

# Economic growth in Kosovo and in other countries in terms of globalization of world economy

Lumnije Thaçi, MSc, PhD Candidate  
College "FAMA", Prishtinë, Kosovo

## Abstract

The global financial crisis causes, as among the greatest crises and consequences, reflected the world in continuously increase of unemployment, poverty and inequality. This crisis was reflected in both developed and developing countries including countries in transition.

The fact cannot be denied that the effects of financial crisis are even felt in the Republic of Kosovo where during this period of time following consequences could be clearly noted: decrease of the real economy, poverty, reduction in remittances, decrease of external investments, contracting criteria for bank loans and other direct and indirect effects.

However, the global economy did continue to recover during 2010 and 2011. Nevertheless, uncertainty regarding to the volatility of global economic recovery in this period is greater than in the previous period. This setting is mainly extracted from instability of financial market due to problems with public finances in several EU member States and entry of protective measures by some rapidly growing economies and developing countries, in response to large capital inflows.

It is important to consider the fact that, despite the recent crisis, economic growth model, based on the deepening of EU integration process, in terms of finance, trade, labour markets and institutions, remains as best model for developing countries and Kosovo itself.

Special treatment is given to achieved achievements and projections for the following years under policies compiled by the Government of the Republic of Kosovo to enable generic analysis for concrete situation of our national economy. Also, this paper shall explain the underlying factors which will influence on a more accelerated economic development.

**Keywords:** economic growth; gross domestic product (GDP); fiscal policy; capital investment or public expenditure

## Introduction

The financial crisis which conquered the international financial system began to be reflected in the real economy sector affected by the crisis. Due to the high degree

of economic integration, the effects of the recession emerged in economies that are not directly affected by the financial crisis. Kosovo's economy, as an open economy, also carries some of the consequences of the recession in the region and beyond. However, the projections of the IMF and the Ministry of Economy and Finance (MEF) in 2008 suggested a real economic growth of 6.6% and 5.2%, respectively this increase did not have any revision of these projections.

On the other hand, some countries in the region despite the revised projections on economic growth have resulted lower than initial projections. Among the first effects in the economies affected by the crisis was the decrease of demands which was reflected in the decrease of domestic consumption and exports (CBK, 2009).

Another channel through which Kosovo's economy was affected by the economic recession in other countries is Kosovo's migrant remittances, which is considered as an important financial source for the economy. This decrease of remittances was clearly observed after the recession which was established in EU countries, where there was a significant shortening of jobs, so in 2009 this was reflected in the decreasing level of remittances to 10 %. The decrease in remittance had negative impact on the level of consumption and investment in Kosovo, which resulted in the decrease of economic activity. In this context, the continuation of credit growth, but under a more moderate measure of banking sector under an efficient management of risk, was very important factor for maintaining the level of consumption and investment. Eventual slowdown of loaning would have negative effects on economic growth which in turn would reflect negatively on sustainable banking system.

Another important factor for stimulation of consumption and investment in Kosovo is fiscal expansion within the bounds of reasonableness, which resulted with increase of budget revenues, whilst from January 2009 the reduction of tax rates was executed, on personal income and profit. This stimulated consumption and investment, including foreign direct investment (FDI) that represents a very important element for economic development. However, the level of FDI in Kosovo largely depends on structural elements of Kosovo's economy, as continuation of privatization process so far attracted considerable FDI. Progress of privatization process and possible privatization of PTK (Post Telecom of Kosovo) including some sectors Kosovo Energy Corporation (KEK), these companies of special importance do promise substantial growth of FDI level in Kosovo. Moreover, investments in infrastructure and lowering tax rates represent very important element for attracting FDI.

Due to the relatively low level of Kosovo's integration in global economy, its economy has been increasingly protected from the global economic crisis. The economy has also grown during the years 2009 and 2010 and continued with the growth in 2011. Growth has resulted with governmental expenditures whilst the external trade balance has remained high (SME Strategy, 2011).

