

# KOSOVO HUMAN DEVELOPMENT **REPORT 2012**

*Private sector and employment*



*Empowered lives.  
Resilient nations.*



The views expressed in this report are those of the authors and do not necessarily represent those of the United Nations Development Programme or the Swiss Development Cooperation Office.

When this report was researched and written, Kosovo was formally under the administration of the UN as per UN Security Council Resolution 1244. On 17 February 2008, the Kosovo Assembly declared independence and its commitment to implement the settlement proposal of UN Special Envoy Martti Ahtisaari.

The declaration followed after two years of negotiations that resulted in no clear agreement between Kosovo and Serbia on Kosovo's status. However, pending guidance from the Security Council, the UN in Kosovo will continue to consider UN SC Resolution 1244 (1999) as the legal framework for the implementation of its mandate in light of evolving circumstances.

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## Foreword

Kosovo's second post-conflict decade is today well underway. As attention continues to focus on the many unresolved political issues, for Kosovo's inhabitants, increasingly it is the economic and social challenges in their everyday lives that dominate their concerns.

This report addresses one of Kosovo's deepest post-conflict challenges – the capacity of the economy to provide jobs and growth. The desire for decent work is one of the most basic of all human needs. To the average Kosovan family, decent work means more nutritious food on the table, a better house to live in, better health and more freedoms. Beyond these essentials, it means dignity and empowerment, the chance to build and share knowledge, to become more capable and pass those capabilities on to others – particularly children. More people in decent work can mean more income circulating in communities, more to spend on essential services, less resentment and poverty and more optimism on a brighter, safer tomorrow.

As Kosovo hurries towards a free market economy, leaders and businesses alike are still struggling to balance twin priorities of rapid private sector growth and equitable social development. This struggle acknowledges that the pursuit of personal wealth cannot be separated from broader social wellbeing. Individual enterprise and communities can only thrive together when freedoms are balanced with safeguards. Private sector growth is a tool for human advancement only when it brings benefits other than income. It must also work with people to create stronger and fairer societies.

This is the essence of the human development approach. A radical concept when it was first introduced in 1990, through the UNDP Global Human Development Reports, this paradigm has become generally accepted as the benchmark against which we measure human progress. Put simply, it says that each human life has equal value and is entitled an equal degree of freedom, opportunity and security. Nations become successful not through wealth or might, but by giving all their citizens an equal opportunity to thrive and prosper. Such thinking is not just well-meaning idealism. It has been shown to be true again and again, through many rigorous socio-economic studies across both developing and developed countries.

Can the human development approach help create jobs and growth in Kosovo? Or is it just more words on paper? This report argues very strongly that a rethought, pro-people economic strategy can and will help Kosovo create sustainable, private sector-led growth. It calls for growth to be restructured to include

more of Kosovo's men and women, unleashing a wealth of potential. It also suggests how private enterprise can play a stronger role in Kosovo's much-needed social development. Ultimately, it envisions a swifter growth-paved road towards the fairer, brighter future Kosovans so desperately wish to reach.

The report contains two central messages:

First, it argues that private wealth creation strategies require active management and broad participation to translate into more decent jobs and better standards of living. Narrow growth is a breeding ground for resentment, poverty and instability. Yet when the catalyzing power of private growth is extended to touch the excluded and vulnerable, it can spark an extraordinary chain reaction spreading income and empowerment to the far reaches of society.

Second, it states that creating this chain reaction is a shared responsibility. Kosovo's administration plays a critical role in setting the environment for a flourishing and inclusive private sector. This means tough choices, fair enforcement of laws, and the will to set a long-term vision over quick fix solutions. However, in the end individual choices will ultimately define how businesses will grow and what benefits they will bring to their communities. Will laws be respected? Will women be hired as well as men? Will competition be fair? Will those unable to find honest work, still get out of bed every day and try? Only people, thinking for themselves and for their common good, can answer those questions.

The most recent Global Human Development Report entitled Sustainability and Equity - examines how power imbalances in governance, across societies, and between public and private interests, erode many of the benefits of booming economies. It brings together years of research proving that the only growth that lasts is rooted in fairness - seeking to liberate human potential while striking a healthier balance between economic growth and preservation of the environment for future generations.

Members of the United Nations Kosovo Team (UNKT) have stood alongside Kosovans for nearly two decades as they have struggled to right their own grave power imbalances. We are deeply committed to a future in which all Kosovans have the chance to explore their possibilities. Our Kosovo Common Development Plan 2010-2015 focuses all our efforts on the key challenges holding back that potential – lack of governance accountability, poverty and disempowerment, and the protection of Kosovo's fragile environment.

This plan is grounded in the certainty that fairness, growth and opportunity go hand in hand. Kosovans instinctively understand this to be true. They have the energy and the goodwill to take a less-travelled road towards a more inclusive form of prosperity. The going may get tough at times. But the UNKT pledges to walk with them, every step of the way.

**Osnat Lubrani**

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# Abbreviations

<b>AKB</b>	Alliance of Kosovan Businesses
<b>AMCHAM</b>	American Chamber of Commerce
<b>BEEPS</b>	Business Environment and Enterprise Performance Survey
<b>CBK</b>	Central Bank of Kosovo
<b>CPI</b>	Corruption Perception Index
<b>ECA</b>	Europe and Central Asia
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>EU</b>	European Union
<b>EWS</b>	Early Warning System
<b>FDI</b>	Foreign Direct Investments
<b>GAP</b>	GAP Institute Prishtina
<b>GDP</b>	Gross Domestic Product
<b>GNI</b>	Gross National Income
<b>ICT</b>	Information, Communication and Technology
<b>IFC</b>	International Finance Corporation
<b>ILO</b>	International Labor Organization
<b>IMF</b>	International Monetary Fund
<b>IPR</b>	Intellectual Property Rights
<b>LFS</b>	Labor Force Survey
<b>KAS</b>	Kosovo Agency of Statistics
<b>KCC</b>	Kosovo Chamber of Commerce
<b>KHDR</b>	Kosovo Human Development Report
<b>MoF</b>	Ministry of Finance
<b>MTI</b>	Ministry of Trade and Industry of Republic of Kosovo
<b>MDG</b>	Millennium Development Goals
<b>HDR</b>	Human Development Report
<b>NACE</b>	European Classification of Economic Activities
<b>NGO</b>	Non Governmental Organization
<b>NHDR</b>	National Human Development Report
<b>OECD</b>	Organization for Economic Cooperation and Development
<b>PS</b>	Private Sector
<b>PSD</b>	Private Sector Development
<b>RAE</b>	Roma, Ashkali and Egyptian
<b>RIINVEST</b>	Riinvest Institute for Research and Development Kosovo
<b>SME</b>	Small and Medium Sized Enterprises
<b>SEE</b>	South Eastern Europe
<b>SOE</b>	Socially Owned Enterprises



<b>TAK</b>	Tax Administration Kosovo
<b>TE</b>	Transition Economies
<b>TI</b>	Transparency International
<b>UN</b>	United Nations
<b>UNDP</b>	United Nation Development Programme
<b>USAID</b>	United States Agency for International Development
<b>WB</b>	World Bank

# Contents

<b>Foreword</b> .....	v
<b>Acknowledgements</b> .....	vii
<b>Abbreviations</b> .....	ix
<b>Contents</b> .....	xi
<b>Executive Summary</b> .....	1
<b>Introduction:</b> PRIVATE SECTOR AND HUMAN DEVELOPMENT IN KOSOVO.....	9
<b>Chapter 1:</b> MARKETPLACE ANALYSIS THROUGH AN EQUITY LENS.....	23
<b>Chapter 2:</b> BARRIERS TO INCLUSIVE GROWTH.....	43
<b>Chapter 3:</b> IMPACT ON A PRO-PEOPLE MARKETPLACE.....	63
<b>Chapter 4:</b> PRIVATE GROWTH IN THE SOCIAL CONTEXT.....	89
<b>Conclusion:</b> MAKING GROWTH WORK FOR PEOPLE.....	107
<b>Statistical Annex:</b> Technical Note.....	117
<b>Boxes:</b>	
0.1 How fair competition is linked to economic growth, increased productivity, higher investments and, most importantly, better standards of living.....	19
A. The financial sector in Kosovo.....	47
A1. Enterprise loans by sector.....	48
B. Participation in Business Associations.....	55
B1. Membership of Business Associations.....	55
C. Primary sector example: Agriculture.....	82
D. Secondary sector example: Food Processing.....	84
E. Tertiary sector example: ICT.....	86

**Figures:**

0.1 Private sector contribution to the four pillars of human development, defined by UNDP.....	15
1.1 Unemployment rate by age group.....	26
1.2 Unemployment rate by ethnicity.....	27
1.3 Employment rate by level of education.....	28
1.4 Employment rate by gender.....	28
1.5 Contribution of different sectors to private sector employment.....	30
1.6 Average monthly salary (in euros) in Central European and Balkan countries.....	31
1.7 Average salary by level of academic qualifications.....	31
1.8 Firms' employment growth by sector.....	32
1.9 Distribution of registered businesses by sector in Kosovo.....	34
1.10 Regional distribution of enterprises.....	35
1.11 Distribution of registered businesses by sector and region in Kosovo (number of enterprises per 1,000 inhabitants.....)	36
1.12 Breakdown of the legal form of companies registered in Kosovo.....	37
1.13 Entrepreneur employment status before starting up their business.....	38
1.14 Enterprise births 2006-2010 (per 1,000 Inhabitants).....	39
1.15 Enterprise termination 2006-2010 (per 1,000 Inhabitants).....	39
2.1 Perceived intensity of business barriers in Kosovo.....	44
2.2 Reported sources of finance for the establishment of companies in Kosovo.....	46
2.3 Perceived corruption intensity across business areas.....	52
2.4 Tax evasion and labour informality by sectors.....	54
2.5 Trust in groups of entities (intensity).....	59
2.6 Respondents' trust in public institutions (intensity).....	59
3.1 Perceived intensity of business barriers, across different sized businesses in Kosovo.....	67
3.2 Barriers to new business activities identified by business representatives.....	68
3.3 Distribution of women-owned businesses by date of establishment.....	72
3.4 Business ownership by women across the world.....	72
3.5 Gender distribution of business ownership across sectors.....	74
4.1 Academic qualification of employees.....	90
4.2 Primary source of staff recruitment.....	91
4.3 Factors perceived by youth as the most important in successful job-seeking.....	92
4.4 Which institution/entity do you think implements the fairest recruiting?.....	92
4.5 Percentage of households which receive remittances.....	97
4.6 Percentage change in GDP and social assistance expenditure in Kosovo.....	99
4.7 Incidence of diseases linked to environmental pollution.....	101
5.1 Kosovo's growth cycle.....	108

