

THE IMPORTANCE OF FOREIGN DIRECT INVESTMENTS ON ECONOMIC DEVELOPMENT OF KOSOVA

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Abstract

Kosova, in the period of nine years, has gone from a post-conflict environment into a state which is considered to be under transition. It has passed the reconstruction period by orienting itself toward the economic development and European Integrations. Yet, an economic development is not enough to be able to address the challenges Kosova is facing, such as high unemployment and high trade deficit rate. The unemployment rate in Kosova is one the highest economic concerns. The unemployment rates fluctuate from around 30% (FMN 2004) up to 40% (ESK, 2006). The high deficit of the current account of balance of payments is also a concern for the Kosova's economy; which is estimated up to 17.3% of the GDP after the foreign intervention. The high deficit of current account is being considered one of the highest ones in the region, whereas the main source of this deficit remains the high level of imports. Therefore, in order to overcome such problems, higher levels of investments are needed. Countries that invest higher proportion of their GDP tend to grow faster. However, as lack of the domestic capital and financial investments, i.e. Kosova, foreign investments represent the most effective way to create new jobs and to create the preconditions for a sustainable economic growth in the future. The aim of this paper is to offer information about the overall investment path including the foreign ones in Kosova in the war aftermath, as well as to analyze the opportunities and priorities for possible future investments.

Keywords: *Foreign dirrect investment, economic development, unemployment, imports, trade deficit.*

Introduction

Physical capital has always stood at the core of economic progress explanations. Countries that invest a large portion of GDP tend to develop faster. In order to invest, a country needs to make savings or have access to foreign savings or assistance. Except for the private sector, the government also has an impact on the level of national savings, and it conducts this through its budgetary policies. After utilizing its internal economy, countries may attract foreign savings in order to finance investments. A country under development may draw foreign investments in the following three ways. One possibility is to have foreign companies invest directly in the country. The second method, through which a country may draw foreign resources, is by means of credits obtained at the global capital market or through financial institutions such as the World Bank. Thirdly, a country may be able to obtain foreign assistance from industrialized countries. However, the lower the income per capita in a country, the more important are foreign savings, such as in the case of Kosovo.

Foreign Direct Investments (FDI) represent the flow of international organisations in various countries, to which on the latter decades a great deal of attention is given, since their number has increased in an extraordinary manner. Based on the OECD and IMF data, the total value of FDI at the global level has increased from \$105 billion, in 1967, to 596 billion dollars in 1984. Only in the USA during the period of 1960-1985, FDI increased form 6.9 to 183 billion dollars.¹

¹ Ilia Kristo, International Business, Tirana, 2002, page 264

Bearing in mind the fact that Kosovo currently faces problems with impediments of various natures, which impede its economical development, FDI could play a key role in the economical development of Kosovo. Kosovo faces lack of financial resources for financing investments, while there is constant pressure for resolving the unemployment problem. Therefore, it is considered that FDI will play a positive role in the Kosovo economy, by introducing fresh capital, modern technology, western experience in the field of marketing and management. Simultaneously, they will assist the restructuring of the economy, opening up of new working places, increase of export and decrease of the trade balance deficit. Factors that characterize the current condition of the Kosovo economy and that make Kosovo a specific country that needs FDI is as follows:

- Significant decrease of foreign assistance in the form of donations after 2003,
- Kosovo banking system is still unable to provide adequate financing for business development (long-term loans, low interest rates, greater volume),
- Considerable decrease of remittances from Kosovo emigrants located in various countries of the world,
- Great needs for investment in the public infrastructure,
- Low rate of unemployment,
- Lack of financial markets.

General information on the Kosovo economy

Economic activities of Kosovo prior to the conflict in 1999 were focused in the industry, energy, mines and metalurgy, construction materials and processing of agricultural products. During the 90's, the Kosovo economy has marked a considerable decrease, initially due to a lack of required investments, secondly due to the devastation of production infrastructure and capacities devastated by the conflict of 1999. Therefore, Kosovo as a post-war country, as well as with a subsequent transition phase, compared to the countries of the region, has also faces a very low level of foreign investments.

