroeconomic indicators are hinting at a permanent stability.

In 1999 Foreign Direct Investment in Hungary amounted to some 20.4 billion dollar which represents two-fifths of all direct investments in the region.

Per capita amount invested in Hungary is of 1900 US dollar –around 1600 US dollar in the Czeck republic-. Hungary, which ranks first in the region as investment destination, can reach 2500 US dollar investment per capita, the EU average.

In the first half of the nineties FDI inflows were related to privatization while in the second halfth most investment from private sources went to greenfield projects.

Germany ranks first as investing country –27.9 % of the total- followed by Holland –16,8 %- and the US –12,2 %-, Austria, UK, France and Italy. Overseas investors are mainly multinational firms while investors from Central Europe are predominantly SMEs.

Transition to market economy in Hungary has been market by an employment loss of about one and a half million jobs. Employment levels started recovering steadily in 1997from peak levels in 1993. The second halfth of the 1990s starts with a consistent unemployment decrease coupled with an employment growth. As a result, unemployment rate has decreased to 6 % by the end of 2000.

At this crucial stage, the Hungarian economy needs to get ready for a new form of capital investments, those that concentrate on enlarging and deepening cooperation and the productive basis of the already established firms. The Hungarian economy has a dual character: Big export oriented firms with outside owners and small-medium sized firms producing for the local market owned by locals.

At a first stage the economic development model was based on the cheaper local workforce with a basis of strong foreign capital inflows generating a modern mass production. At a second stage, economic development relies upon three elements: a creative and qualified workforce, outside capital attraction and innovation.

In Central Europe there is a strong competition to attract foreign capital. Promoting the transition of the economy to a new development model guided by innovation is a State endeavor and therefore a main goal of the Szechenyi Plan is to provide for a critical mass which is essential to the success of the change of the model.

Understanding the rapid changes of the new global economy is fundamental. It is a change from the manufacturing economy to an economy based on knowledge. In this framework, a preferential place is held by the electronic economy. The difusion of the global network economy can be of advantage for Hungary but it can also pose a danger if it adjusts too late.

The goals of the Szechenyi Plan as a medium term economic development plan are as follows:

- To guarantee a sustainable and dynamic economic growth.
- To widen the basis of growth.
- To stress the economic strengths.
- To match advanced European countries.
- To mobilize local and international economic resources
- To create economic opportunities
- Social revitalization
- To bring answers to the challenges of the new economic era.

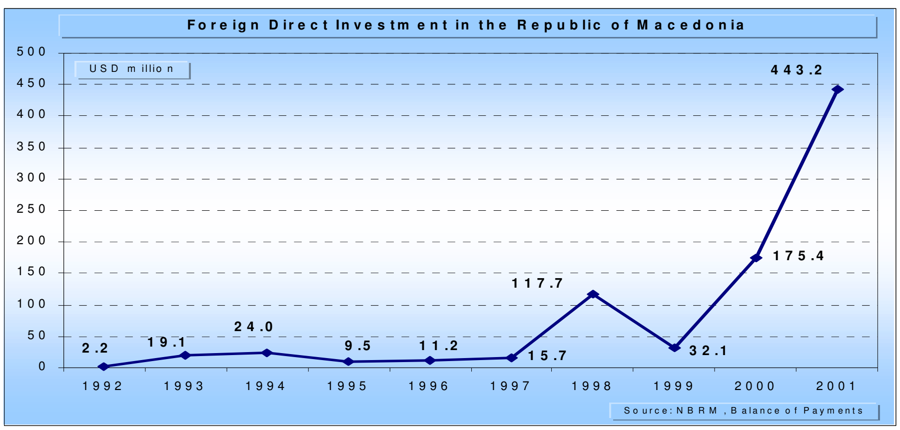
## 5. MACEDONIA

## Foreign Direct Investment in the Republic of Macedonia[4]

The transition period of the Republic of Macedonia has been associated with several external shocks, affecting the economic activity of the country. The negative impact on the economy and foreign trade of the country, particularly, was as a result of UN sanctions against Yugoslavia, trade embargo by Greece (1994-95) to Macedonia, Kosova crises (1999) and the inter-ethnic conflict in Macedonia in 2001, which had very negative implications to the foreign direct investments in the country, as well, due to the increased country risk (one of the key determinants for attracting FDI).