## Main macroeconomic developments

Based on recent economic developments, we can assume that stable macroeconomic policies and implementation of structural reforms associated with external financial assistance, economic growth for 2011 is estimated 5.3%. Main contributors of economic growth are: (KASH, 2011)

- *Investments* - successful transition towards the independence and membership in international institutions such as World Bank and International Monetary Fund, already contributed to improvement of perception of Kosovo's stability and its improvement in investments. In 2010 private investments in general was estimated 759 million euros, while private investment in 2011 was estimated 860 million or an increase of 10.8%, comparing to 2010. Public investment in 2010 was estimated 455 million euros, while in 2011 was estimated 528 million euro or an increase of 16%, comparing to the previous year.
- *Consumption* - economic growth mainly is attributed to increase of consumption, as a result of increasing public sector wages and the highest level of projected external income and income from interest on external investments. As in previous years, consumption continues to be the main component of GDP growth. Consumption will continue to positively contribute to the economic growth at a more moderate measure. More precisely, consumption during the period 2012-2014 is expected to annually grow 4.7% reaching 106% of an average participation in GDP during the period, compared with 109.3% in 2011. Although consumption is expected to provide the largest contribution, its effect on economic growth is expected to be reduced gradually being replaced with more investment and exports.
- *Exports of goods* are increased for 12.95% in 2011. Exports of goods, approximately increased for 70% in 2010, are expected to follow the growth trend over the period ahead. Exports are anticipated to grow at a moderate rate while the assumption of increased domestic production of agricultural products and improving the environment of doing business and global economic recovery, exports are expected to expose their growth in the coming years. Also, exports of goods are relatively related to change of world prices of metals, as the bulk of export is metal. Thus expectations for change of world prices for metal goods and demands for metals in countries that Kosovo exports will have significant impact on the export of goods in Kosovo.
- *Stable level of import* is a key indicator of consumption in Kosovo during 2011. Import will temporarily increase as a result of the income effect. However, their participation in the GDP is expected to decrease gradually. With an increase in domestic production capacity, relatively low prices and as a result of a competition to improve the economy should begin to generate import substitution.

- *Inflation* - inflation during 2011 achieved level of 5.3% comparing to 2010 which was 3.5%, mainly driven by food and oil prices.

Table 1: Main macroeconomic indicators from 2008 until 2012 (in millions of euros)

Description	2008	2009	2010	2011	2012	2013	2014
<i>In millions of Euro, unless noted otherwise</i>							
Consumption	4,345	4,280	4,760	5,074	5,336	5,545	5819
Investments	1,094	1,166	1213	1,433	1,620	1,704	1,756
Neto export	-1,587	-1,534	-1684	-1,867	-1,979	-2,035	-2,075
Export of goods and services	612	820	875	933	995	1,049	1,049
Import of goods and services	-2,156	-2,146	-2504	-2,742	-2,742	-3,030	-3,124
<b>GDP</b>	3,905	3,912	4289	4,639	4,978	5,214	5,501
Real growth of GDP, in %	6.9	2.9	4.0	5.3	5.1	5.4	6.0
GDP per capita, in euro	1,847	1,848	1,996	2,127	2,249	2,321	2,412
Inflation, in %	9.2	-2.4	3.5	5.3	2.1	1.5	1.4

Source: Department of Macroeconomics, MF

Kosovo's economy is characterized by low per capita income. Given that population growth, and most of it is under the age of 30 years, GDP should grow in Kosovo.

