FOREIGN DIRECT INVESTMENT LEGISLATION: A PRECONDITION FOR CREATING A FAVOURABLE INVESTMENT CLIMATE IN THE CASE OF KOSOVO

Besime ZIBERI¹, Rrezarta GASHI²

^{1,2}AAB University, Prishtina, Kosovo

Corresponding author's e-mail: besime.ziberi@universitetiaab.com

Abstract. Foreign direct investment (FDI) represents a significant impetus for sustainable economic growth and development. From the context of the importance that FDI carries as the transfer of knowledge, experience, employment growth and development of human capital, its attraction definitely requires a proper legal basis, namely, the implementation of the law and the proper functioning of judiciary. The main aim of this study is to elaborate the legislation on foreign direct investment in Kosovo and to analyse FDI in Kosovo over the years. This study is based on local literature, specifically the interpretation of the current law on FDI in Kosovo and international literature to examine the effects of legislation on a business climate. This study is descriptive, comparative and analytical, based mainly on secondary data provided by the World Bank indicators on FDI in Kosovo over the years. Kosovo as a young, post-war state has drafted a number of reforms in the economic field and in the field of law enforcement and judiciary, but undoubtedly the current law governing strategic investments has room for improvement, thus, must be enforced in order for investors to feel safe while operating in Kosovo. This study also concludes that Kosovo is attractive for foreign investors due to the increasing rate of GDP, labour market conditions, high rate of degree holders complying with labour market requirements. The study goes further with recommendations on supplementing the current law versus the European FDI legislation. The major implication of the study is the comparative analysis of Kosovo's law in regard to the EU Law on FDI.

Keywords: *Business climate; Foreign direct investment (FDI); Knowledge transfer; Law on FDI.*

JEL Classification: K10, B22, B23

INTRODUCTION

Foreign direct investment (FDI) is a catalyst for economic growth of any country, whether it is an economically developed or developing country. Foreign direct investment is recognised in broader economic literature as a source of knowledge transfer, human capital development, know-how and employment growth in host countries. The tendency to attract foreign direct investment is evident in almost every country, regardless of the economic development of the country, for the sake of the positive effects that FDI has on the economies of the host countries. Undoubtedly, when it comes to developing countries, as Kosovo is among other Western Balkan countries, the role of FDI in the economy becomes

even more pronounced. Kosovo is a new state, but it has implemented a number of reforms in almost every field, starting with the economic, legal and other.

Legislation, law enforcement and the functioning of the judiciary are, among other things, preconditions for attracting FDI and for creating a favourable business climate. It is worth noting that in addition to FDI legislation, political instability also plays a significant role in attracting FDI in the case of Kosovo. However, the focus of this study is precisely the analysis of FDI legislation in the case of Kosovo in the context of the impact on FDI withdrawals as well as the creation of a favourable climate to attract new investors. Foreign direct investment plays a crucial role in economic growth. FDI and its impact on the economy are addressed from both the microeconomic and macroeconomic perspectives. We will analyse and present the research problem in the context of law and law enforcement on FDI to see if foreign investors are legally safe to invest in Kosovo.

Foreign direct investment has many implications for the economies of the host countries. In general, the host countries benefit from technological innovations and knowledge transfer, human capital advancement, increased competitiveness and good management practices. However, states are able to absorb and create a favourable investment climate, which depends on many factors, including law enforcement, sustainability of economic growth and sustainable economic development, protection of rights, simple administrative procedures etc.

The absorptive capacity of the host country affects the volume and type of FDI inflows (Luiz & De Mello, 2014). The latter depends on institutional factors, such as the recipient economy's trade regime, legislation, and political stability; and scale factors, such as balance of payment constraints and the size of the domestic market for the goods produced via FDI. Despite the many benefits for developing countries, specifically for the host economies of FDI, it is worth noting that the current crisis caused by the COVID 19 pandemic will also affect FDI.

Based on the World Investment Report 2020, the overall directional trend in international production points towards shorter value chains, higher concentration of value added and declining international investment in physical productive assets. This will bring huge challenges for developing countries. For decades, their development and industrialisation strategies have depended on attracting FDI, increasing participation and value capture in GVCs, and gradual technological upgrading in international production networks (UNCTAD, 2020). The success of further development of Kosovo's economy cannot be imagined without the strong presence of foreign-owned businesses as a guarantee that this goal will become objectively achievable (Sahiti, Ahmeti, & Sahiti, 2020).