Foreign direct investments (FDI) are considered as a crucial component for supporting the transition process in the Republic of Macedonia and sustainable economic development in long-run. This is more relevant for Macedonia (and other transition countries) taking into consideration the lack of domestic capital and the low level of domestic savings.

### FDI statistics




FDI in Macedonia has been extremely low during the last decade, mainly due to the political, economic and social instability of Macedonia, without a consolidated policy framework for FDI. However, FDI has increased rapidly in 2000 and 2001, as a result of the large companies sold to strategic foreign investors. The major investors in the Republic of Macedonia are Greece, Hungary, Liechtenstein, Switzerland, Germany, Austria and Slovenia with the following structure in the last two years (table 1).

Table 1: FDI in the Republic of Macedonia by the country of origin

(000) USD

| Country of origin | 2000 | 2001 |
|---|---|---|
| Greece | 102,516.73 | 67,394.08 |
| Hungary | 9.10 | 322,681.76 |
| Germany | 11,212.13 | 4,757.42 |
| Austria | 2,043.59 | 1,462.54 |
| Slovenia | 11,585.59 | 3,865.95 |
| Switzerland | 1,300.84 | 8,784.28 |

Source: NBRM, Balance of Payments Department

[4] By Fatmir Besimi, Association for Modern Economy, Skopje.

Analyzing by sectors, the highest FDI inflow is registered in the manufacturing sector (mainly food products) and construction, with an increase of FDI in the sector of services in the last two years. Thus, in 2000, the largest bank in Macedonia - Stopanska Banka a.d. Skopje – was sold to National Bank of Greece (60%), IFC (15%) and IBRD (15%). The same year, was sold the largest insurance company, ADOR a.d. Skopje, to QBE International (55%) from UK. In 2001, FDI by the Hungarian MATAV entered the country through the privatization of the Macedonian Telecommunication - the most profitable state-owned company with a monopoly power in the country.

Table 2: FDI in the Republic of Macedonia by activity

(000) USD

| Activity | 2000 | 2001 |
|---|---|---|
| Agriculture, Hunting and Fishing | 3.19 | 1,324.14 |
| Mining and Quarrying | 9,615.69 | 2,092.78 |
| Manufacturing | 34,498.40 | 37,617.03 |
| Construction | 19,138.31 | 12,367.61 |
| Services | 112,226.66 | 390,117.68 |
| **Total** | **175,482.25** | **443,519.23** |

Source: NBRM, Balance of Payments Department

In addition, the major FDI has been registered in 1999, by the privatization of the monopoly of oil refinery (OKTA Skopje) to Hellenic Petroleum from Greece (54%). The remaining large state-owned companies waiting for strategic investors, i.e. FDI are the Electro-economy and the Post office of Macedonia.

Further, the Government of the Republic of Macedonia has adopted an Action Plan which provides the overall framework for the restructuring of the state- and socially-owned enterprises (in particular, enterprises which have been showing losses or large debts over the past several years). The 40 enterprises identified by the Government have been classified into groups, depending on the overall impact they have on the economy (annex 2). The restructuring of these enterprises will take place on a case-by-case basis, according to a schedule developed by the Committee for Structural Reforms.

## FDI Strategies and Programs

Liberalization of FDI policies in Macedonia began in 1993 with the enactment of a new foreign investment law and continued in 1996 with the adoption of a Law on Commercial Companies. The law grants the foreign investor the right to establish a company, to terminate the investment, to receive national treatment, to freely repatriate profits after payment of due taxes and other charges, and protect the foreign investor from future legislative changes.