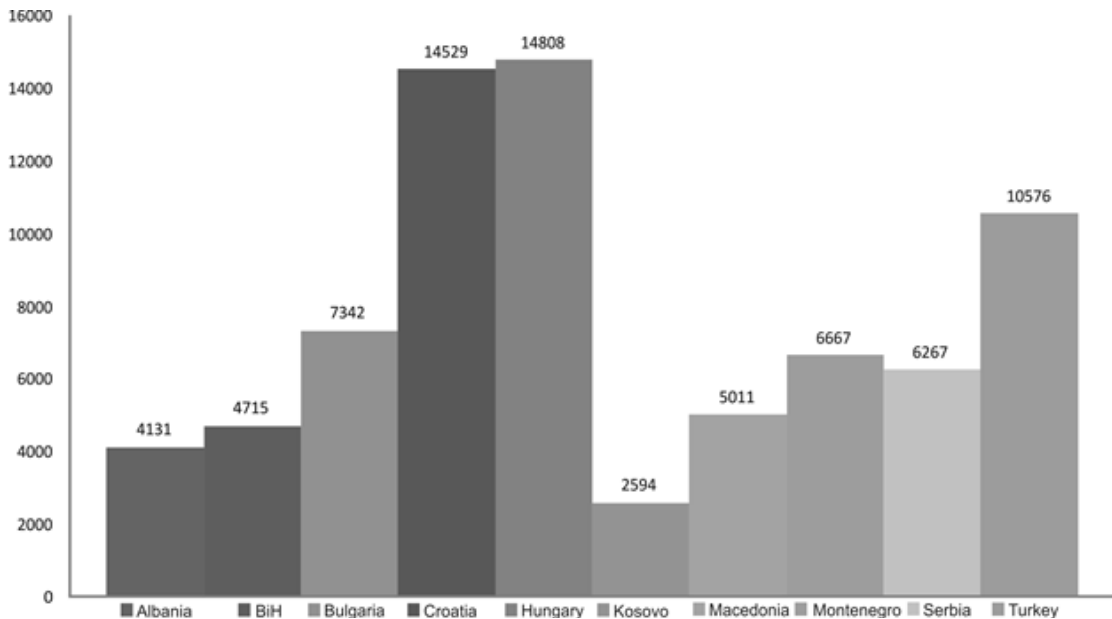


Figure 1: Comparison of GDP per capita, Kosovo and the region (IMF, 2011)

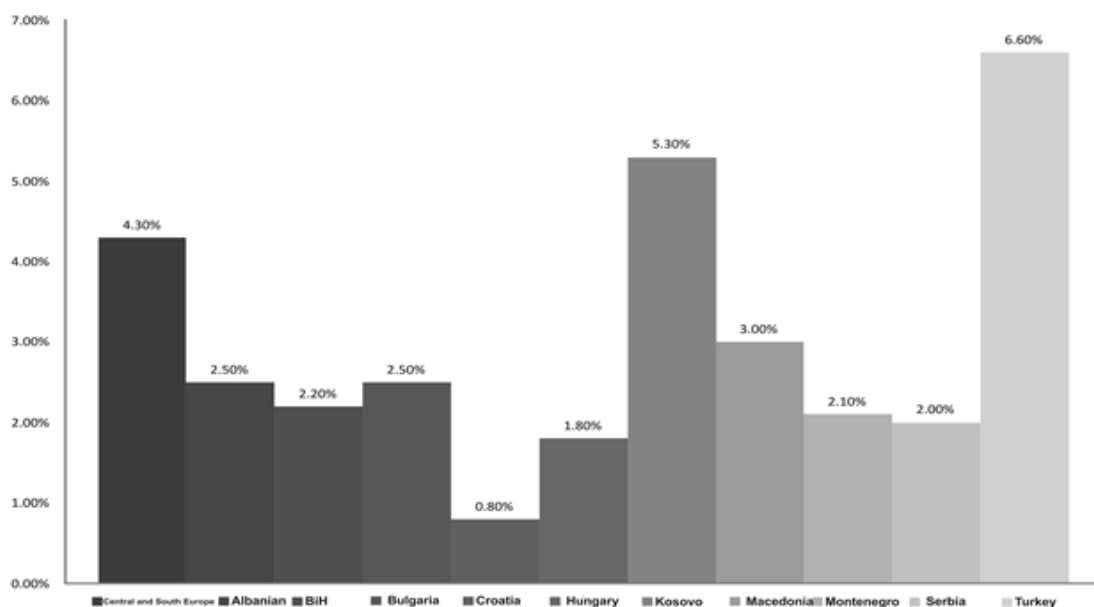


Figure 2: Economic growth, countries of Central-Eastern Europe (IMF, 2011)

### Main fiscal developments

During 2007-2010 Government of Kosovo developed fiscal policies that were able to maintain the country's macro-fiscal stability. This was made possible by providing a sufficient basis in revenue through increased tax base and implementing prudent fiscal policies. Kosovo has already built up a tax system that has powered the growth of taxes collected from year to year. Also during 2009, the Government of Kosovo, implemented tax reform, which is mainly focused on reducing tax rates in place and maintain the revenue by strengthening the institutions responsible for collecting taxes (MTEF, 2001).

Commencing in 2008, the Government has begun to openly implement fiscal policy, focusing primarily on raising capital. Such policy resulted in almost balanced budget over the years 2008-2009, which ended in 2010 with the primary deficit of 1.8% as participation in GDP.

Whilst in 2011 projected primary deficit was 3.7% in general primary deficit generated during these years was funded through a single revenues received in the form of dividends from public enterprises, direct support of donors and accumulated banking balance (MTEF, 2012).