1. LITERATURE REVIEW

Kosovo is limited in its ability to attract foreign investment due to the lack of information distribution within global markets, poor international communication regarding its economic environment and opportunities for foreign investment, and the absence of a credit rating by a credible foreign rating agency (Group for Legal and Political Studies, 2017). Based on the report of the International Monetary Fund on Foreign Direct Investment in European countries compared to the countries of

the Western Balkans, it is stated, among other things, that the countries of the Western Balkans, including Kosovo, are less attractive to direct investment, as these countries still face uncertain prospects for accession to the European Union (Jirasavetakul & Rahman, 2018). It is also worth adding that despite gaining a candidate status for the EU, they are still stuck in economic and political reforms. In general, FDI is also affected by institutional gaps.

Host countries should pay special attention to these gaps, which, according to (Khanna, Palepu, & Sinha, 2005), include political social systems, openness, product market, labour market, and capital market.

Another study examines the impact of the indicators of institutional quality (such as political stability, control of corruption, rule of law, voice and accountability, regulatory quality and government effectiveness) on inward FDI in developing and developed countries. The important dimensions of institutional quality are (1) political stability, (2) administrative quality, and (3) democratic accountability (Sabir, Rafique, & Abbas, 2019). With regard to the rule of law, Kosovo has implemented a lot of reforms based on the EU legislation and a lot of international agreements for supporting and attracting FDI.

FDI is an important vehicle to promote the connection between domestic economy and international private sector as the history shows that at the end of the day, countries grow because they produce new and better goods and services, or find better ways to produce those goods and services, and retain more of the value added from their exports (World Bank Group, 2017). Every single country is competitive in the way to attract FDI with regard to both micro and macro benefits for host countries. Considering the level of economic development, the economies of the Western Balkans have a greater need for FDI given their limited domestic savings. However, they also have lower levels of income, and the region may find it hard to exploit the potential technological and employment spill-overs from FDI (Estrin & Uvalic, 2016). Even though a lot of studies discuss the positive effect of FDI in hosting countries, many studies also address negative effects on competitiveness. Negative spill-overs on local firms are also possible, notably, through crowding out effects; thus, foreign investors may gain market share at the expense of local firms (Meyer, 2005).

In the light of the attraction of FDI and influential factors, it is also worth mentioning the level of transparency. In the economic literature, the discussion about transparency mostly focuses on corruption, bribery and protection of property rights, but the issue is much larger as we shall now argue (Drabek & Payne, 2002). In order to attract more investment, about 2500 bilateral investment treaties have been concluded worldwide, despite questions about their usefulness, and many bilateral or regional trade agreements have investment provisions (USAID, 2007).

After setting their activity in Kosovo, investors have to deal with a number of large institutions, and sometimes protracted bureaucratic procedures (e.g., obtaining permits and licenses) are made unaffordable.

This has created a situation where Kosovo has lost its competitiveness with the countries of the region, especially when the fact is taken into account that the institutions of these states have able to 'negotiate' in a more structured way with investors (American Chamber of Commerce in Kosovo, 2020).

2. RESEARCH METHODOLOGY AND DATA

The study of FDI legislation in the context of attracting and creating a favourable investment climate is a topic that connects the two basic pillars of the functioning of the state, justice and economy. From this point of view, in this study national and international literature is discussed, noting the importance of FDI and the importance of legislation, law enforcement and the judiciary for attracting foreign investors in case of Kosovo. This study is descriptive in its nature, analytical and comparative.

The focus is on FDI laws in Kosovo and the FDI rate in the case of Kosovo over the years. The data used are mainly secondary data provided by the World Bank indicators, exactly the data on FDI for Kosovo (World Bank, 2020).

In this study, we go also through the interpretation of the legislation through time stages and the current law on FDI in case of Kosovo. The laws are provided by the official website of the Republic of Kosovo, Official Gazette published by the Assembly of Kosovo. Laws, in addition to interpretation, are critically evaluated giving the recommendations for future reforms.