**Tables:**

0.1 Kosovo Human Development Index – regional comparison.....	10
0.2 Women in positions of political power.....	12
1.1 Key labour market indicators.....	26
1.2 Youth employment ratio by ethnicity.....	27
1.3 Size-class breakdown of registered companies in Kosovo.....	37
3.1 Perceived intensity of business barriers across different sized businesses in Kosovo.....	64
3.2 Perceived intensity of business barriers across Kosovos' regions.....	70
3.3 Perceived intensity of business barriers broken down by gender.....	71
3.4 Perceived intensity of business barriers across the primary, secondary and tertiary sectors.....	76

<b>Notes.....</b>	<b>119</b>
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## Executive Summary

Just over a year ago, the global approach to human advancement known as the Human Development concept reached an important milestone. Two decades had passed since its first appearance in 1990, pioneered by a team of economists, philosophers and other brilliant minds who dared to challenge deeply entrenched opinions on how to measure the success of nations. Much of value has emerged out of this approach over the last two decades, including the Millennium Development Goals and the world's first global agreement on environmental targets. These goals demand more of leaders and people alike, calling them to account for the state of the human experience. The first global Human Development Report to be published after the two-decade milestone was, appropriately, entitled Sustainability and Equity. It asked: how can those gains be preserved and built on? And how can they be spread more broadly, to touch more lives?

Kosovo has also recently passed an important milestone. Three years ago, it marked the end of the first decade since the end of hostilities. The second decade of relative stability and security is now well underway. However, human development gains are not quickly realised and even in a Kosovo freed from repression and violence, people's lives are still constricted by poverty and lack of opportunity. Small

wonder, then, that lofty human development principles can sometimes seem like unaffordable luxuries, in the eager quest for economic growth and political recognition.

This report is timed to make a simple case within a fairly complex issue. It argues that human development principles – far from being expensive add-ons to straightforward economic strategies – are Kosovo's most viable route towards sustainable wealth creation within a healthy social context.

Entitled Private Sector and Employment, Kosovo's seventh Human Development Report focuses on the linkages between human development and private sector expansion. Private sector growth is Kosovo's best hope for generation of jobs and revenue. There is a clear logic to this. Kosovo's public sector has, hitherto, been by far the biggest single employer in Kosovo. The long legacy of socialist policies swelled public responsibilities and stifled private enterprise. This pattern has been slow to shift – but it is not sustainable in the long term. Over the coming years, Kosovo's public sector will have to be gently scaled back until it is proportionate to its administrative responsibility of less than 2 million people. The private sector must therefore have room to breathe and be stimulated to grow - providing jobs, income and hope to the bulk of the population.

This growth must occur within a deeply challenging social context. Kosovo is grappling with many deep and entrenched human challenges. Some are plainly linked to poverty and lack of opportunity – poverty rates, unemployment rates and lack of access to basic services. However, some spring from decades of social fractures, repression and power imbalances. They include gender discrimination, ethnic enclaves, corruption, nepotism, income inequalities and deep rural-urban divides.

It has been argued that growth alone can solve Kosovo's problems. That if only businesses can become competitive and expand, then money will flow into society and everyone will be better off. Does this argument bear closer analysis? This report seeks to answer that question for the sake of all Kosovans. By diverting already scarce resources away from economic stimulation plans, the "human" components of development are often last to be considered and are easily dismissed. This report strives to highlight the opportunities for mutually reinforcing private sector growth and human development and points towards an alternative, and likely faster route towards a future within the prosperous European context most Kosovans dream of experiencing.

**Methodology:** This report developed organically through a long consultation process with Kosovan leaders, business men and women, vulnerable groups, Non-Governmental Organizations (NGOs) and some of Kosovo's leading thinkers and academics. The outline was shaped over the course of four months in a series of roundtables. The report itself was produced by UNDP and Riinvest, Kosovo's primary economic think-tank. A new survey on Enterprise Barriers was prepared and conducted by Riinvest with a repre-

sentative sample of 600 business owners across the reach of Kosovo, and results tested through focus groups with wider audiences. This survey forms the basis of many of the findings. Analysis stems from a comparison of these new results with more than a decade of broader socio-economic research on growth, education, health, participation and environmental sustainability trends from within the UN system and from Kosovo's authorities and international partners. The research and preparation team also surveyed the wealth of extant global literature on human development and growth paradigms. Over the last 20 years, much has been learned about the intersection between wealth creation and other indicators of human wellbeing – including education, poverty rates, crime rates and social equity. In applying global lessons to the Kosovo context, every effort has been made to keep the analysis practical and focused on solutions.

**Key analytical principles:** the report looks at the potential for private sector growth to provide jobs and revenue from the point of view of equity; i.e., can private sector growth narrow the deep divides fracturing Kosovan society? And would it be faster and fairer if approached from that direction?

There are sound reasons for taking this approach. The human development context in Kosovo is certainly one of the grimmest in Europe. The 2011 Human Development Index places Kosovo below all its regional neighbours in terms of life expectancy, learning rates and Gross National Income per capita – extraordinary indicators of poverty and denied potential at the very doorstep of Europe. There are as many, if not more, poor people in Kosovo today than in the moment hostilities ceased in 1999. Nearly half of all Kosovans live on or below the poverty

line, and one in four is unable to meet their critical daily needs. Subsistence living and low skill levels are the norm. Nearly two thirds of Kosovan adults are estimated to have only basic levels of education in a region where expensive new cars and palatial houses can be seen in many of the major cities. There are other divides, too, even more troubling than poverty. Kosovo still harbours deep ethnic divisions after years of repression and discrimination. Every day, these fractures exclude many groups from full participation in Kosovo's school, work and political life. Enclave mentalities are rife. In addition, women – particularly young women – face a life of constrained potential. Only a fraction of women participate in the workforce and even fewer in political life. They are held back by a legacy of cultural prejudices and a widespread lack of opportunity, so far unchallenged by uneven enforcement of EU-compliant legislation.

Private sector growth will play an important role in addressing – or worsening – this picture, depending on the strategies used to promote it. Private sector growth can generate a range of powerful direct and indirect benefits – but there are also many pitfalls to haphazard private sector growth in fragile transition contexts. Direct benefits in Kosovo could include wealth creation for families and communities, enterprise stimulation leading to more jobs and empowerment, positive effects on price and quality of goods, introduction of innovations and more Corporate Social Responsibility programmes. Indirect benefits could include greater capacity for revenue redistribution, reinforcement of education systems, more effective public-private partnerships and more opportunities for social cohesion. Pitfalls, however, lie in the potential for weak and unregu-

lated business environments to allow corrupt business practices, in the potential for the widening of income divides and in the often devastating environmental impact of unregulated industries. Kosovo's inhabitants cannot afford not to pass Kosovo's growth strategies through the filter of fairness and responsibility, to ensure the maximum advantage to the Kosovo's vulnerable human context.

**Main findings:** the report suggests that the pattern of Kosovo's economic strategy to date, vis-à-vis private sector growth and job creation, has worked well to assist enterprise creation of a certain kind – mostly micro-firms operated by and employing Kosovans of medium to low skills. To transform this very narrow pattern of growth into a much more dynamic and encompassing private sector will require a conceptual and structural adjustment of growth strategies. The main findings of the report are:

- **Kosovo's marketplace is unbalanced – both in terms of the composition of its labour force and the size and distribution of its businesses.**

Two key weaknesses within the Kosovan marketplace are (i) low labour force participation rates combined with low employment rates – less than a quarter of working-age Kosovans has a job; and (ii) the high emphasis on enterprise creation in an environment already saturated with low value-added tertiary sector firms. Together these two findings indicate a lack of faith in growth – particularly among women – and a “family first” enterprise culture deeply in need of more skills and vision to grow.

- **As currently structured, investments in private sector growth are not impacting poverty.** This is because employment opportunities

created are generally low-value jobs, offering insecure, low wage work in a marketplace highly disposed towards informality. A good third of households unable to meet their critical needs has an employed member. The constraint against women in the workforce actively perpetuates poverty at the household level.

• **Institutional & “cultural” barriers to business are limiting expansion and the social dividends of growth.**

Most of the top barriers to growth as perceived by businesses are institutional and cultural, not regulatory barriers or barriers associated with Kosovo’s ongoing status dispute. Unfair business practices such as corruption, tax evasion and anti-competitive strategies are all perpetuated by weak or discretionary enforcement of rules, and a public sector that seems insensitive to the struggles of businesses. The intensity of these barriers increases as businesses grow and become more exposed. Most ventures are self-financed. However, those without capital to spare find working with banks a tremendous challenge - working against innovators, women and the poor. As a result, many companies stay small and “informal”, without incentive to become internationally competitive, integrate with national financing systems, apply labour laws, respect worker rights, pay taxes and support social development.