In 1988, the general production of Kosovo was dominated by industry, which comprised about 50% of the GDP, whereas agriculture comprised only about 20% of GDP². Economic development during the 2000-2006 period was characterized by a small economic increase compared to the fairly low base at the commencement of the transition, as a generally unsustainable macroeconomic indicator, which may be observed from the table provided below.

Table 1 Some key macroeconomic indicators

	Years				
	2002	2003	2004	2005	2006
Real GDP growth (%)	9.6	8.3	2.1	0.3	3.0
Inflation (%)	3.6	1.2	-1.4	-1.4	0.7
Growth of investments	-9	-7	25.1	-26.0	29.4
Increase of export (%)	2.2	0.1	-8.7	-11.1	30.3
Increase of import (%)	-5.6	-4.5	1.0	9.4	13.3
Coverage of import with export (%)	2.3	2.4	7.7	6.5	8.1
Remittances (mil. euro)	341.4	341.4	215.0	281.0	318.0
Foreign assistance (mil. euro)	897.5	698.7	565.0	491.0	465.0

Source: IMF, *Aide Memoire*, February 2007

² UNDP, Human Development Report, Kosova, 2006, page 27

The immediate increase of the GDP until 2002 was fairly affected by the large amount of international donor contributions, which amounted to approximately 900 million Euros and was concentrated in the construction of houses and infrastructure damaged by the conflict of 1999. Afterward, this assistance had decreased considerably and by 2006 it is considered to be two times lower than in 2002. The adoption of Euro as a national currency has been in favour of sustainable monetary policies and exchange rates. The trade deficit remains high, whereas exports are scarce and due to limited production capacities for export and inability to cope with the competition. The coverage of import with export is still very low, at about 8%.

Even though it is clear that Kosovo needs a higher rate of economic growth in order to address the challenges it faces, the level of economic growth in 2006 should be considered encouraging, because it had been achieved not with standing the limiting effects that have resulted from the reduction of donor assistance (from 426 million Euro to 343 million Euro) as well as the reduction of government capital expenditures. This growth has been mainly supported by the private sector investments, which were financed by credits of the banking sector and FDI.

Due to the high consumption rates in relation to GDP, national savings in Kosovo are negative, achieving the mark of 15.3% of the GDP. At the end of 2006 investments in Kosovo amounted to 618 million Euros and were by 4.0% higher than those of 2005. From 2001, when investments were at their peak by amounting to 661 million Euros, a gradual decrease of investments was noted until 2003, whereas from 2004 a slight increase of investments followed. During 2005 about 22% were spent from the total budget on behalf of capital investments, which is about 1% lower than in 2004. On the table below you have the total investments in Kosovo from 2001 until 2006.

Table 2 Investments in Kosovo, 2001-2006, in millions of Euro

	2001	2002	2003	2004	2005	2006
Investments	661	603	572	594	600	618
Donor sector	245	180	132	65	69	86
General government	6	15	36	169	153	153
Private investments	409	408	404	357	376	383
Housing	300	258	241	190	195	195
Others	109	150	163	167	181	188

Source: IMF staff estimates, 2006

Except for volume-based growth, investments also increased as part of GDP, at 28.3% in 2006, which is one of the highest in the region. However, the value of GDP in Kosovo, during the reviewed period, was lower; in 2006 it amounted to 2,477 million Euros, which is noticeable on the data presented on table 3. Only Croatia, with 31.3% had a larger participation of investments in GDP, within the framework of regional countries, whereas all the other countries had a lower participation, such as Bulgaria - 28.0%, Albania - 26.6%, Romania - 22.7%, Bosnia and Herzegovina - 20.3% etc.³

³ EBRD (2006), AQBK (2006)

Table 3 GDP in Kosovo during the period 2001-2006, in million Euros

	2001	2002	2003	2004	2005	2006
Consumption	2,680	2,623	2,600	2,711	2,660	2,667
Investments	661	603	572	594	600	618
Net Export	-901	-780	-753	-800	-806	-808
GDP	2,439	2,447	2,420	2,505	2,453	2,477
Budget revenues	307	498	492	635	609	655

Source: IMF, Aide Memoire, February 2007

Sources of investments in Kosovo are loans from the banking sector and FDI. On average, each year since 2002 the flow of loans of the banking sector ranged at about 140 million Euro in the local economy, in which case the vast majority was provided to the private companies. FDI in 2006 was assessed to be at 266.3 million Euros, compared to 59 million Euros in 2005.