3. RESULTS AND DISCUSSIONS

Kosovo as a young state with increasing economic growth has designed a number of reforms in the economic and legal field. In addition to reforms in the economy, new laws have been drafted specifically on investment and foreign direct investment. Foreign direct investment in Kosovo is primarily regulated by the Law "On Foreign Investment which seeks to assure foreign investors that their investments will be protected and treated fairly and in accordance with the accepted international standards and practices (Levitt & Botts, 2020). The Republic of Kosovo ensures equal legal rights for all investors and all domestic and foreign enterprises (Official Gazette of the Republic of Kosovo, 2015).

The current basic law on foreign direct investment in Kosovo is the Law on Strategic Investments in the Republic of Kosovo (Law no. 05/L-079, 2020). The special feature of this law is precisely the scope of the law as it is conceived in principle to support all investments that the state of Kosovo considers a priority sector for economic growth, including:

- energy with infrastructure and mining;
- transport and telecommunications;
- tourism;
- manufacturing industry;
- agriculture and food industry;
- health;
- industrial and technology parks;
- wastewater and waste management.

These sectors are also expected to increase the number of employees, technological and technological development, and transfer of knowledge to improve the well-being of citizens in the country.

Based on the fourth article of this law, the procedure for submitting the application for obtaining the status of strategic investment and concluding the strategic investment agreement (Law no. 05/L-079, 2017) is provided. According to Point 1 of Article 4 of this strategic investment law, the investment entity can be any investment entity whether domestic or foreign, public investment authority and any public investment authority in cooperation with any foreign or domestic investor. The investing entity, according to Point 2 of this article, must submit a written request to the Agency for Investment and Enterprise Support. Point 3 of Article 4 provides for the conclusion of agreements for strategic investments after the Government of the Republic of Kosovo has approved the request of the investing entity for the granting of strategic investment status.

Article 15 of this law provides for procedures for strategic investments (Law no. 05/L -079, 2020): Administrative procedures provided by this law which are related to the preparation, selection, implementation and supervision of strategic investment projects, as well as the issuance of licenses, permits, authorizations and recommendations, pursuant to this law, are considered as administrative procedures with high priority and are followed by accelerated procedures by all institutions and public authorities of the Republic of Kosovo involved in these procedures. The current law governing strategic investments is conceived towards the legal regulations of the European Union.

Law no. 02/L-33 is to improve the business climate and conditions in order to attract foreign investments and ensure fair treatment of investors in accordance with international standards. The law regulates all aspects of foreign investments, addressing non-discrimination, expropriation, compliance with obligations/standards and laws, and, among others, mechanisms for the resolution of investment disputes (Group for Legal and Political Studies, 2017).

However, according to the study report from the institutes for free market economy, it is emphasised that administrative obstacles (licensing, cost, time, obtaining construction permits, prolonged procedures for the use of municipal property, lack of business premises (economic zones) continue to create problems for foreign businesses (Institute for Free Market Economics, 2019) in addition to the current law as other laws in this regard count:

- Law no. 02/L-123 on Business Organisations;
- Law no. 04/L-159 on Economic Zones;
- Law no. 02/L-75 on Arbitration;
- Law no. 2004/7 on the Kosovo Chamber of Commerce;
- Law no. 2004/12 on Standardisation (Regulation no. 2004/12);
- Law no. 03/L-008 on Execution Procedure;
- Law no. 05/L-057 on the Establishment of the Kosovo Credit Guarantee Fund.

We can conclude that Kosovo has established a lot of reforms in order to achieve competitiveness towards attracting FDI. Thus, it is expected that the law, judiciary and contract enforcement will affect positively the FDI in case of Kosovo, and the economic growth will increase.

Fig. 1. GDP trends in case of Kosovo (2004–2019).

Figure 1 source: World Bank indicators (World Bank, 2020), GDP growth for Kosovo, time period 2004–2019, the authors' calculations.

Figure 1 presents the data related to the GDP growth annual as percentage for time period of 2004–2019 in case of Kosovo. As we can see from Fig. 1, GDP has an increasing trend in the time period under consideration. In 2004, GDP was 2.61 when the highest percentage of GDP growth rate was 4.38 in 2011. GDP trend, in general, is positive with some fluctuations in the time period under consideration.

Fig. 2. FDI trends in case of Kosovo (2004–2019).

Figure 2 source: World Bank indicators (World Bank, 2020), FDI growth rate for Kosovo, time period 2004–2019, the authors' calculations.