Continuous positive economic growth which was recorded during 2008-2011, was accompanied with continuous increase of overall budget expenditure, as a share in GDP. Total expenditure as a share in GDP increased from 19.5% in 2007 up to 28.2% in 2010 and in 2011 increased up to 31.0%. Commencing in 2008 the Government increased level of capital expenditure up to 120%, and the share of these expenditures in GDP grew from 4.6% to 9%. During 2009 and 2010, its participation was brought at approx. 10% -11% whilst in 2011 the share of capital expenditure to GDP was about 12.4%. This increase of capital investment reflects the needs of increased investment in infrastructure including construction of roads, construction of schools, hospitals including additional investments in infrastructure.

The following chart shows the structure of expenditure under various categories from 2007 until 2011

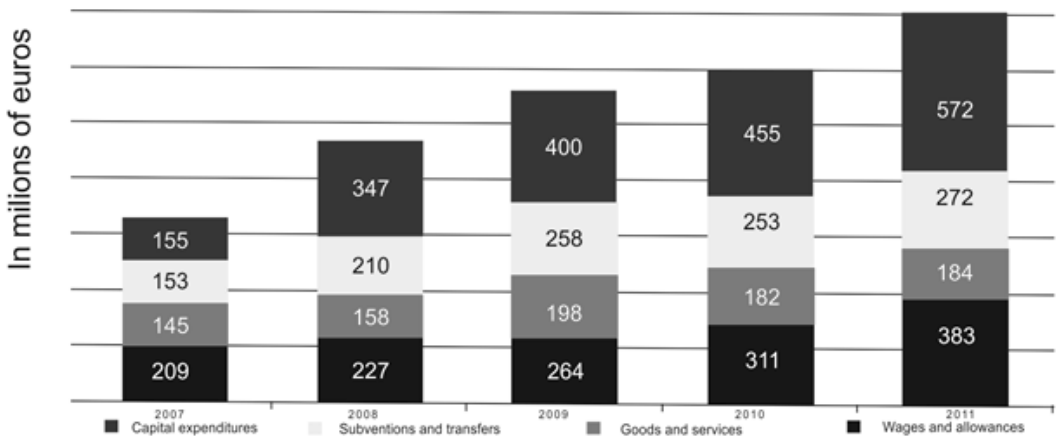


Figure 3: Structure of Expenditures, 2007-2011<sup>1</sup>

In order to maintain fiscal stability and realization of revenue plans to target full fiscal functioning of all businesses, preventing the informal economy, installing new information systems in the Tax Administration of Kosovo and Kosovo Customs, the customs union with countries with which Kosovo achieved an agreement, regional competitive tax system, financial market development, increasing the tax rate and the awareness of taxpayers. Continuous increase of budget revenues is a result of increase of public expenditures, increase of economic growth and improvement of the performance of collection agencies.