Immediately after the war, in the emergency reconstruction period in Kosovo, there were investments by various donors. The vast majority of donor investments during the period of 1999-2004 were focused on public services (26%), housing investments (16%), economy, industry (13%), education and health (9%), transport and infrastructure (6%), police and justice services (5%)⁴ and so on.

During the same period (2001-2006) the Southeast Europe region had undergone an industrial reformation from considerable revenues of FDI, realized from an improved investment climate, achieved mainly from reforms undertaken for EU membership, which means economic stability measures in order to maintain a sound position of the monetary and fiscal system. The net FDI in the region has increased from \$13 billion in 2005, to \$19.3 billion in 2006, which indicates an increase of 48.5%. The highest level of FDI was marked in Romania, where FDI was at \$ 8.65 billion, in Serbia \$3.5 billion and in Bulgaria \$3 billion. The lowest level of FDI was marked in Montenegro with a net FDI of \$150.2 million, which is visible in Table 4.

Table 4 Net Foreign Direct Investments (million dollars)

Years	Albania	B&H	Bulgaria	Croatia	FYROM	Montene gro	Rumania	Serbia
2001	204.0	130.0	803.3	1,178.5	440.7	10.0	1,154.0	165.0
2002	135.0	266.0	876.3	585.6	77.7	84.0	1,080.0	475.0
2003	178.0	382.0	2,070.3	1,932.0	96.0	44.0	2,156.2	1,360.0
2004	332.2	490.0	2,777.1	870.9	155.9	63.3	6,368.0	966.0
2005	264.8	300.0	2,297.9	1,509.1	97.0	474.3	6,587.3	1,481.0
2006	350.0	570.0	3,000.0	2,824.8	300.0	150.2	8,652.0	3,500.0
Average	244.0	356.3	1,970.8	1,483.5	194.5	137.6	4,332.9	1,324.5

Source: Business Monitor International (2007); EBRD (2006)

⁴ MTI, Annual Report 2006, Prishtina, page 7

Foreign Direct Investments in Kosovo during the period of 2000-2006

Kosovo, as a post-war country, with large material and economic devastations, as well as with a succeeding transitional phase compared to the regional countries, has also faced a very low level of foreign investments. From 2000 until 2006, FDI in Kosovo reached the amount of 790 million of Euros, whereas the number of foreign registered businesses was 1,304. The table below provides the number of foreign enterprises that have invested in Kosovo.

Table 5 Number of foreign enterprises that have invested in Kosovo

Type of enterprise	Quantity	%
Production, extraction and processing enterprise	180	11.5
Construction enterprise	120	7.5
Trade enterprise	1002	63
Service enterprise	286	18
Total	1588	

Source: Annual report, Ministry of Trade and Industry, Prishtina, 2007, page 13

From the data provided in the table, we can observe that foreign investors in Kosovo have mostly invested in trade enterprises (63%), afterward in service enterprises (18%), production, extraction and processing enterprises, (11.5%) and in construction enterprises (7.5%). The Agency for the Promotion of Investments in Kosovo (APIK) has prepared a list of foreign enterprises which have invested large capital in Kosovo, listing them according to the sector in which they have conducted their investments:

1. Raiffeisen Bank from Austria, finance sector;
2. Procredit Bank from Germany, finance sector;
3. Nova Ljublanska Banka from Slovenia, finance sector;
4. Telekom Slovenia & IPKO NET from Slovenia, telecommunications sector;
5. Insurance Company "INSIG" from Albania, insurance sector;
6. Alferon from Great Britain, mine sector;
7. Llamkos from India, metallurgy processing sector;
8. Xella from Austria, construction material sector;
9. Kosovaplast from Macedonia, construction material sector;
10. Semenarna from Slovenia, agriculture sector;
11. Sharr Cem from Switzerland, cement production sector;
12. Silosi from Switzerland from Macedonia, food industry sector;
13. Winery Rahovec from USA, winery sector;
14. Newco Trofta Istog from Belgium, hotel and food sector;
15. Scan colour from Norway, sector of paints.