Figure 2 illustrates the data related to FDI net inflows as percentage of GDP from World Bank indicators. FDI shows an increasing and positive trend when in 2004 the rate of FDI net inflows was 1.50 in case of Kosovo. The highest value of

FDI was 12.9 in 2007. From 2007 to 2012, the trend was decreasing. In 2015, the trend reached 5.33, and in 2019 the FDI trend was 3.84. Based on macroeconomic statistics from the Central Bank of Kosovo, FDI in the first quarter of 2020 was 104.7 million (T1) and 60.1 in the second quarter (Central Bank of Kosovo, 2020). This drastic reduction is also a result of the conditions created by the COVID 19 pandemic.

Thus, we can conclude from the data presented that the law on FDI in case of Kosovo should positively affect the FDI growth rate even though the rate has its own fluctuations. We can also note that the law enforcement and judicial reforms are the key issue in attracting FDI. In its turn, FDI is also important for developed countries by enhancing their competitiveness, creating jobs and economies of scale, bringing capital, technologies, innovation, expertise, and opening new markets for the exports. It supports the objectives of the Investment Plan for Europe and contributes to other projects and programmes (European Union Regulation, 2019).

Kosovo is in an advantageous position, in contrast to other Balkan countries, due to a high rate of youth in the labour market, positive and increasing trend of GDP and flat rate of corporate tax. With regard to attracting FDI in case of Kosovo, the ratified Law on Strategic Investment aims at facilitating market access for investors in key sectors (Çollaku, 2018).

CONCLUSIONS

Kosovo, as a young state with a growing economy, has consistently drafted judicial reforms, law enforcement, including legislation governing strategic investments. Kosovo has implemented a number of international agreements for trade liberalisation and the creation of economic zones in order to increase the attractiveness of the economy for foreign investors. Kosovo is known for a high number of remittances which, in addition to private consumption, are also known for investments. However, law enforcement is one of the main challenges towards building trust in attracting foreign investors. Kosovo has made a lot of progress in running a business as well as in completing the Legal Framework for Foreign Direct Investment (legal infrastructure regulated and harmonised with the EU standards); however, the improvement of the legal environment, namely, the strengthening of the rule of law, according to the research findings, is one of the issues for which the Government of Kosovo should take faster measures as a precondition for the operation and development of business and the attraction of foreign businesses (Institute for Free Market Economics, 2019).

The GDP growth in case of Kosovo had an increasing trend for the time period of 2004–2019. Thus, FDI shows fluctuations between the cycles but in average the trend remains decreasing. We can note that Kosovo should do more in this regard, as the economy can benefit from FDI in every area, including human capital development through training, increasing the employment rate, technical and technological developments, increasing exports, increasing competitiveness in sectors etc. To this end, the law on foreign direct investment must be enforced in order for investors to feel safe while operating in Kosovo.

In addition to the advantages that the state of Kosovo has in the legislation on FDI, as well as on the labour force that is considered young in the region, the political factor is also important, namely, the political stability of the country in terms of attracting FDI and creating a favourable business climate for investment.