• **Compliance with pro-growth and workforce rights legislation needs to be incentivized within Kosovo’s enterprise culture, impacting human dignity and international competitiveness.** Kosovo has a raft of EU compliant legislation on its statute books protecting worker rights as well as requiring transparency, compliance and fairness in business practices (for example, over taxation). However, its

under-resourced and over-laborious approach to disseminating and implementing these laws is costing Kosovo’s companies, employees and those hoping to join the workforce. Dialogue is absent in public-private interaction. Only special interests are heard, increasing incentives to avoid and evade and limiting the scope for meaningful, responsible and competitive expansion.

• **Underperformance must be addressed in the public sphere to stop this overshadowing private growth.**

Kosovo’s enterprise development pattern gravely undervalues skills. Most businesses feel that the existing low-skill climate is sufficient for their needs. They also question why they should comply with onerous obligations on labour, the environment and taxation when government performance to provide public services and business support is unreliable. Companies and the communities they operate in should be able to expect a minimum standard of services from their municipal authorities, and a more transparent interaction with them during municipal planning cycles.

• **Job creation strategies need special targeting to connect more women and men with decent work.**

Kosovo’s job market is already saturated with men, usually with a high-school degree or less. The challenge in connecting others with the workforce, particularly women and ethnic minorities, needs careful planning. Less than three in ten of Kosovo’s women currently participate in the workforce, and only one in ten is in work. The bigger companies get, the less likely they are to employ women – so job creation by itself is not the answer to more decent and gender-balanced work. Women face unique barriers to entering the

workforce, such as cultural ties to the family, or lack of collateral to facilitate access to finance. Unless these issues are addressed through targeted strategies, Kosovo's workforce potential cannot grow at full pace.

• **Highly targeted sectoral and social strategies could rebalance sectors and marketplace profiles.**

Kosovo has perpetuated a large trade imbalance for the sake of easily collected import tax revenues. Internally, it has seen a construction boom – now finished – and concerned itself with the privatization and stimulation of former State-Owned-Enterprises. This has not yet helped to rebalance Kosovo's private economy – in part because barriers to fair and sustainable business growth differ greatly across sectors. Lack of reliable electricity supply and anti-competitive customs regulations impact the agricultural sector (which is primarily located in poor, rural areas) far more than they do city-based industry and services. Kosovo has capacity to grow competitive, standardized businesses with its young and relatively more skilled upcoming workforce. However, it needs to focus on stimulating a balanced and sustainable portfolio of sectors that are internationally tradable, highly labour-intensive and value-added.

Building upon these main findings, the report also considers how Kosovo might mobilize some of the more indirect benefits of private sector growth – such as reinforced education systems, revenue redistribution and investments in environmental sustainability. Here, too, there are many lessons to be learned if Kosovo's labour market is to be strengthened and draining cycles of dependency broken. A culture of nepotism, low value for learning

among hirers and a narrow opportunity window is eroding youth commitment to learning as a route to personal advancement. Only one third of young people feel school is preparing them well for life – yet, positively, most feel that learning still has an inherent value. Those unfortunate enough to have missed out on education opportunities struggle to access catch-up or vocational training schemes – particularly rural women, among the poorest of the poor.

Kosovo's budget-neutral Law on Family and Social Assistance is also a key driver of dependency cycles - limiting the impact of private sector growth on poverty and inequity. Social assistance levels have remained static in recent years despite rising GDP, and the current system ejects poor families once their youngest child reaches five if there are no other dependants in the household. Kosovo has not yet considered the long-term value of linking a more targeted social welfare programme to school attendance, job-seeker, catch-up or vocational schemes. The potential for effective revenue redistribution and a deeper well of human capability is therefore limited, both now and for the future.

Finally, Kosovo's environment and energy efficiency legislation, designed to support private enterprise, is now being put into effect in an arena of virtual ignorance about the value of environmental compliance. The fate of this legislation depends absolutely on a rapid and sincere outreach effort to businesses to build a willing, environmentally-friendly culture, particularly at the municipal level. So far, Kosovo's businesses have neither taken notice of environmental obligations, nor significantly invested in "green job" pro-



grammes except in the most minimal of ways – often spurred by international partners.

### **Recommendations:**

This report shows that private sector growth is intricately connected with Kosovo's social context. Private sector growth needs to be built from a much wider and fairer base than currently to unleash the real potential of Kosovo's market place. Undertaking this challenge is not solely the responsibility of government, nor of private businesses. It is a Kosovo-wide priority – concerning those in power, those in the marketplace and those currently excluded from it. Dialogue and transparency emerges as a central tool to solve major growth issues. In this dialogue, municipal authorities have a much greater role to play than they are currently undertaking.

Three major areas for focus if Kosovo is to make growth work for its people:

## **1. BUILD A VISION FOR INCLUSIVE & LABOUR INTENSIVE GROWTH**

Kosovo needs a cross-government strategy for inclusive growth tied to the MTEF (Medium Term Expenditure Framework) process. This strategy should seek to reduce barriers to business across a balanced portfolio of tradable, labour-intensive and value added sectors, as well as connect more women and men with the workforce and link growth more closely with development in public services and social protections. Implementation of this strategy should closely engage business owners, workforce participants (current and potential) and public authorities in dialogue to ensure transparency and build incentives for compliance. Municipal authorities

should be empowered to lead the active dialogue process.

## **2. CREATE THE RIGHT CLIMATE FOR FAIR AND SUSTAINABLE ENTERPRISE**

Kosovo should set key targets in two major areas: (i) the leap in size from small to medium-sized businesses (including access to finance for new and expanding businesses – particularly those run by women and youth – and support for compliance with EU standards); and (ii) an increase in formality in the primary (agriculture) and tertiary (services) sectors.

These targets could be supported by a Kosovo-wide campaign against unfair business practices including corruption, anti-competitive practices and tax evasion. This campaign should also include detailed plans to lighten the compliance burden on businesses in the areas of financing, labour laws, and taxation (including a drive to reduce VAT and internalize its collection).

There must also be renewed focus on accountable, fair enforcement of legislation concerning business operation, labour protections, energy and the environment. This means, in effect (i) resourcing adequate enforcement through data capacities, the court system and on-the-ground inspectors; (ii) swiftly punishing discretionary enforcement; and (iii) incentivizing compliance through outreach, practical support and education – bringing workers and employers together to create a culture of compliance and mutual benefit.

It is also essential to establish minimum standards for quality public services in areas with the lowest levels of formalized enterprise, labour force participation, knowledge acquisition and gender parity.

### **3. CONNECT MORE MEN AND WOMEN WITH AN EQUITABLE MARKETPLACE**

Kosovo can move towards a balanced, skilled and productive labour force, by (i) setting graduated targets and strategies to increase labour force participation among men and women from all ethnicities; (ii) supporting youth into the marketplace, through partnerships, work placements and sponsorships with local businesses through CSR programmes; (iii) establishing a “life-long learning” programme linking work-skills in the school curriculum to skill development in adulthood, targeted at those who traditionally miss out (rural women, and Roma, Ashkali and Egyptian groups particularly); and (iv) establishing a public-private funding pool for urban and rural populations to cooperate on innovations serving the public interest for environmental sustainability.

It is critical to rethink the intersection between revenue redistribution strategies and growth. Kosovo’s Family Law must be linked to GDP growth, and the categorization of dependent children as “under five years” should be dropped. Benefits can be more effectively linked to dependency breaking initiatives such as school attendance, job-seeker schemes and catch-up programmes. Municipal leaders can also incentivize local populations to create more sustainable value from remittance inflows, by directing them towards enterprise-boosting opportunities.

There is no perfect formula for generating sustainable, equitable private sector growth – in Kosovo or elsewhere. However, these recommendations can help Kosovo to make more of its resources, to break its dependency on international assistance and to move with confidence towards a full

welcome into the EU. If Kosovo wishes growth to result in a better life for all, it will discover that its people are infinitely more valuable than any wealth in mines or minerals. They hold the key to a more prosperous, happier future, and they deserve a chance to contribute all their strength, and to see their un-tapped power unlocked.



# Introduction

## Private Sector and Human Development in Kosovo

*“Act so that you treat humanity, whether in your own person or in that of another, always as an end and never as a means only.”*

**Immanuel Kant (Philosopher and Anthropologist)**

Private enterprise is a fundamental part of human history and almost as old as society itself. Private ownership and trade of goods and services, to profit individuals, families and communities, has evolved alongside human culture. It predates the nation state, the formalization of capitalist and socialist economic systems and the industrialization of modern societies. Historians have dated private enterprise to the dawn of early human communications systems. This suggests it may be one of the most deeply rooted social impulses - intrinsically linked to the healthy function of societies.

Across the world, in almost every society, private enterprise has become a highly complex and sensitive, but no less essential, mechanism for socio-economic development. Indeed, this sector is often the primary engine of economic growth – particularly in developing countries, where it tends to be responsible for a higher proportion of annual GDP.

In an increasingly connected and interdependent world, finding the right model for human progress is seen to be paramount. In this respect, it has been argued that private sector growth and human development are opposing paradigms. While the private sector focuses on wealth creation and profit, human development focuses

on people’s wellbeing. Private sector growth is income-centred, human development is centred on human potential and human freedoms. The private sector demands a free hand to make investments wherever growth looks most likely. Human development calls for positive action to invest in those whose rights and capacities are most denied, irrespective of their potential impact on the economy’s “bottom-line”.

This report asks whether, in Kosovo, a human development-private sector growth dichotomy can be shown to be short sighted. It seeks to show that here in Kosovo, as elsewhere, private sector growth and human development are compatible goals – moreover, that responsible private sector growth is a core part of the human development concept.