The vast majority of foreign enterprises that are present in Kosovo have commenced their activities following the conclusion of the conflict of 1999. Most of them come from neighbouring Balkan countries such as: Albania, Macedonia, Serbia, Montenegro, Bulgaria and Turkey. Moreover, a considerable number of enterprises come from the EU countries as well as the United States of America.

Although Kosovo is a small market, its geographical position represents an important element for the presence of foreign enterprises in Kosovo with the aim of expanding in the market of the regional countries and furthermore.

The table below represents the countries as well as the number of enterprises that have invested in Kosovo:

Table 6 Number of foreign enterprises based on countries of origin

No.	Country	Number of enterprises
1.	Austria	21
2.	Belgium	6
3.	Great Britain	4
4.	Bosnia & Herzegovina	9
5.	Bulgaria	38
6.	Egypt	9
7.	France	10
8.	Greece	12
9.	Germany	87
10.	Italy	35
11.	India	56
12.	China	233
13.	Croatia	21
14.	Macedonia	211
15.	Moldavia	14
16.	Pakistan	25
17.	Rumania	2
18.	Slovenia	39
19.	Serbia	11
20.	Albania	142
21.	USA	29
22.	Turkey	169
23.	Thailand	6
24.	Switzerland	36
25.	Others	79
Total		1304

Source: Official MTI data, 2006

Foreign investments in Kosovo based on regions and municipalities

Based on the data of the Ministry of Trade and Industry, it results that the greatest participation of business activities of foreign investors is in the Prishtina region, at 60%. We can hereby conclude that foreign investors are oriented in the locations in which economic development has had higher trends of development and better conditions, such as infrastructure, higher concentration of population, proximity to the airport, market etc.

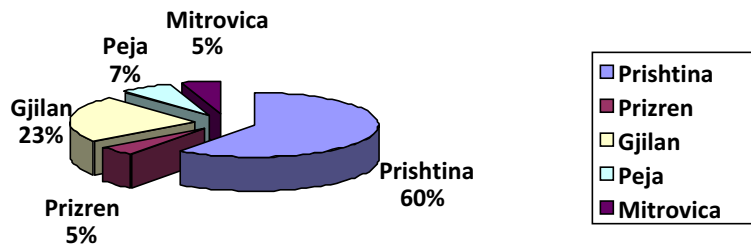
Five regions that include municipalities characterized by differing levels of investment attraction are as follows:

- Prishtina (Fushë Kosovë, Lipjan, Obiliq, Shtime, Podujeve, etc.)
- Gjilan (Ferizaj, Viti, Dardane etc.)
- Peje (Gjakove, Deqan, Kline, Burim etc.)
- Prizren (Therande, Rahovec, Dragash, etc.)
- Mitrovica (Vushtrri, Skenderaj etc.)

The regional structure of investments conducted by foreign enterprises in Kosovo is illustrated by the following graphical data:

Graph 1

Structure of enterprises based on regions



Source: Ministry of Trade and Industry, Bulletin, Prishtina, 2006, page 4.

From the data presented it is evident that the region of Prishtina leads in the attraction of foreign investments, the second is the region of Gjilan, Peja, followed by Prizren and Mitrovica.

Conditions/possibilities of investment in Kosovo

Kosovo is located at the centre of the Balkan Peninsula, between Serbia, Macedonia, Montenegro and Albania. Kosovo is connected by the regional road Belgrade-Prishtina-Skopje through the valley of the Iber River, regional road Nis-Prishtina-Adriatic Sea and with railway connection Belgrade-Fushe Kosove-Skopje. Kosovo is connected to Albania through the Prishtina-Prizren-Kukes-Tirana road. Kosovo also has its own international Airport in Prishtina. Regional vehicle and rail roads join in Kosovo and enable a more efficient connection to the Adriatic Sea, Aegean Sea and Ionian Sea. Position and climate are important factors for the development of many economic activities. There are several factors that affect the promotion of investments in Kosovo, however, the following are considered more important:

- Natural and human resources
- Flexible working market and competitive working force
- Stimulating business environment
- Stable banking system
- New customs code – customs alleviations
- Low tax regime

Natural and human resources – Republic of Kosovo has an area of 10.887 km² and more than 2 million inhabitants (estimate of 1991)⁵, and an average density of 192 inhabitants per square kilometre, represents the areas with the highest density in the Balkan peninsula. The majority of the population, or 90% are Albanians, 8% are Serbs whereas 2% are of other nationalities: Turks, Muslims, Ashkalis, Romas, Egyptians etc. Kosovo is a country with the youngest population in Europe, in which 70% of the population is under the age of 35, which represents a young and motivated population for education and work, it is particularly characterized by an entrepreneurial spirit. The average salary is under 220 Euro. In Kosovo, the Albanian, Serbian and English languages are used as official languages, however, there is a

⁵ Ministry of Environment and Spatial Planning, Kosovo Institute for the Protection of Nature, Natural Heritage Values of Kosovo, 2005, Prishtina, page 23

large number, especially the youth, which are familiar with European languages, such as: German, English, Italian, Swedish, French etc. Kosovo provides a modern system of telecommunications as well as young educated generations with a satisfactory level of informatics knowledge as well as higher levels of internet communications technologies, moreover, a considerable number of youth which is educated in western universities. Whereas, on the other hand, there is great interest from these generations to emigrate in order to find jobs due to the insufficient capacities of the Kosovar economy to generate new working positions.

Table 7 Labour market characteristics of Kosovo

Age	Male	Female	Total
16-24	39.1	41.4	40.2
25-34	30.4	30.6	30.5
35-44	18.1	19.5	18.8
45-55	8	6.7	7.4
55-64	4.4	1.8	3.2

Source: Riinvest Institute, Labour market and unemployment in Kosovo, 2003

From the table above it is evident that the youth comprises the largest portion of the labour market in Kosovo, from the age of 16 – 24 (40.2%). Whereas, about 20000-25000 people look for work in the labour market on an annual basis. It is estimated that about 500.000 inhabitants live and work temporarily in various western countries.

There are few countries or administrative-political territories that have such a diversity of resources of mineral raw materials and energy resources in such a small area as does Kosovo. Based on geological research, it has been concluded that Kosovo has significant primary energy, metal and non-metal resources. Kosovo has an immense quantity of coal and lignite; its reserves are estimated at 14 billion tons⁶. Research has concluded that there are significant reserves of minerals such as lead, zinc, (21.6 millions of tons), silver, gold, cadmium, bismuth, nickel (14 millions of tons), aluminium, chrome etc. Kosovo also has large reserves of mineral non-metallic resources, especially magnesium (about 4.5 millions of tons), kaolin, benton, asbestos etc. The potential of natural resources of Kosovo represents a good basis for its development in the future, however it is not being used to the extent required due to lack of investments. Due to its climate, good tradition that exists as well as diversity, from orchards, vegetables to wheat, this sector has been determined as one of the sectors of the highest priority. Kosovo is known for the production of wheat, cabbages, potatoes, fruits, wines, mushrooms, tobacco etc. However, the agriculture of Kosovo is characterized by small farms as well as low production capabilities.

Tourism also represents an underused potential for the economic development of Kosovo. The territory of Kosovo has a very complex natural composition with mountainous, field, river zones that are very attractive, beautiful views, natural and historical monuments. Some of the most representative values of Kosovo nature are as follows: Natural Park (Malet e Sharrit), Skiing Centre in Brezovica, Marble Cave in Gadime, Mirusha Canyon, Germia Park, Bifurcation of river Nerodime, Rugova valley etc.