In order to overcome some remaining obstacles and inconsistencies in the application of the Law on Commercial Companies, the Ministry of Development prepared a Program on Attracting Foreign Investment with concrete reform measures and recommendations which has improved the consistency of national treatment regulations and removed the tax on repatriating profits.

To implement this investment promotion program, the government established the Investment Promotion Unit (in November 1996) within the Ministry of Development. The IPU was charged with facilitating FDI and promoting industrial co-operation between Macedonian companies and foreign partners. Further, the IPU is to be transferred into the Agency for Investment Promotion in the near future with an expanded mandate which includes image building activities, investment services, research and training.

Also, there are no restrictions for foreign investors in the privatization process, i.e. the Law on privatization considers domestics and foreign investors equally. But, there has been a privileged position for employers and management team on the privatization. However, the most FDI through privatization and post-privatization is realized in the Macedonian stock exchange through a sale of government and Agency's of Privatization securities.

In 1998, the government established the agency for Reconstruction and Development, which has been active in coordinating and promoting FDI (started with a major project of 1 billion USD FDI from Taiwan, where part of this investment was proposed to be in the form of Industrial Zones).

Finally, the FDI policies and programs in Macedonia, as continuity, within the Stability Pact framework, will have the following objectives:

- clarifying the framework for access to real estate by foreign investors (the Law on ownership relations was adopted in February 2001, in order to clarify the ownership status to enable investment in real estate and abrogate restrictions on sale of land, mortgaging or leasing to foreign investors in cases of expropriation);
- facilitating the access to land and release of state-owned land for investment projects (transfer of catadastral registers in order to improve information for investors on land use, establishment of Free Zones);
- strengthening institutions in the field of investment promotion (the Law on Commercial Companies was revised to simplify the registration procedure and establishment of a single institution - one stop shop - aimed at providing all the necessary services for prompt and efficient registration of foreign companies) and
- improving risk environment for foreign investors (intensification of negotiations with MIGA for obtaining additional risk guarantees for foreign investors).

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## 6. POLAND

# FDI Experience in Poland

### Regulatory Framework and governmental Policies

The companies or businesses with foreign ownership have been operating in the post-war Poland since 1976 r. In the beginning they were established by Poland - originated foreign residents (called "Polonia"), next by foreign residents and they were called "foreign small businesses" due to the size of the activity[5]. The Polish economy was more broadly opened for foreign investors in the years 1986-1988. That time joint venture companies were developing, there were mixed partnership with state-owned enterprises only, the foreign ownership was limited up to 49%. The *Act on economic activity of companies with foreign shareholders dated 23.12.1988* assured right for 100% of foreign ownership, automatic tax holiday and partly custom exemption[6]. However licensing for foreign companies and certain barriers related to profit transfer existed until 1991.

Special conditions for FDI were created in 1994, when The Law on Special Economic Zones was introduced. The Act provided for tax holiday (PIT or CIT) up to 10 years and 50% of PIT or CIT reduction in the following 10 years. On basis of this act the Government created 17 SEZs but in 2002 only 14 are functioning. In 1996 the program of reducing general CIT rates for all companies operating in Poland was introduced. The initial rate of 40% CIT was reduced to 38% in 1997. The program was accelerated in 1999 and the CIT rate was reduced to 30% in 1999. The rate for 2002 is 26% and for 2004 the final rate of 22% CIT is planned to be introduced.

On January 1st 2001 the new *Commercial Companies Code* was introduced and together with the new *Law on Economic Activity* and the *Law on the National Court Register* creates legal base of taking up and conducting economic activity in Poland[7] for all corporations, including foreign investors These changes were due to the entry into force of the Europe Agreement standards of 1991, obliging Poland to securing freedom to establish enterprises and provide services by European Community entities. The changes are also the consequence of adjustment of Poland's law with EU directives[8].