In doing so, the report seeks to understand what policy adjustments need to be made to enable wealth creation to enhance human potential. At its most effective, private enterprise fosters growth, capability and opportunity for hundreds of millions of people worldwide. On the other hand, it can also play a significant role in widening human development gaps – aggravating inequities, contributing to environmental degradation and undermining fragile governance systems. Without the keen and sensitive

	Human Development Index (HDI)	Life expectancy at birth (years)	Mean years of schooling	Expected years of schooling	Gross national income (GNI) per capita
Slovenia	0.884	79.3	11.6	16.9	24,914
Croatia	0.796	76.6	9.8	13.9	15,729
Montenegro	0.771	74.6	10.6	13.7	10,361
Bulgaria	0.771	73.4	10.6	13.7	11,412
Serbia	0.766	74.5	10.2	13.7	10,236
Albania	0.739	76.9	10.4	11.3	7,803
Bosnia and Herzegovina	0.733	75.7	8.7	13.6	7,664
Macedonia (The former Yugoslav Republic)	0.728	74.8	8.2	13.3	8,804
Kosovo	0.713	70.0	11.2	11.3	7,410

The human development index has three components: health, education and living standards and is calculated based on a methodology built upon the four primary indicators in Figure 0.1 above: life expectancy at birth, mean years of schooling, expected years of schooling and GNI per capita.<sup>1</sup> Indicators for countries in the region taken from UNDP Global Human Development Report (GHDR) 2011. Indicators for Kosovo (which is not a UN member state therefore is not included in the HDR 2011 statistics) calculated by Research and Policy Unit, UNDP Kosovo

engagement of governments and individuals themselves, the pitfalls can easily come to outweigh the benefits. Much also depends on how closely private sector growth is mapped to the changing human development challenges of Kosovan society.

### 0.1 Kosovo's human development context

The potential for positive and negative interaction between the private sector and human development is nowhere more finely balanced than in middle-income developing contexts. These countries may be urgently seeking and even poised for economic advancement, but often still carry significant burdens of poverty and social inequality. In Europe, Kosovo is perhaps the most striking example of such a situation - a region seeking to foster an inclusive society and economic growth, but on parallel and not yet mutually reinforcing tracks.

Producing a clear human development picture of Kosovo today is extremely

challenging. Kosovo's *sui generis* status and the challenges of its post-conflict administration have made reliable data difficult to source. Unfortunately, the range of data available suggests that Kosovans live in the single most challenging human development context in Europe. According to the UNDP Human Development Index (HDI), Kosovo ranks 87th in the world, behind all the rest of Europe. The HDI is the most comprehensive tool available to assess the capacity of an administration to enlarge the choices and enhance the capabilities of all its stakeholders equally. It measures the state of the human experience in three fundamental categories: a long and healthy life, access to knowledge and a decent living standard. Against these measures, Kosovans will, on average be born to a shorter life expectancy, less expected years of schooling and a poorer existence than all of their European counterparts.

Taking a closer look at Kosovan society reveals deep fractures along three divides: 1) between the rich and the

poor; 2) between ethnic groups; and 3) between the sexes, particularly affecting the young. Inequity is the common theme running through these fractures, and is reflected throughout their economic, socio-political and gender dimensions.

### **Poverty and economic exclusion**

are prevalent throughout Kosovo, despite significant investment in infrastructure and enterprise by international partners – and despite the rising GDP. Poverty rates are controversial; estimates range between 34 and 48 percent for absolute poverty and from 12 to 18 percent for extreme poverty – those people unable to meet their critical survival needs.<sup>2</sup> One 2006 survey suggested that absolute poverty is rising most sharply in rural areas.<sup>3</sup> All data sources agree that poverty rates in Kosovo are not reducing, as in other transitioning European contexts. Poverty rates in Kosovo are disproportionately high among certain groups – specifically children, female-headed households and members of Kosovo’s Roma, Ashkali and Egyptian ethnic minority (RAE). It is also important to highlight that the levels of poverty in Kosovo are very sensitive to the definition of absolute poverty, with a large number of people living on and around the poverty line. A slight increase or decrease in income pulls or pushes a great deal of people from or into poverty.

Poverty in Kosovo is an outcome of the economic exclusion facing many Kosovans, denying them access to income sources offering provision for their basic needs. Unemployment rates are the highest in Europe at 43 percent, rising to 73 percent among young people.<sup>4</sup> In a region where

nearly half the population are reliant on self-generated forms of income, an estimated 8 percent of Kosovans depend absolutely on a social protection system that fails to target the poorest and currently cuts families off from several important benefits once their youngest child reaches the age of five. Even where income sources are available through jobs, arable land or property rental, they are often insufficient to lift families out of poverty. A staggering 30 percent of those households unable to meet their basic needs have one employed member.<sup>5</sup> As a result, many Kosovan families look outside Kosovo for their livelihoods, with one in every five families dependent on remittances for over a quarter of their household income.<sup>6</sup>

Poverty in Kosovo represents a cycle of denied and stifled human potential. The collapse of Kosovo’s heavy industry during the 1990s coupled with the effects of repression and conflict pushed thousands out of school, out of work and into poverty. A 2007 survey indicated that nearly 62 percent of Kosovo’s adult population had low levels of education, with a bare 1 percent holding a college or university degree.<sup>7</sup> There is no reason to assume that conditions have improved dramatically within the past five years. Amid so many pressures, many Kosovans struggle to envision a future in which they have more economic choices, greater knowledge and more freedom to fulfill their aspirations. Expecting them to build such a future without vision and optimism is a step too far.

**Socio-political exclusion** is also pro-found across ethnic as well as urban/rural and age divides, undermining

human capital by blocking equitable participation in education, work, social activism and politics. Conditions for RAE and rural inhabitants of all ethnicities are particularly challenging. Up to one third of RAE are not registered at birth and 70 percent leave school aged 12 or under.<sup>8</sup> Self-exclusion is another factor of Kosovo's post-conflict interethnic landscape. Up to 86 percent of Kosovo's Serbian population (K-Serbs) did not participate in the 2007 elections<sup>9</sup>, and while this figure fell in 2009, enclave mentalities continue to dominate in the education, enterprise and political spheres. Rural areas face increased rates of socio-political exclusion; members of the rural labour market are less likely than their urban or peri-urban counterparts to have access to non-land based sources of income, illiteracy rates are higher among rural women, and rural children – particularly girls – are less likely to attend school. Generally speaking, the young in Kosovo struggle to gain any kind of meaningful foothold in society. While Kosovo is committed on paper to nurture and foster talent in childhood, prepare children for decent work in adolescence and create a place for young voices in society – in practice, little is done to support them. Young people with special needs are the most excluded of all – only a fraction are in school (less than 24 percent, according to one study<sup>10</sup>) and most will play no role in Kosovo's broader socio-political life.

**Gender-based exclusion** is equally apparent throughout Kosovan society. Evidence of a denial of freedoms and capabilities is ubiquitous - from employment data (three out of every four young women active in the labour market are without jobs), to the limited

participation of women in political life. Despite having a relatively healthy quota of women in government and an increased number of women holding senior political positions in Pristina, outside of the capital, the picture is less promising. The fact that women held between 22 and 28 percent of the seats in each municipal assembly in 2009 is seen as largely due to quota enforcements, rather than a genuine reflection of empowerment. The fact remains that no municipal assembly is led by a woman, nor among Kosovo's minority communities is any senior political position held by a woman.<sup>11</sup>

TABLE 0.2 Women in positions of political power

	Total	Women	Men
Ministers	18	2	16
Permanent Secretaries	18	2	16
Members of Parliament	120	40	80
Chairs of Parliamentary Committees	13	2	11
Mayors	36	0	36

Kosovo Parliament 2010

Generally in Kosovo, women are the least likely to finish schooling, to engage in the private economy, to own land and businesses and to run for political office. Female members of rural, poor and minority communities are the worst affected. A remarkable 14 percent of rural women are illiterate, compared to 4 percent of rural men.<sup>12</sup> In a conservative culture and economically constrained climate, a poor Kosovan woman is more likely to be perceived to have duties than rights. Her capabilities are only valued insofar as they support her husband and children in traditional roles, and her potential to expand her knowledge, participate

in the workforce and contribute her voice to political decision making is of secondary – if any – importance.

Kosovo's human development picture is complex. Less than one hour's flight away are some of the world's most sophisticated European nations. Their success and organization overshadows Kosovo, which looks grim indeed by comparison. However, to the average onlooker, a region in which most people seem to be housed, fed and accessing technologies such as cars, mobile phones and televisions does not match the traditional image of poverty and under-development. However, there are two caveats worth bearing in mind. First, pockets of Kosovan society – particularly RAE communities and those in extreme poverty – fall within an indicator range that would not look out of place in sub-Saharan Africa. This underlines deep social inequalities. Secondly, much of Kosovo's poverty and lack of opportunity is hidden behind closed doors. The political, social and economic exclusion experienced by such a wide range of people has life-threatening consequences in many cases. Kosovo's deadly combination of extreme pollution and environmental degradation (including the worst heavy metal contamination in recorded history), prevalence of high-risk behaviours (notably smoking, including during pregnancy), poorly targeted social protection and weak healthcare systems has undoubtedly contributed to many chronic illnesses and preventable deaths – albeit many unattributed. Any Kosovan family living near the poverty line would put illness ahead of all other fears. Every day in Kosovo, diseases relatively easily treated in neighbouring countries add to an already heavy burden of

poverty, erosion of human potential and social fragility.

## 0.2 Private sector as a human development tool

Kosovo's leaders, acutely aware of the challenges they face, have linked their vision for the future to the European Union (EU) 2020 Strategy for sustainable and inclusive growth. This decision is wisely intended to prepare for a time when Kosovo's status disputes are resolved and Kosovans can take their eventual place as full members of the United Nations (UN) and the EU community.