Political Stability – The political situation in a country has a decisive impact on the attitude of foreign investors. Kosovo now as an independent country has established its institutions and has held free elections several times, both at the local and central level and it has proven that it

⁶ Aziz Abrashi, Burhan Kavaja, Natural Resources of Kosovo in the interest of economic-social development, UESH, 2000, Prishtina, 2000, page 356

is capable of conducting such elections in a democratic manner. Following the declaration and recognition of independence, the establishment and operation of government institutions is a key priority of the Kosovo Government. The main objective and destination of Kosovo is undoubtedly the European Union. Therefore, the Kosovo Government is dedicated to implement policies which ensure Kosovo permanent peace, stability, security and cooperation with regional and other countries. Security in the country has demonstrated positive trends in the aspect of the decrease of political crimes and crimes that put life and property in danger. KFOR, within the framework of NATO forces, guarantee security in Kosovo. Recognizing the fact that proper economic development and general economic welfare of Kosovo depends on the existence of a strong and competitive private sector; the Government of Kosovo is engaged in the establishment of a legal framework lead by a market-oriented economy and in favour of business. In order to contribute to this end, among other, the Law on Foreign Investments has been endorsed, which assist and encourages foreign investments in Kosovo through some basic and executable rights for foreign investors, and which also guarantees the foreign investors that their investments will be protected and treated in a fair manner and in accordance with the rule of law and acceptable international standards and practices. The law aims at enabling the complete integration of Kosovo in the regional, European and global economy by encouraging the flow of capital, modern technology, know-how, financial and intellectual services, and management and information capabilities in Kosovo.

Low tax regime – The tax system in Kosovo is a modern system that enables Kosovo to raise budgetary revenues at approximately 30% of GDP, making it possible for Kosovo to be at a comparable position to the regional countries. Kosovo for the time being has a relatively simple tax system, based on uniform and all-inclusive taxes. However, in the future there are needs for new reforms in the aspect of broadening the tax base and regulation of expenditures such as salaries, goods and services, subsidies and transfers, in order to increase capital expenditures and address the need for investments, necessary to successfully face the structural problems of the economy. With regards to taxes that are related to the business activity, the following tax level prevails:

- Customs tax on import of 10% and 0% tax for capital goods and agricultural inputs
- VAT – 15%
- 0% export tax
- Income tax: from 0 – 20%
- Corporate income tax 20%.

The Kosovo market is liberalized with regards to the foreign trade regime, however, this liberalisation forces local businesses to face fierce competition from the imports, which brings them difficulties, since it is not easy for them to tackle this. However, Kosovo is interested to sign bilateral trade agreements with other countries in order to ensure a higher level of trade exchange. Now, Kosovo has signed a Free Trade Agreement with Albania, Macedonia, Bosnia and Herzegovina, and Croatia and is a member of CEFTA (Central European Free Trade Agreement), a membership which ensure Kosovo exporters access free of customs obligations to the regional market composed of 25 million consumers⁷.

Financial Sector – represents one of the sectors with highest level of development in the local economy. In particular, the Banking sector of Kosovo, with 7 commercial Banks, marks positive trends and has a continuous increase of deposits and credits; however there is room for improvement. Kosovo Banks are among the best in the region, both in the level of development

⁷ Economic Initiative for Kosova: Top 10 reasons to invest in Kosova

and trustworthiness and they enjoy. However, there is an opinion that interest rates are relatively high (11-13%, depending on the type of credit) and not stimulating for investments. The sole method to have lower interest rates is through the increase of competition.

Conclusion

Based on the experiences of economical development of countries that have gone through the transition stage in the latter years, we could say that FDI plays a key and very significant role in the economic development of countries in transition, in particular of countries in development and concurrently have a multidimensional positive impact. Such investments are very necessary for the current period of development in which Kosovo finds itself, since it is facing a lack of own financial resources for investments. Therefore, foreign investments represent the most efficient method of achieving a positive impact, as they enable:

1. Sustainable development, much better than loans in the form of credits, due to the fact that foreign investments do not entail interest rates that put the investor at risk of being overloaded with debt,
2. Promotion of the development of human capital based on the transfer of new technology, knowledge and training,
3. Increase of budgetary revenues, as a result of the increase of taxes from the larger number of businesses and employees as well as the decrease of the need for subsidies,
4. Alleviated penetration into the regional, European, and other markets,
5. Increase of export and improvement of the trade balance (decrease of the trade deficit),
6. A positive connection has been ascertained between investments and GDP.

Therefore, the main objective of the competent bodies in Kosovo is to make foreign investments a significant resource for the economic development of the country. This objective may be achieved by conducting an active policy that would present Kosovo as the right and lucrative location for foreign investors.

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