### FDI Progress

The political and economic reforms introduced in the beginning 90. leaded to macroeconomic stabilization and rapid economic development. Poland has never experienced any currency or fiscal crisis unlike its partners in the region. It has turned the country into one of investors' most desired target locations. More than USD 56,83 billion of foreign capitals have been invested in Poland since 1989[9], (almost USD 1500 per capita). Investments over USD 1 million came to USD

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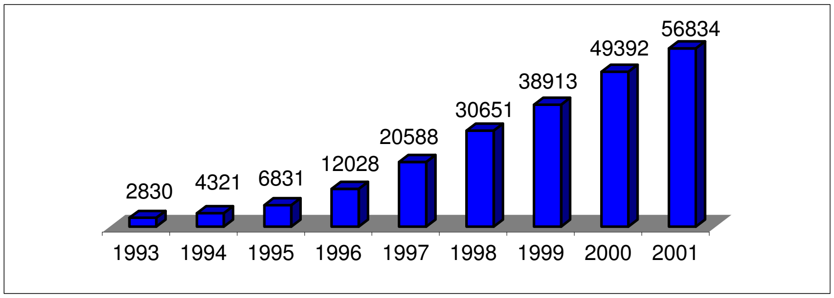
[5] On the basis: **G. Kuciapski**, *Foreign Investment in Poland* (*Inwestycje zagraniczne w Polsce)*, http://ww.stosunki.pl
[6] Income tax exemption was soon reduced only to investment over 3 M$ and when regulations concerning SEZ came into force these tax exemptions were lifted.
[7] Law of 15.09.2000 – Commercial Companies Code (Dz. U. No. 94, item 1037), Law of 19.11.1999 – Economic Activity Law (Dz. U. No. 101, item 1178, as amended0, Law of 20.08.1997 – on National Court Register (Dz. U. No. 121, item 769, as amended).
[8] *Foreign Investments in Poland*, Foreign Trade Research Institute, Warsaw 2001.
[9] Information from Polish Agency for Foreign Investment (PAIZ)

53.15 billion with investments below USD 1 million assessed by Polish Agency for Foreign Investment (PAIZ) at USD 3.7 billion.

**Graph 1**
**Foreign direct investment stock (in USD billion)**




Source: PAIZ

According to PAIZ calculations, foreign companies invested in Poland USD 7,146.6 million in 2001, while over USD 3.88 billion falls to the second half of 2001. The success of political and economic transformation in Poland has found international recognition evidenced by accession to OECD (1996), NATO (1999) and upcoming membership in the European Union (2004). It is also a kind of guarantee for foreign investors that rules used by developed countries were introduced in Poland. The process of implementing *acquis communautaire* contributed to the creation of advantageous conditions for business activity in Poland, an improvement of the investment climate and an increase in the capital inflow into the economy. The attracted foreign capital made Poland the leader in this respect in Central and Eastern Europe.

Key FDI drivers in Poland include:

- The biggest market size in Central Europe
- Moderate labor costs
- Improved overall business environment
- Growing integration with the world economy
- Successful privatization of state-owned enterprises
- Solid macroeconomic foundations.

According to PAIZ's statistics, in 2000 foreign companies have invested over USD 10 billion accounting for nearly 40% of total capital located in Central Europe.

**Obstacles to FDI**

Despite relatively good investment climate, some obstacles to FDI in Poland can be mentioned. This include:

- Relatively High Corporate Income tax. Planned scale down of CIT to 22 percent in 2004 would be probably not sufficient, as taxes in e.g. Russia are significantly lower
- Technical and Transport Infrastructure. Relatively poor road infrastructure, low quality of the roads, small number of freeways.