<sup>1</sup> Source: KASH2011

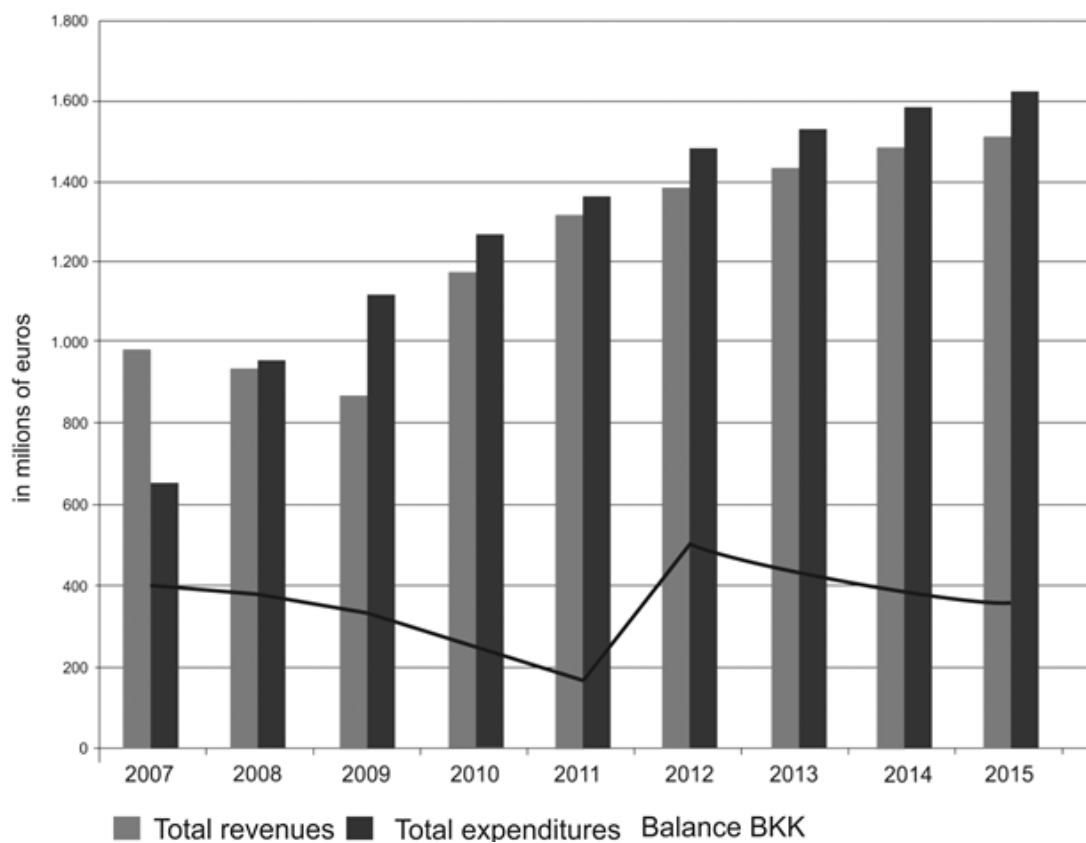


Figure 4: Total Revenues and Expenditures 2007-2012<sup>2</sup>

<sup>2</sup> Source: Ministry of Finance 2012

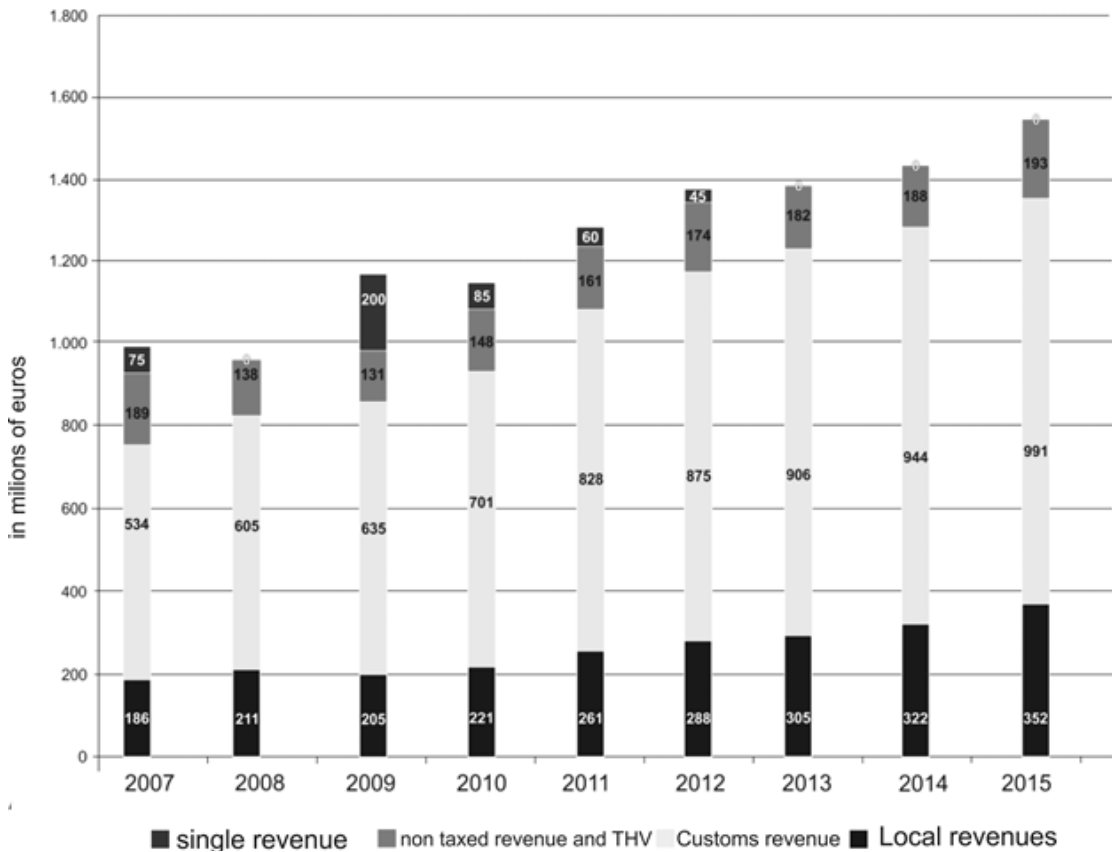


Figure 5: Public Revenue 2007-2012<sup>3</sup>

Revenues in 2001 were increased by 18% comparing to the previous year. So there is a steady increase in tax revenues reflecting fiscal policy developments and the impact of economic growth. The telecom sector has provided single revenues from the sale of mobile licenses, as well as through dividends from public telecom company.

### Factors that influence in economical development of Kosovo

- *Investments, the investment environment and supporting the private sector:* amendment and fulfilment of the legislation base, which will stimulate foreign and domestic investment in Kosovo and create a favourable environment for business development by reducing excessive administrative barriers.
- *Rule of law and reduce of informal economy:* business incentive policy which will affect the reduction of informal economy. The informal economy also seriously hinders competition toward reducing competition in business life. Informality

<sup>3</sup> Source: Ministry of Finance 2012



also would seriously weaken the financial system. Relevant international and local authorities have achieved encouraging results in combating the informal economy. The government has built strategies and legislation that put the basic framework for preventive mechanisms. Customs and Tax Administration have developed their own methods and systems in order to rationalize revenue collection. Police, prosecutors, courts, Intelligence Financial Centre, Anti-Corruption Agency and other relevant authorities have built structures which are key elements in preventing crime (MoF, 2012).

- *Energy and Mines:* Kosovo with its rich natural resources provides numerous opportunities for investment in various economic sectors, including direct investment and investment through the privatization process. Revitalisation of mines will be a catalyst of economic growth and reducing unemployment rate in Kosovo, and therefore requires the completion of necessary legislation and policies for this sector ([www.invest-ks.org](http://www.invest-ks.org)). In order to ensure stable supply of energy we have to continue with reforms in the energy sector. Establishing a sustainable energy system should be based on investments in cooperation with the private sector (PPP). Also realisation of projects such as: New Kosovo through Public-Private partnerships; Rehabilitation of power plant "Kosovo B", heating connection for the city and connecting to the transmission with Albania, alternative energy projects including new plants (MTEF, 2011 ).