REFERENCES

- American Chamber of Commerce in Kosovo. (2020). *Policies in Focus: Law on Strategic Investments*.
- Central Bank of Kosovo. (2020). Available: <https://bqk-kos.org/eag/sq/>
- Çollaku, P. (2018). Kosovo's Problem With Foreign Direct Investment. *The Vienna Institute for International Economic Studies*.
- Drabek, Z., & Payne, W. (2002). The Impact of Transparency on Foreign Direct Investment. *Journal of Economic Integration*, 17(4), 777–810. <https://doi.org/10.11130/jei.2002.17.4.777>
- De Mello, L. (1999). Foreign Direct Investment-Led Growth: Evidence From Time Series and Panel Data. *Oxford Economic Papers*, 51(1), 133–151. <https://doi.org/10.1093/oenp/51.1.133>
- Estrin, S., & Uvalic, M. (2016). Foreign Direct Investment in the Western Balkans: What Role Has it Played During Transition? *Comparative Economic Studies*, 58(3), 455–483. <https://doi.org/10.1057/ces.2016.10>
- European Union Regulation. (2019). Regulation (EU) 2019/452 of the European Parliament and of the Council. Official Journal of the European Union.
- Group for Legal and Political Studies. (2017). *How 'Friendly' is Kosovo for Foreign Direct Investments: A Policy Review of Gaps From a Regional Market Perspective*. Kosovo: GLP.
- Institute for Free Market Economics. (2019). *Foreign Direct Investment in Kosovo: The Investment Climate, Potential and Barriers*. Prishtine.
- Jirasavetakul, I.-B. F., & Rahman, J. (2018). *Foreign Direct Investment in New Member States of the EU and Western Balkans: Taking Stock and Assessing Prospects*. International Monetary Fund working paper.
- Khanna, T., Palepu, K. G., & Sinha, J. (2005). Strategies That Fit Emerging Markets. *Harvard Business Review*, 63–76.
- Law no. 05/L-079. (2017). *Oficcial Gazzete of Republic of Kosovo*. Prishtine: Assembly of Kosovo.
- Law no. 05/L-079. (2020). *LIGJI Nr. 05/L-079 për Investimet Strategjike në Republikën e Kosovës*. Prishtine: Gazeta Zyrtare e Republikës së Kosovës.
- Levitt, M., & Botts, B. (2020). *Foreign Direct Investment Regimes 2020A practical cross-border insight into FDI screening regimes*. Global Legal Group Ltd, London.
- Meyer, K. E. (2005). Foreign Direct Investment in Emerging Economies. Policy Discussion Paper. Official Gazette of the Republic of Kosovo. (2015). *The Constitution of the Republic of Kosovo (with amendments I-XXIII)*. Republic of Kosovo. Constitution of the Republic of Kosovo.
- Sabir, S., Rafique, A., & Abbas, K. (2019). Institutions and FDI: Evidence From Developed and Developing Countries. *Financional Inovation*, 5(1). <https://doi.org/10.1186/s40854-019-0123-7>
- Sahiti, A., Ahmeti, A., & Sahiti, A. (2020). FDI Trends and Characteristics in Kosovo. *Baltic Journal of Real Estate Economics and Construction Management*, 8(1), 12–21. <https://doi.org/10.2478/bjreecm-2020-0002>
- UNCTAD. (2020). *International Production Beyond the Pandemic*. United Nations publication issued by the United Nations Conference on Trade and Development. Geneva.
- USAID. (2007). Foreign Direct Investment Putting it to Work in Developing Countries.
- World Bank Group. (2017). Maximizing Potential Benefits of FDI for Competitiveness and Sustainable Development.
- World Bank. (2020). World Bank Open Data. Available: <https://data.worldbank.org/>

AUTHORS' SHORT BIOGRAPHIES

Besime Ziberi is a Teaching Professor at the Faculty of Economics, AAB College, Kosovo. She obtained her Bachelor's degree with honours in Business Administration in 2009 and completed postgraduate studies in the field of Finance and Accounting at the Faculty of Business and Economics, South East European University (SEEU), Tetovo, Republic of North Macedonia. In 2016, she completed her Doctoral studies in Economics at the Faculty of Business and Economics, SEEU, Republic of North Macedonia. From 2009 to 2017, she worked at the Faculty of Business and Economics as a Student Academic Advisor. Since 2017, she has been an Assistant Professor at the Faculty of Economics, AAB College, Kosovo. She delivers study courses at the Bachelor and Master study programmes. The study courses at the Bachelor level include Macroeconomics, Advanced Macroeconomics, Public Finance, Financial Market and Institutions, and the courses within Master studies are Research Methodology and Research Methods at the Faculty of Economics and Faculty of Computer Sciences, AAB College, Kosovo. She has also had under her supervision more than 30 Master students who graduated (ten more in process). She also serves as a Consultant for a local project.

E-mail: besime.ziberi@universitetiaab.com

ORCID iD: <https://orcid.org/0000-0003-2891-3832>

Rrezarta Gashi received her Ph. D. in Management from the European University of Tirana in 2016. She is currently an Assistant Professor at the Department of Marketing and Business Administration, Management and Informatics. Her current research interests include customer behaviour, marketing, sales management and product development. These fields are interesting for her, after she has worked for seven years in the position of Import and Sales Manager.

E-mail: rrezartag@gmail.com

ORCID iD: <https://orcid.org/0000-0003-2490-9553>