- Increasing administrative burdens, especially on local levels. Problems with obtaining different construction permissions, necessary during investment process. (In this area there are significant differences between different locations. Some local authorities created very good conditions for investment and business operation) Administrative burdens are created also by national authorities, e.g. in relation to Social Security Reform, Implementation of new Commercial Code etc.
- Changes in internal demand. However negative effects of recession and dropping internal demand can be reduced by export to the region (Many foreign investors successfully implement this strategy)

**Lessons Learnt**

The research shows that FDI has significant impact on measurable effects like growth of GDP but also on various qualitative effects: educational, transfer of modern technology, quality of products and services, quality of management, quality of work environment[10]. The educational effect is related to improvement in the skills of employees. Levels of professionalism, knowledge of foreign languages, responsibility and self-reliance also increase. A lot of firms with foreign capital posses technical equipment comparable to that of the best foreign companies. Very often it meets world standards in given field. The Polish producers styled on the example of the foreign investors. In the result the quality of products and services is improved. In companies with foreign capital the percentage of complaints does not exceed 1.5%. Improvement in the quality of management is one of the most important effect of foreign investment. The financial management as cost control, planning, personnel management, clarity of organizational structure, staff selection and delegation of duties were improved. Thanks to foreign investors work environment was significantly improved: technical facilities available to employees, comfort of working conditions, all kinds of compensation related to work are much better than earlier.

In all above aspects a strong imitation effect was observed. Domestic competitors quickly adopted foreign standards. Foreign investment also brought changes in firms' market strategies. According to the IPED research, foreign enterprises operations had created patterns imitated by domestic competitors operating on the same market. In the opinion of foreign firms' managers, domestic companies were engaged in a higher level of promotion and advertising and more frequently participate in fairs and exhibitions. In the result of described process, the consumers gained access to better domestic goods and services.

However we should state also that FDI in Polish economy:
- transfers new technology but only in some fields
- causes multiplier effect but in certain industries
- In most cases foreign investors do not invest in Research and Development, developing new technologies outside Poland

In spite of mentioned facts, positive effect of FDI on Polish economy are prevailing.

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[10] Ed. M. Bąk, P. Kulawczuk, *The Foreign Investment Impact on Polish Economy (Wpływ inwestycji zagranicznych na gospodarkę polską)*, Institute for Private Enterprise and Democracy, Warsaw, 1996.

## ANNEX 4. OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC)

OPIC is a self-sustaining, independent U.S. government agency that promotes economic growth in developing countries by encouraging U.S. Private investment. OPIC (1) assists in financing investments through direct loans and/or loan guarantees; (2) insures investments against a broad range of political risks; (3) operates a data bank; (4) organizes conferences and seminars; (5) assists with project development; and (6) supports private investment funds.

To be eligible for OPIC assistance, a project must demonstrate the potential to positively affect the U.S. economy and promote the economic and social development of the host country. OPIC will only provide financing to projects that cannot obtain adequate commercial financing. In the case of partial ownership by a foreign firm, OPIC will only insure the US investor's portion of a project.

OPIC provides financing through direct loans and loan guarantees that provide medium- to long-term funding to U.S. businesses. OPIC can furnish financing in countries where conventional financial institutions often are reluctant or unable to lend, and OPIC supports U.S. companies of all sizes so that they can compete in new and growing markets overseas. OPIC can offer loan terms of up to 15 years using flexible financing structures and security packages, and can help U.S. Companies secure timely and appropriate financing. For larger projects, OPIC provides loan guarantees to U.S. financial institutions that have over 50% U.S. ownership. OPIC normally provides loan guarantees from $10 million to $75 million, and in some cases, up to $200 million. For projects sponsored by U.S. small businesses or cooperatives, OPIC will provide direct loans ranging from $2 million to $10 million. OPIC will participate in up to 50% of the total cost for a new venture and up to 75% of an expansion. OPIC also provides financing to a number of investment funds that provide equity capital to facilitate business promotion and expansion.