The EU 2020 Strategy (which sets ambitious targets for Member States in areas of employment, innovation, education, social inclusion and energy/climate change), itself demonstrates how the language of growth is being gradually reframed by human development terminology. The Strategy naturally evolves from the World Summit Document in 2005 and its description of the three fundamental elements of sustainable development: economic development, social development and environmental protection (a fourth, cultural development, has since been proposed in addition). Both documents stem from a revolutionary revision in the way human progress is measured globally – the shift from a utilitarian approach using quantitative economic measures to one focused on *human capacity* – the degree to which people are able to *enlarge their choices and expand their capabilities and freedoms*.

The human development approach represents a paradigm shift in thinking. It aims towards an environment in which



people can expand the choices that they have, develop their full potential and lead productive, creative lives in accordance with their needs and interests. Equity lies at the heart of this vision of human progress. Instead of the *speed* of progress, it measures the *breadth* and *fairness* of progress across societies and nations – starting with those for whom freedoms, capacities and choices are the most constrained. A key tool for and hallmark of human development approaches is the building of human capabilities where they are most lacking. Without this, many choices will simply remain unavailable, and many opportunities inaccessible.

This approach shares many unexpected elements in common with the values underpinning private enterprise. Both centralize human agency and freedom – to make choices, explore opportunities and develop potential. Both place this agency within a social contract, which outlines the nature of individual responsibility towards others and to the good of society at large. Both depend, to a greater or lesser extent, on the regulatory and supportive role of governance in the public interest.

Common sense also dictates that economic growth is an important contributing factor to enlarging people's choices. Without sustainable economic growth, further expansion of choices and capabilities is limited, which, in turn, excludes a significant segment of society from accessing a decent standard of living, from having long and healthy lives and gaining access to knowledge.

Kosovo, like many other middle-income countries with reasonable education and literacy rates, sees growth through private enterprise as a key factor in solving entrenched socio-economic

problems. However, there are many barriers to be overcome. Prior to the decade of repression and conflict leading up to NATO's intervention in 1999, Kosovo was administered by a highly centralized, ideologically socialist state system that owned all the major means of production and relegated private enterprise to small scale and informal<sup>13</sup> ventures. There is no tradition of well regulated and socially responsible private industry – whether for small family businesses, medium scale ventures or Kosovo's major industrial assets. Despite the post-1999 effort to transition to a market economy, the public sector still dominates in Kosovo's labour market. Today, over a decade since the end of active conflict, the nascent private sector is more than ever viewed as a lifeline for Kosovo's statehood aspirations and a pivotal piece of its development vision.

### **0.3 Public/Private interaction in Kosovo – benefits and pitfalls**

The principal challenge facing Kosovo vis-à-vis its private sector today is simply expressed, if not simply managed: how to direct and regulate private sector growth in order to reap the many potential human development benefits, whilst avoiding the most obvious pitfalls. A strong, responsible private sector represents far more to a country than wealth creation for individuals or even the state. It offers a striking range of direct and indirect benefits to countries with equity related human development challenges.

Equity	Productivity	Sustainability	Empowerment
<ul style="list-style-type: none"> <li>- Income opportunities for the poorest</li> <li>- Self-sustaining social cooperation</li> <li>- Levelling gender, ethnic, and other divides</li> <li>- Enabling inclusive redistribution of national revenues</li> <li>- Partnering public sector for broader and better services.</li> </ul>	<ul style="list-style-type: none"> <li>- Providing dignity through decent work</li> <li>- Raising individual, community and national incomes</li> <li>- Promoting innovation and exploration</li> </ul>	<ul style="list-style-type: none"> <li>- Promoting the wise use of national resources</li> <li>- Creating green jobs</li> <li>- Sourcing future technologies for energy efficiency</li> <li>- Providing additional sources of investment and expertise for environmental protection.</li> </ul>	<ul style="list-style-type: none"> <li>- Promoting the power of individual agency</li> <li>- Enlarging the capabilities and experience of the most excluded – women, minorities, the disabled.</li> <li>- Increasing opportunities for activism among the unrepresented</li> <li>- Reinforcing the link between learning, human capital and human wellbeing.</li> </ul>

### Direct benefits of a flourishing private sector include:

- **Wealth creation via profit and employment:** private sector development generates wealth for business owners and creates jobs. Consequently, the private sector increases income levels for households, including those on low incomes. Through it, individuals gain more skills and have more income at their disposal than without it, and can secure a better standard of living, contributing to benefits for their families and wider communities.<sup>14</sup> With a public sector unable to expand to accommodate the estimated 36,000 young people<sup>15</sup> entering the workforce each year, the private sector is Kosovo's best hope for creating decent work on a wide scale;
- **Enterprise stimulation amongst excluded communities:** a growing private sector can create more

opportunities for business activities among the poor (which in many developing countries include largely informal and unregulated activities between small scale providers, farmers and the self-employed). This links impoverished and excluded communities to mainstream markets, creating new spaces for growth and potential for greater productivity and returns on goods sold. It also adds significantly to human dignity in some of the most rights-deprived segments of society, when communities become able to organize, finance and manage their own businesses, spreading the example of possibility and the benefits of employment throughout their communities. With most unemployment in Kosovo long-term, and such a high prevalence of dependence on remittances and subsistence farming, enterprise stimulation could be central to poverty reduction – particularly for those living on or close to the poverty line;

- **Competition impacting price and quality for goods and services:** the natural competition of a free market economy can, in a well-regulated system, drive down prices or push up quality in order to attract customers. For the poorest people, this can mean cheaper goods and services in their communities as well as a greater range of choice. The freedom to expand choices is a fundamental pillar of human development, and, in the context of a strengthening public sector, private businesses also have a role in expanding choice around such essentials as health, water and education services, with the potential to improve living standards.<sup>16</sup>

This is a particularly sensitive issue in Kosovo, where health care is privately delivered without any client oriented insurance coverage available to reduce financial shocks when poor households encounter large out-of-pocket health care costs. Should such a system be introduced, experience elsewhere has shown that users are empowered to demand higher quality services and accountability from their health care providers;

- **Innovation for social technologies and the environment:** the quest for profit drives businesses to invest in a wide range of products and in novel markets. Such self-generated investment and exploration is usually the primary source of innovation within national socio-economies. Private sector innovations can not only strengthen the foundation of the economy, but also transform rights-based approaches to governance.

In development and transition contexts, the private sector is also key to sourcing and adapting new technologies developed elsewhere to the local context, and using them in partnership with the public sector to promote governance efficiency. In other contexts, such innovation based partnerships have alleviated disease, opened the door to education and knowledge development among remote or excluded populations, devised solutions to problems of pollution and environmental degradation and afforded governments with new techniques for gathering and managing essential population data. In Kosovo, the private sector has a unique capacity to lead the adoption and integration of new technologies into communities, with the potential to foster stronger inter-social linkages in a historically fractured society;

- **Corporate Social Responsibility:** the alignment between social and commercial interests is increasingly applied in the private sector as a means to increase the contribution to sustainable development and poverty alleviation. As companies develop they attract attention, not just for the economic value they bring, but also for the environmental and social value they add. Corporate Social Responsibility (CSR) captures the values, issues and processes that companies must address to minimize any harm from their activities and to create economic, social and environmental value. Private sector managers are also increasingly paying attention to CSR as it may directly affect —

both in the short and long term — a company’s reputation and, in turn, company profits. Companies committed to CSR review both positive and negative impacts of their business activities and incorporate social (i.e. core labour standards), environmental (i.e. sustainable management of natural resources such as forestry, fishery, and mineral reserves) health and safety, and corruption issues into their corporate commitments.<sup>17</sup>

CSR also encourages feedback between businesses and the communities in which they operate – promoting a positive cycle of development benefits on the ground and a socially responsible business culture.<sup>18</sup>

CSR is in its infancy in Kosovo, which still has a large reliance on aid provision, dulling the innate will of inhabitants to support their own societies. The lack of significant medium scale enterprises also challenges small businesses to approach CSR systematically, looking beyond their immediate family or group. However, if Kosovo moves to reinvigorate its enterprises, particularly building upon the strong wealth of mineral resources in Kosovo, CSR should and could play a major role for its future business environment;

**Indirect benefits of a flourishing private sector include:**

- **Revenue redistribution capacity:** the private sector is a prime source of revenue redistribution towards greater inclusion and equality. Through taxation, it generates revenues to fund essential public expenditures for essential services and social protection.

- **“Virtuous cycle” improvements in education systems:** the prospect of merit-based, skilled decent work strengthens social commitment to education. While not all decent work is provided within the private sector, it nonetheless offers more fluid, flexible and often rewarding incentives for the most skilled labour force entrants. In a growing society, young people who are qualified academically and vocationally should be in a position to choose between public and private employment opportunities. Since there is a direct correlation between increased education and level of income, greater participation in education in turn leads to better living standards and human development.<sup>19</sup>

Kosovan students are currently deeply discouraged about their job prospects, and the degree to which schools are preparing them for the working world beyond the already oversubscribed public sector. A thriving private sector would be an extraordinary impetus to improve quality and relevance in secondary and higher education;

- **Public-Private Partnerships:** where government revenues and reach are limited, the private sector has a role to play in partnering for the enhanced efficiency of essential services and other public goods (such as monitoring and evaluation to promote rights-based governance). The private sector often provides transportation, communication, information technology, human resource support and other services to strengthen the administration of service delivery locally

and nationally. In this way, the private sector supports both the performance of government and the effort to build human capital through better health, social protection and education services. Private sector participation in secondary and higher education is particularly visible at a community level. It has increased during the last two decades, and now serves a sizeable share of the target market in Kosovo where private universities are seen as the most viable route to a valuable degree. Kosovo is also exploring how the private sector might help to bridge the development data gaps, using privately managed information technology to gather and analyse critical population statistics;