- *Transport infrastructure:* Continuation of construction of road infrastructure, which will be the function of a more rapid and sustainable economic development.
- *International and Regional Relations in economic aspect:* with a specific importance will be the membership of the European Bank for Reconstruction and Development (EBRD), World Trade Organization (WTO). Development Bank of the Council of Europe, free trade agreements with third countries. Kosovo will continue Autonomous Trade Agreement with the EU and the General System of Preferences by the U.S. through which Kosovo facilitate trade exchange.
- *Revitalization of the agricultural sector:* the main aim should be to increase support for the agricultural sector in order to increase domestic production, increase exports and thereby improve country's trade balance, create additional jobs in agriculture, and create additional jobs in non-agricultural sector. Supporting this sector should be mainly focus on primary productivity of agricultural subsidies from the state budget through continuous coordination of donor projects and analysing the appropriate forms to create the tax and administrative facilities for the development of this sector. Governmental strategic mid- term priorities in agricultural sector are more effective inter-sectorial coordination, increase of budget for the agricultural sector higher than 3% of the state budget level, strengthening the advisory services, institutional capacity building, generation specific applicable research, improving access to profitable loans, as well as establishment and improve of the infrastructure (MTEF, 2011).

## **Economic Developments in Eurozone**

During 2010 economic recovery was noted in most of Eurozone countries. However, some of these countries during 2010 faced with major fiscal problem that created the need to establish a special fund to help European economies from future crises. Despite steps taken by most of advanced economies to reduce the budget deficit in 2010, the risk to fiscal sustainability continues to be evident. European Union leaders in an effort to avoid future crises agreed to enhance economic cooperation and to impose tougher sanctions against countries that violate budget (MTEF, 2011).

With public debt in Europe, EU leaders asked the plans for long-term solution-close supervision of national budgets and stiffer penalties for countries that do not comply with these. This is a signal that, despite current problems, the European Union and its common currency remain attractive alternative (IFK, 2011).