OPIC insurance for investments covers a variety of risks, such as expropriation, currency inconvertibility, and losses due to political violence, war, and civil disturbances. OPIC covers investments in a range of sectors including infrastructure, manufacturing, and financial services. Coverages are tailored for financial institutions, leasing arrangements, oil and gas projects, natural resource projects, and contractors and exporters. OPIC insurance covers 90% of an eligible investment for up to 20 years, and provides 180% coverage on an investment to account for future earnings. OPIC can insure up to $200 million per project and has no minimum investment size requirements.

OPIC's financing is designed to complement and supplement the lending and investing facilities of commercial banks; local, regional, and international development banks and investment funds; other agencies of the United States Government such as the Export-Import Bank of the United States; and a number of other multilateral lending institutions including the World Bank, the International Finance Corporation, and the European Bank for Reconstruction and Development. OPIC advises and assists U.S. sponsors in securing debt and equity financing from these institutions where appropriate in conjunction with OPIC financing.

In 1999, OPIC established a Southeastern Europe Initiative, which includes a regional representative based out of Zagreb, Croatia. To date, OPIC has financed the modernization of a

Bulgarian power plant, the expansion of American food chains to Southeast Europe, several construction projects, and expanded telecommunications services.

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## ANNEX 5. PROMOTIONAL ACTIVITIES

### a). USAID – KBS

The Kosova Business Support Project has been actively developing a Trade and Investment Practice (T&I) since late summer 2001. This practice became fully operational on 1 December 2001 with the hiring of a fulltime international specialist. Since this time, the T&I team has directed and engineered deals worth over €10 million. These deals include exports, investment (primarily helping companies access new sources of credit), access to new, less expensive sources of raw materials, new technology and machinery and equipment. They also include out-sourcing and other supply chain-related deals with foreign multinationals. KBS has yet to facilitate any Foreign Direct Investment into Kosova; however, we are currently working with some groups interested in such an investment.

Below are some of the main areas and activities in which we are working to support trade and investment activity in Kosova.

- KBS has crafted the Market Access Program which includes internal/external and sector specific business-to-business (B2B) activities, trade fairs and inbound and outbound trade and investment promotion missions, with initial sectoral focus on:
  - construction/building materials,
  - food/agribusiness,
  - textiles/garments, and
  - other light industrial manufacturing
- We are focusing on countries in the region with which Kosova enterprises will most likely be able to develop linkages, particularly Macedonia, Albania, Croatia, Slovenia, Bulgaria, Turkey and Montenegro.
- We are encouraging the Kosova and Albanian Diaspora in Europe and the United States to become more involved in the development of the province by supporting both inward investment as well as outward trade and investment missions to their respective countries. This is being done by supporting the KIKOs program but also by designing a Kosova
- We have created a Kosova Export Association that will contribute to Kosova's economic development through an emphasis on expanded trade and export opportunities.
- KBS has published the *Trade and Investment Guide to Kosova* which has become the definitive source for many potential investors on areas related to T&I activity.

KBS has developed considerable institutional knowledge and understanding of the Kosova private sector as it is structured today. In addition, KBS is the major driving force in expanding markets beyond the borders of Kosova for the private sector. Furthermore, with the credibility that KBS is achieving in the market, primarily due to the millions of euros in deals we have helped close, we are beginning a process of becoming more proactive in promoting investment in Kosova. This is evident by the video we have recently produced, *Investing in the Future* and the recent meetings that the KBS project held with Albanian and Kosovar Diaspora in New York City. KBS will continue to expand upon these areas while also developing a local sourcing/supply chain market development initiative and other programs to support the goal of increasing trade and investment opportunities for the Kosova Private Sector.

**b). Swisscontact involvement in Investment Promotion in Kosova**

Swisscontact is a Foundation of the Swiss Industry and active in Kosova since November 2002. Currently Swisscontact is running a project called Job Oriented Modular Training (JOMT) and one called Business Advisory Service (BAS). Swisscontact proposed a
Swiss – Kosova Investment fund to the Swiss Government.