- ***Strengthened social cohesion: the*** private sector has a unique fluidity, which brings people from different ethnicities, religions and genders together in daily interactions directed by their own interests. In an enclaved society such as Kosovo, there is considerable potential for people to manage through enterprise what they cannot through politics – a peaceful and mutually prosperous coexistence. The presence of women, the disabled and multi-ethnic groups in private companies serves as a barometer for social inclusion. While public sector employment may be obliged to fill quotas for disadvantaged and excluded groups, private enterprise has no such constraint. Many women in Kosovo, for example, still see private enterprise as a fragile and “improper” line of work – seeking public sector employment or none

at all. This reflects, to some degree, the position of women in Kosovo’s poorer communities, where it is not seen as appropriate for women to compete with men in business on a private basis. Greater gender equality in private enterprise can thus be seen as both a means and an end to establishing gender equality in society;

Despite the positive contributions mentioned above, many developing and transitioning countries are unable to grasp to a full extent the benefits of a well developed and flourishing private sector. There are many potential pitfalls for an effective, responsible private sector in transitioning contexts such as Kosovo. These include:

- ***Weak regulatory and operating environment:*** developing contexts often lack the proper foundations for private sector activity. These include a lack of a transparent and systematically enforced legislative framework for commercial, customs, property and contract law. Predictable rules with fair administration and enforcement, coupled with efficient dispute resolution mechanisms, are essential for entrepreneurs to engage in the long-term arrangements that enable them to invest and scale up, innovate and diffuse their knowledge and benefits. Unfair rules, corruption, arbitrary enforcement and other onerous requirements and inefficient practices hamper private activity and circumscribe private enterprise. In addition, private enterprise requires a stable policy and institutional environment that establishes and maintains the ‘rules’ of the market, efficient

physical infrastructure (electricity, roads and telecommunications) and adequate market infrastructure and services. However, in Kosovo as in many developing contexts, the 'rules of market operation', including entry, operational and exit rules, are cumbersome, while the necessary legal and regulatory institutions function irregularly. Many developing and transitional countries have excessive procedural requirements for business registration and licensing procedures, complex labour and tax rules and inadequate bankruptcy rules, all of which create additional hurdles for private sector activity, limiting competitive access to market opportunities and increasing the cost of entry into the formal sector. Meanwhile, institutions may not be in a position to support the rules because of capacity constraints or ineffective

relationships with government and government officials leading in turn to weak, often arbitrary, enforcement and corruption. The poor are likely to be the first victims of a "lawless" and unregulated private sector, which may provide jobs but not decent work (explaining in part why such a high proportion of Kosovo's poor are employed yet still classified as poor).

**Emphasis on exclusive growth:** in environments where private enterprise is largely informal and easily dominated by powerful special interests, exclusive rather than inclusive growth (which allows a large portion of the labour force to contribute to and benefit from economic growth) is often the result. Put simply, the rich become wealthier and the poor become more isolated. An over-focus on the GDP bottom line and the promotion of macro-economic growth (particularly where a country has

## 0.1

How fair competition is linked to economic growth, increased productivity, higher investments and, most importantly, better standards of living

When a market is competitive, new firms enter it, effective ones succeed, and substandard firms fail and exit the market. Studies show that there is a strong correlation between effective competition policies and growth (OECD 2006). In a competitive market, firms have to find innovative ways to produce and distribute their products and services in order to reach their target consumers more effectively. The effect of thriving competition on human development derives from lower prices, variation in choice, and improved quality. In addition, competitive markets create employment opportunities and increase incentives for entrepreneurial initiatives. If firms achieve high competitiveness in their domestic markets, then they can also start to compete internationally, which will not only increase company profits but also the welfare of the employees and, overall, the country from which the company is from. Farmers benefit from competitive markets, and agriculture is highly important for poverty alleviation. Statistics show that 75 percent of Kosovans living in rural areas on less than 1\$ a day depend greatly on subsistence agricultural production. Competitive markets put them in a more favourable position for buying inputs, arranging transport of crops and selling their outputs, including to value-added processing (Commission on Human Development 2004).

natural resource assets such as oil or – as in the case in Kosovo – minerals) means wealth creation can miss those who need it most. Jobs are created without thought to where they are being created, who they are accessible to and whether they are effective in lifting the poor out of poverty. A macro-micro economic balance which is not aligned towards inclusive growth is far more likely where local entrepreneurs, including those with limited income, struggle with limited access to productive resources, e.g. skills and capital, which, in turn, affects their ability to scale up a business. In addition, large incumbent enterprises in developing countries frequently stifle entrepreneurial energy and initiative, taking advantage of weak institutional environments to raise anticompetitive barriers and protect their dominant positions. High associated risks, especially with micro, small and medium sized enterprises, whether real or perceived, limit the expansion of access to finance. In developing country contexts, banks face limited protection in the case of default, have high costs, and often face challenges acquiring information that they can trust, particularly as many of these countries lack effective rules for sharing credit information. These factors create increased interest rates and reduced lending volumes, setting up both price and quantity barriers to private sector access to capital – something which is a critical enabler for enterprise growth. Where formal businesses are too complex or costly to establish, an informal economy grows in its place – creating a further uneven playing field for businesses and offering limited term solutions for poverty reduction. Labour productivity tends to be much lower in the informal sector while worker rights and protections stand up poorly when compared to those in the formal sector.

Also, as a result of informality consumers are denied product guarantees and often do not have alternatives to purchasing goods of inappropriate quality and safety standards. Further, most new enterprises in developing countries are set up simply because individuals are unable to find employment in the formal sectors and decide to try their hand as an entrepreneur. Such start-up enterprises in most cases lack sufficient initial capital, business management skills and technical know-how. Therefore, such enterprises are able to advance only into fields of business that do not pose high capital (both start up and operational) and technical know-how barriers. These include for the most part low value-added and often low-quality goods or services. Because of low barriers to entry, such areas of business attract many entrants, creating a situation of permanent oversupply. Consequently, the profit margins of these enterprises in Kosovo, as well as their incomes and investment potential, remain low;

- ***Environmental implications:*** where profit is prioritized over social responsibility, private industry can drive the unsustainable use of natural resources and consequent damage to the environment, something which there have been many examples of worldwide. Kosovo already bears a heavy legacy of pollution and environmental collapse from its days at the heart of Yugoslavia's state-run heavy industry. While most of its agricultural and industrial plants now lie dormant or disused, the question of how to manage the resources for domestic energy generation and overseas trade remains. Significant brown coal reserves and lead in the Trepça mines remain for potential extraction by new, privatized ventures. Kosovo's

smaller businesses are also causing damage such as damaging forests through logging, clogging waters with waste and contributing to the ubiquitous disposal of garbage in public areas. Compliance with laws to mitigate environmental damage is seen to be costly and unenforceable – with major implications for Kosovo’s living standards in the future.

In conclusion, the role of the private sector in human development is highly important generally and particularly central to Kosovo’s unique challenges. The private sector is the main pillar for overcoming poverty by delivering growth, encouraging entrepreneurial initiatives and creating jobs and stable livelihoods. In addition, the private sector can enhance the efficiency of basic services, which empower the poor by improving the delivery of health and education systems and improving access to essential infrastructure. In a developed private sector, fair competition thrives and its effect on human development is shown through lower prices, variety of choice, easier access and improved quality of goods and services. Moreover, overcoming barriers that prevent the private sector from expanding – or that encourage it to expand in socially irresponsible directions – requires a thoughtful and complex response engaging government, businesses and communities alike.

#### **0.4 Towards a more mutually profitable partnership between the private sector and human development in Kosovo**

This report focusses on the link between private sector development and employment as a way of fostering human development in Kosovo. It approaches the goal of growth from an inclusion

perspective, believing that increased labour demands generated by private sector growth will mean a greater share of the active population can enjoy more income - the best possible stepping stone out of widespread poverty. Sole proprietorships and decent work are also explored as more than income generators. They are fundamental to human dignity, a core factor within social cohesion and linked to the knowledge, wellbeing and life opportunities of future generations.

The report is organized into four chapters. Chapter One looks at the structure of the private sector and the labour market in Kosovo, through an equity lens. Chapter Two identifies critical barriers to private sector development from the perspective of inclusive growth – exploring how structural, sectoral and socio-cultural factors affect the private sector’s ability to deliver human development benefits. Chapter Three explores how these barriers affect businesses and the communities around them. Chapter Four focuses on the private sector within Kosovo’s social context, and the potential for a more innovative, dynamic relationship between the private sector and human potential. The final chapter gives conclusions and provides policy recommendations for Kosovo’s critical years ahead.

*The expansion of GNP [is] an essential means for expanding many human options. But the character and distribution of economic growth are measured against a yardstick of improving the lives of people*

**Mahbub UI-Haq  
(Founder of the UNDP Human Development Report)**





# Marketplace Analysis Through an Equity Lens

*“The human development paradigm provides an important service in questioning the automatic link between expanding income and expanding human choices.”*

**Mahbub Ul-Haq (founder of the UNDP Human Development Report)**

## 1.1 Kosovo’s marketplace profile

Kosovo is among the last countries in Europe to transition to a market economy. The transition process began from a very difficult starting point. Kosovo has a long history of State-dominated economic and financial systems, limiting the scale, scope and experience of the private sector. During the 1990s, the economy suffered many years of poor policies, lack of domestic institutions, broken external trade and financial links, international sanctions, underinvestment and de-industrialization. After 1999, through joint efforts with the international community, significant improvements were achieved in terms of post-war reconstruction and the establishment of new institutions.