It was noted that countries that faced with high budget deficits have encountered major problems to receive funds from financial markets; depending on the assessment of fiscal sustainability set interest rate also incorporates the assessment of systemic risk premium. Among fiscal policies that some Eurozone countries applied are those of the increased tax base, pension reform and increase of the VAT. However, according to the International Monetary Fund, the Eurozone economies are expected to recover but will remain below the level of their potential development and high unemployment figure.

Developing EU economies had an increase in real GDP by 1.75% in 2011 and 2% in 2010, whilst developing economies are expected to rise 3.7% in 2011 and 4% in 2012.

Among the EU countries to be specified is Germany, which from an economic moderate increase of 3.5% in 2010 decreased in 2011 for 2.5%, which will mainly be affected by the prohibition of fiscal stimulus packages and a decline the growth of external demands. A similar trend is expected to be in some other EU countries, whilst according to the IMF's prediction, Turkey continued with faster increase even during 2011 which will be affected by rapid increase of demands in private sector and loans. Year 2011 and subsequent years will be accompanied by fiscal actions and keeping public debt under control. (KASH, 2011).

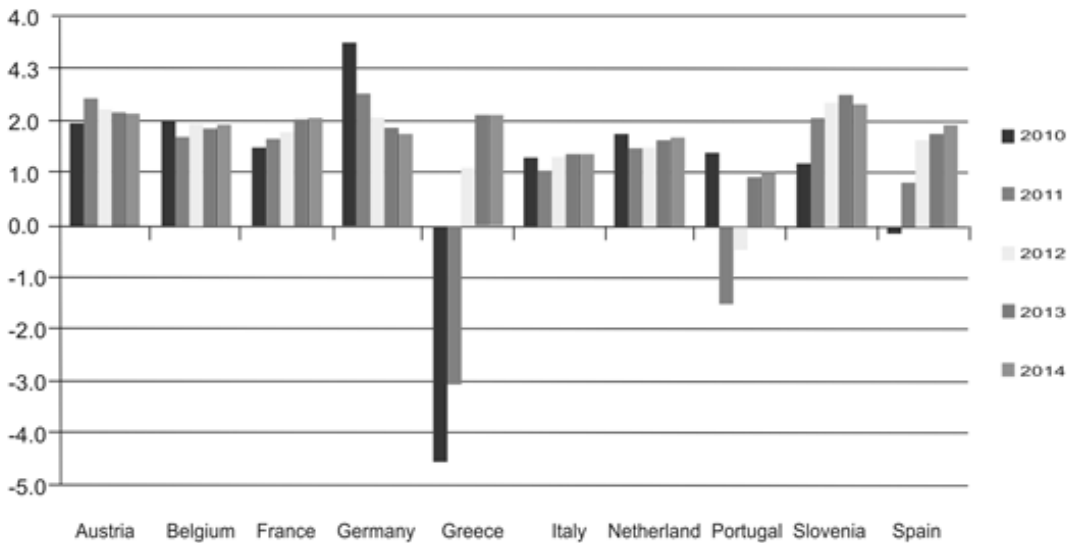


Figure 6: Growth rate of GDP for selected countries 2010-2014, in %<sup>4</sup>

Inflation in Eurozone is expected to remain within certain boundaries of the European Central Bank, at 2%, which as the main objective of monetary policy is price stability as a key factor for prosperity and economic growth. In this context, during 2011 the ECB increased interest rate in order to slow inflation, and as a result of this action, it is expected to have an income of the capital which will be invested in denominated assets in euro unlike investments in denominated assets in U.S. dollar. Such action is expected to have an impact on decrease of demands in Eurozone which will also result with decrease of imports.

## Recommendations

Preconditions for the realization of a sustainable economic growth should be:

- Maintain macro-fiscal stability, additional fiscal discipline;
- Protection of financial stability;
- Provide a business environment that stimulates free economic initiatives and investments;
- Avoidance of administrative barriers in order to stimulate investments;
- Provide opportunities for Public-Private partnerships;
- Governmental budget discipline – there is no state-owned property;
- Maintain the competitiveness of laborers – young population;

<sup>4</sup> Source: KASH2011

- Maintain low tax rates and simple tax system;
- Increase the competitiveness of the country by keeping low costs, comparing to the other countries in the region;
- Increased cooperation with international financial institutions, membership in the EBRD and other organizations;

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