Role of the three projects in promotion of Foreign Direct Investment (FDI):

1.) JOMT

JOMT is improving Vocational Training system in Kosova through various interventions. Thereby the human recourses (a qualified labor force) of Kosova improve. This contributes to the environment for FDI.

2.) BAS

In the pilot phase (till Dec. 2001) BAS project was directly linked to Returnees and Diaspora from Switzerland. Returnees were supported in their endeavors to start businesses and Diaspora was motivated to invest in businesses in Kosova.
Conference for privatization of SOEs was sponsored (Gjakova, Jan. 2002).

In the implementation Phase (Jan 2002 – Dec. 2004) BAS wants to contribute to the growth of private sector through facilitation of the market for Business Development Services.

3.) Swiss – Kosova Investment Fund

Savings of Diaspora in Switzerland shall be attracted by the fund by issuing bonds in Switzerland. Swiss government guarantees for repayment of bonds. Swiss bank, administering the fund, will give long – term refinancing to Kosova partner banks with the precondition for these banks to offer long – term financing for SME in Kosova.
Through this Fund Diaspora capital shall be funneled towards SME sector in Kosova.

**c). EURO INFO CORRESPONDENCE CENTRE**

Euro Info Correspondence Centre belongs to a network of around 300 Euro Info Centers established by the European Commission and located throughout Europe and the Mediterranean region.

EICC Kosova is hosted by the Kosova Chamber of Commerce and funded by the European Agency for Reconstruction (EAR) as part of its efforts to boost the small and medium-sized enterprises. The tasks of the EICC are to inform, advice and to assist Kosova companies an all phases of their development in their local and European context, with the aim of improving their familiarity with Europe.

The EICC Kosova serves as a first stop shop and a neutral consultant for all European issues related to companies in Kosova, offering information on: EU markets, EU financing instruments, EU programmes for Kosova and the Balkans, EU- Kosova joint ventures, EU tenders, EU regulations and guidelines, events, EU partner search.

The EICC's objectives are to inform the Kosova business community about the regulatory framework in Europe, inform European companies about the regulatory framework in Kosova, provide access to European Community information resources, and facilitate business cooperation between Kosova and European SME's.
EICC establishing its network throughout Kosova it is offering services facilitating SME-s towards world markets. Kosova SME's are very much interested about exchanging information with Europe and the World.

The advantage of the EICC in promoting Foreign Direct Investment is because the EICC is an institution possessing relevant information and possibility of acting as a surface between Kosova companies and European Union through the network of EIC-s and other possibilities that networking offers such as intranet with other EIC's, VANS, online data base, CD ROMs as a information resources, EU database such as: ECHO, Eurobases, KOMPASS CD ROM which contains the profiles of 400.000 European companies.

The other tool of promotion is the EICC website www.Kosova-eicc.org offering different relevant information on Kosova and possibilities of doing business and investing in Kosova which is frequently visited by many international companies asking different services online.
The EICC has daily contacts with clients who are both locals and internationals.
EICC publishes its bimonthly newsletter in the daily newspaper Koha Ditore dedicated to business community. This newsletter except Kosova is distributed in European countries as well.

The EICC has already been working towards investment promotion. In the Annual Conference of EIC's that took place last month, many companies had a chance to be informed about Kosova through the distribution of CD presentation on Tips for foreign investors coming to Kosova, published in cooperation with the Kosova Trust Agency, different promotional materials for Kosova, and direct questions and answers.

In the future we plan to expand our scope of work regarding promotion of investment through different publications and workshops about investment possibilities. EICC so far has organized many workshops with local and international companies such as inviting foreign companies to Kosova in order to be informed with the business environment, legal framework of doing business in Kosova, and also sending Kosovar business delegations to Europe.

From the EICC activity and services will benefit Kosova business community and international companies offering financial investment, goods and services

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