Following the end of the war, economic growth reached double digits in terms of percentage annual growth in GDP, mainly driven by international aid. However, Kosovo’s industrial back was broken. Many Socially Owned Enterprises (SOEs)<sup>20</sup> went out of business once they were exposed to hard budget constraints and competition. Others downsized, reducing their labour force and shedding redundant labour to reach an economically efficient size. Since 2005, the Kosovo’s

growth rates, though steady, became more sluggish, averaging about four percent annual growth in the second half of the decade.<sup>21</sup>

This growth rate was to a large extent driven by consumption and public expenditure fuelled by foreign aid (especially in the first few years after the war) and remittances. Meanwhile, investments, despite continuously increasing, are considered as insufficient to boost domestic production. This growth pattern has been unable to fulfil Kosovo’s development needs and failed to translate into better living standards for citizens given that neither unemployment nor poverty have decreased.<sup>22</sup>

Presently, Kosovo’s GDP stands at approximately 4.7 billion EUR. The per capita income is slightly more than 2,000 EUR (IMF 2011); half of that of Bosnia and Herzegovina, about a third of that of FYR of Macedonia and Albania and about a quarter of that of Serbia. The impact on the Kosovo economy of the global financial and economic crises of the late 2000s and early 2010s was relatively low, reflecting the limited level of integration into the larger regional, European and international economy. The crises were felt mildly, through decreased exports,<sup>23</sup> foreign investments and remittances, while other countries in the region were much more significantly affected. Nevertheless, Kosovo needs to signi-

*The major concern of Kosovo's economy continues to be reliance on unsustainable sources of growth.*

ificantly accelerate its growth if it is to reach regional income levels. According to World Bank estimates in 2010, Kosovo's economy would need to grow at 10percent annually for a decade to reach Albania's income level (assuming Albania's economy continues to grow by 5.5 percent annually during this period). Similarly, to reach Montenegro's current GDP per capita level of 5700 EUR, Kosovo's economy would have to grow at 12percent annually an entire decade.

Inflation, which was kept under control for a long period, has recently jumped back to as high as 8 percent,<sup>24</sup> fuelled by increases in the prices of food and energy, both of which are heavily reliant on imports. Kosovo's external trade balance continues to be significantly negative, with the current account deficit reaching more than 15 percent of GDP, even after large inflows of remittances (which account for about 12 percent of Kosovo's GDP) and foreign assistance (9 percent). Import taxes still account for a disproportionate amount of Kosovo's GDP. The total value of exports of goods cover only about 14 percent of the value of goods imported. According to Kosovo Customs, the total value of goods exported in 2010 was approximately 293 million EUR, 90 percent of which was recorded with EU trade markets. Meanwhile, Kosovo's approximate 2.14 billion EUR of imports originated mostly in Macedonian, Serbian and German trade markets.

Kosovo has exhibited some good progress in establishing and strengthening the capacities of its marketplace institutions and its tax administration and customs authorities in particular now both have reasonable systems in place. Tax burdens for companies are relatively modest, a generally good legal framework has been adopted (albeit with insufficient monitoring and oversight

in implementation), and a relatively dynamic banking sector has been established. Political systems are also generally favourable to private enterprise and at the political level, Freedom House (a U.S. based NGO that conducts research and advocacy on democracy, political freedom and human rights) assesses Kosovo as partly free, ranking it alongside most of the other countries in the region. Similarly, Kosovo ranks close to its neighbours in terms of institutional development and governance, and is given a similar ranking based upon World Bank governance indicators.<sup>25</sup>

However, a number of other serious problems remain which have been inadequately addressed and continue to constrain growth and job creation. In terms of business environment, the World Bank (2011) ranks Kosovo as 119<sup>th</sup> out of 183 countries, a level that is unfavourable and represents an impediment for local businesses and discourages foreign investors. Low levels of job creation and lack of opportunities widen the income gap between the rich and the poor, and unemployment levels are high, especially among the youth, compared to the levels in the region. Though broadly stable, reported unemployment in Kosovo remains at an exceptionally high level (according to Labour Force Survey (LFS) 2009 an estimated 45.4 percent in 2009, down marginally from 45 percent in 2006, with youth unemployment at 73 percent). While actual employment is likely to be higher than official records (due to Kosovo's large informal economy), these figures are still alarmingly high.

In general, a major concern for the economy of Kosovo remains reliance on unsustainable sources of growth: *inter alia*, foreign development aid, importation of goods to sell to a large and wealthy expatriate aid community,

remittances from abroad and governance expenditure. Black market enterprise also plays a role in generating income in Kosovo – although there is little data on its proportionate impact. There has been, to date, over-emphasis on exploiting natural resources (such as mineral reserves) and international trade opportunities, and insufficient emphasis on developing human capital and human capacities to build a balanced, socially-integrated private sector.

## 1.2 Labour market profile: access and exclusion trends

The quality of labour market data in post-conflict Kosovo is limited, due partly to lack of census data and a reliable sampling frame. However, despite discrepancies in exact figures found in data from different sources at different times, they uniformly present a very bleak picture of the Kosovan labour market. This section draws on secondary data from different agencies and from enterprise surveys conducted previously in order to provide an overview of this labour market. Quantitative measures of employment and unemployment and labour force participation will also be discussed, along with the demographic and socioeconomic characteristics of different categories of the labour market (including non-participants where possible), and the 'quality' dimensions of employment in terms of working conditions and social protection. Finally, this section will also highlight any gender, ethnic and other issues which are underlying any of the labour market access and inclusion concerns which are discussed.

The two most comprehensive sources of employment data in Kosovo are the Labour Force Surveys (LFS) conducted by the Kosovo Agency of Statistics (KAS) and the Annual Reports on Labour and Employment produced by the Ministry of Labour and Social Welfare (MLSW). LFS data are arguably more reliable because they incorporate unregistered as well as registered employment (this is not the case in the Labour and Employment Report, MLSW 2010, which only takes account of those registered as employed)<sup>26</sup>.

The data suggest that Kosovo's *unemployment rate for men and women* in the recent years has fluctuated around an alarming 40-50 percent. This is many times higher than any conceivable figure in a developed economy, but also substantially higher than those in the transition economies of south-east Europe (SEE). The highest unemployment rates recorded in other countries in the region in 2009 were FYR of Macedonia, 34 percent; Bosnia and Herzegovina, 23 percent; and Montenegro, 17 percent.<sup>27</sup> Disaggregation of the data by gender reveals that women in Kosovo are more likely to be unemployed: the level among women is 57 percent – 16 percentage points higher than the figure recorded for men.

*Most of the job vacancies require work experience, which most of us do not have. It is also difficult to get positions as interns that could help us get jobs eventually.*

**Focus Group with Youth**

	Unemployment rate (percent)	Participation rate (percent)	Employment ratio (percent)
All	45	48	26
Female	57	29	12
Male	41	67	40

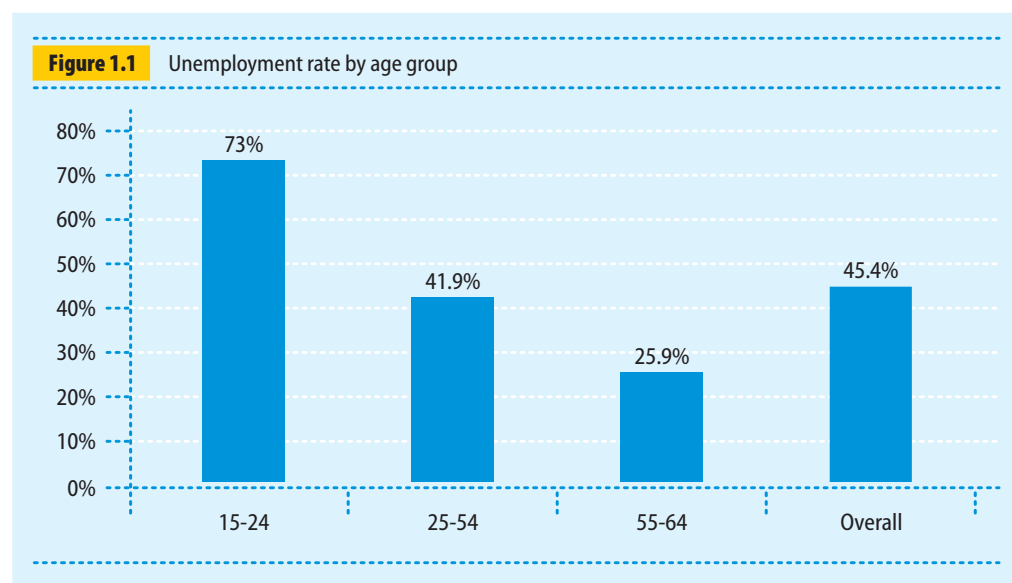
Adapted by authors, based on data of KAS 2009

Kosovo's labour force participation rate by gender is equally as discouraging as the unemployment rate data. Low labour force participation implies a degree of disaffection with the labour market's potential. Many of those excluded from the labour force are willing and able to work, but have simply given up searching for a job.<sup>28</sup>

Kosovo's employment gender gap widens further if labour force participation rates are taken into account. Participation among males is more than double that for females (67 and 29 percent, respectively), compared to an EU average for female labour force

participation of 64 percent). Out of every ten women of working age, less than three participate in the labour market.<sup>29</sup> All things considered, the employment ratio for males in Kosovo is more than triple the level among females (40 and 12 percent, respectively) and overall, only one in four working-age individuals in Kosovo is employed.

**Employment outcomes by age** appear to differ substantially. According to KAS (2009), the unemployment rate is especially high among the youth (i.e., aged 15–24 years), at 73 percent, decreasing to 42 percent for the age group 25–54 years and 26 percent for the 55–64 age group (see Figure 1.1). However, KAS (2009, p. 24) notes that the more favourable figure for the 55–64 age group is likely to be merely due to individuals dropping out of the workforce either due to early retirement or because they are discouraged.



KAS 2009

All Roma have difficulties in finding a job. Just the fact of being Roma makes things difficult. In terms of employment in public institutions it is difficult since you need to have the right connections, which the Roma Community just does not have.

**Focus Group with RAE**

**Employment outcomes by ethnicity**

suggest that certain groups are either excluded from the labour forces or choose not to participate (self-exclusion – a combination of internal cultural value systems seeking to preserve boundaries and a perception of being unwanted by external

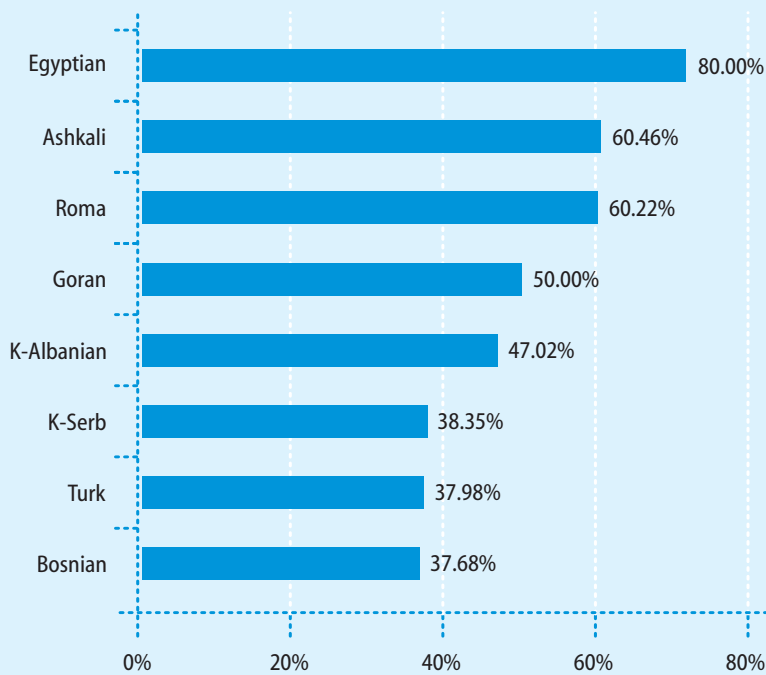
dominant powers). The young Roma, Ashkali and Egyptian is the most disadvantaged among Kosovan youth with – as shown in Figure 1.2 below – an employment ratio that is six and twelve percentage points lower than that experienced by young K-Serbs and K-Albanians, respectively.

**TABLE 1.2** Youth employment ratio by ethnicity

	Employment ratio (%)
All	28
K-Albanians	29
K-Serbs	23
RAE	17

Corbanese and Rosas 2007

**Figure 1.2** Unemployment rate by ethnicity

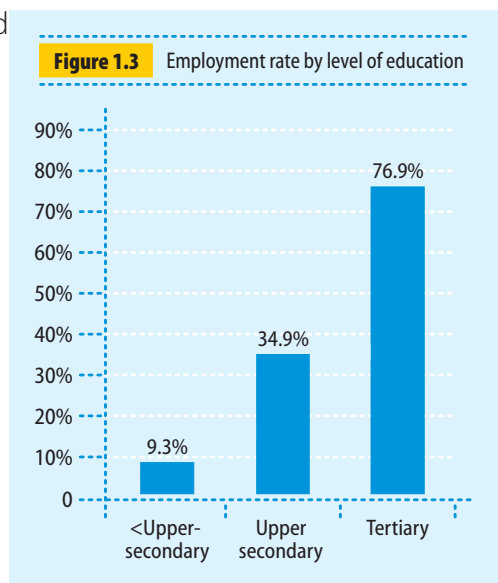


UNDP Remittances Survey 2011

Not surprisingly, far more RAE cannot find a job than any other ethnic group.

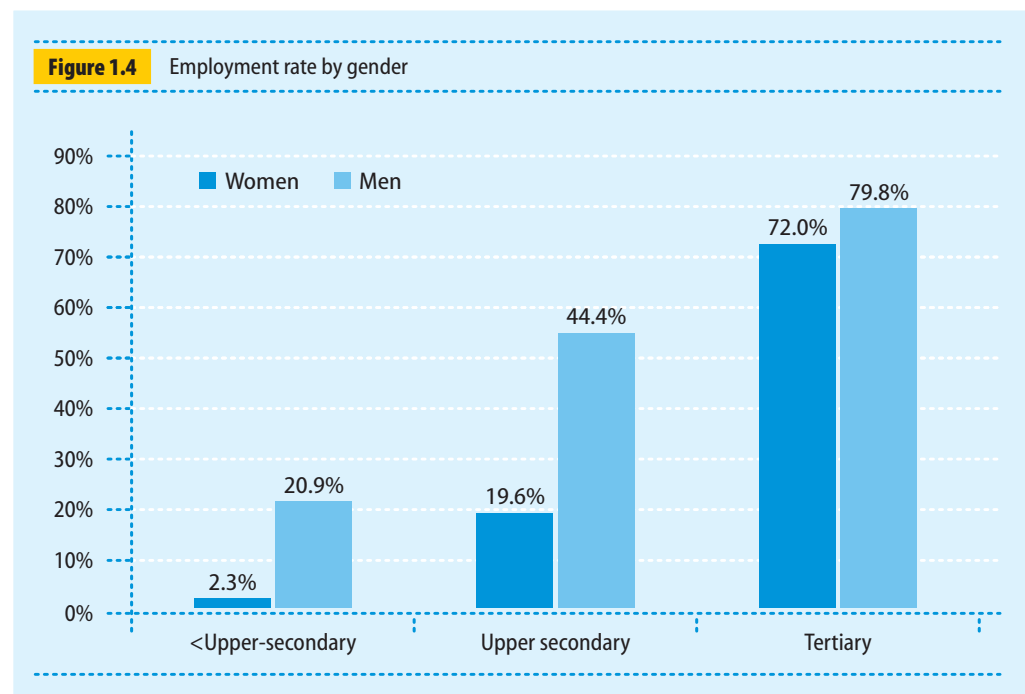
The *level of education attained* appears to be strongly related to both labour force participation and employment outcomes. Economically inactive individuals tend not to have completed upper-secondary education (73 percent have not and 24 percent have). Furthermore, more educated individuals are also more likely to be employed. As seen in Figure 1.3, those who have attained tertiary education enjoy an employment rate that is approximately 42 percentage points higher than those who have completed no more than upper-secondary education, and 66 percentage points higher than those who have not completed that level of education.

Tertiary education attainment, in particular, not only seems to be related to labour market performance, but also seems to reduce gender gaps. Figure



KAS 2009

1.4 shows clearly how a gender gap of 19–24 percentage points that is found at lower levels of education decreases to less than eight percentage points for individuals who have completed higher education. In short, women who have completed higher education participate and compete more equally with men in the labour market.



KAS 2009

## 1.3 Growth-ready sources of decent work, by sector

Where could Kosovo look, to build a demand for decent work? Job creation and, specifically, decent job creation,<sup>30</sup> has lagged far behind Kosovo's relatively stable post-conflict economic growth. In addition, while Kosovo's decision-makers and investors are fully committed to creating jobs, they have been less concerned with the type of jobs created, their accessibility to the poor, their potential to build skillsets and their working conditions and protections. A 2007 labour market survey<sup>31</sup> provides data on the qualitative dimensions of employment for young people, which may indicate conditions for the labour market as a whole. These results suggest that only a minor share of young people have decent jobs when judged against such measures as security, working conditions and labour protection conditions. The vast majority of these jobs classified as decent (96 percent) were in the public sector.

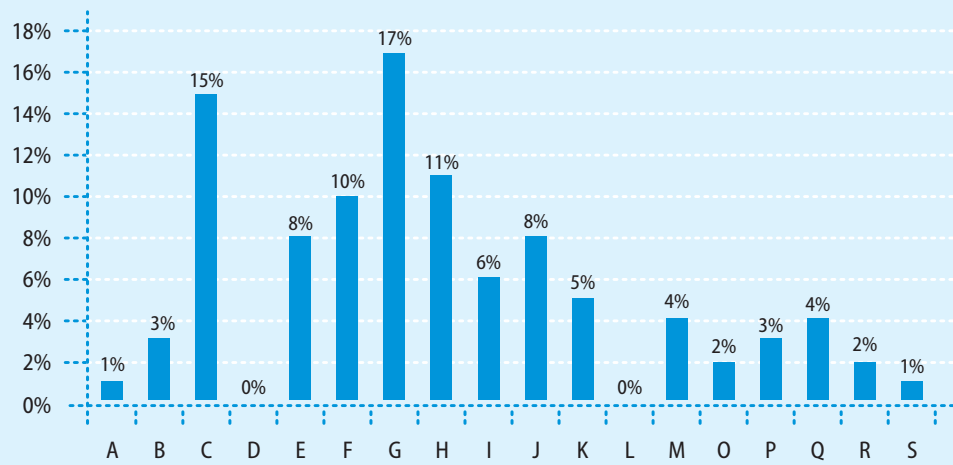
Despite the conditions of the labour market, Kosovo's population is growing fast, with an estimated 25-35 thousand young people entering the labour market each year.<sup>32</sup>

If Kosovo wishes to increase participation, access and equity in the labour force and marketplace (i.e., seeing more women, young people and ethnic minorities join the workforce and eventually gain employment) then the pressures on its existing market will only grow. With an already large and inefficient public sector, new entries in the labour market will have to be absorbed by the private sector. The private sector is thereby at the centre of the effort to stimulate growth-ready sources of decent work that promote both sustainable livelihoods and dignity.

**Employment rates by sector** in Kosovo currently show a heavy emphasis on low-skilled services such as the wholesale and retail trade/repair of motor vehicles and motorcycles (sector G - 17 percent of the private sector workforce) and the manufacturing sector (sector C - 15 percent). The sectors of accommodation (I), construction (F), water and waste management (E), and IT (I), each contribute approximately 8-10 percent of the private sector workforce, and high-skilled service sectors such as financial services (K), professional, scientific and technical activities (M), education services (O), and health services (P) each contribute approximately 4 percent.



**Figure 1.5** Contribution of different sectors to private sector employment



Employment rates by sector

High level categories within the NACE system for the classification of economic activities in the European Community.

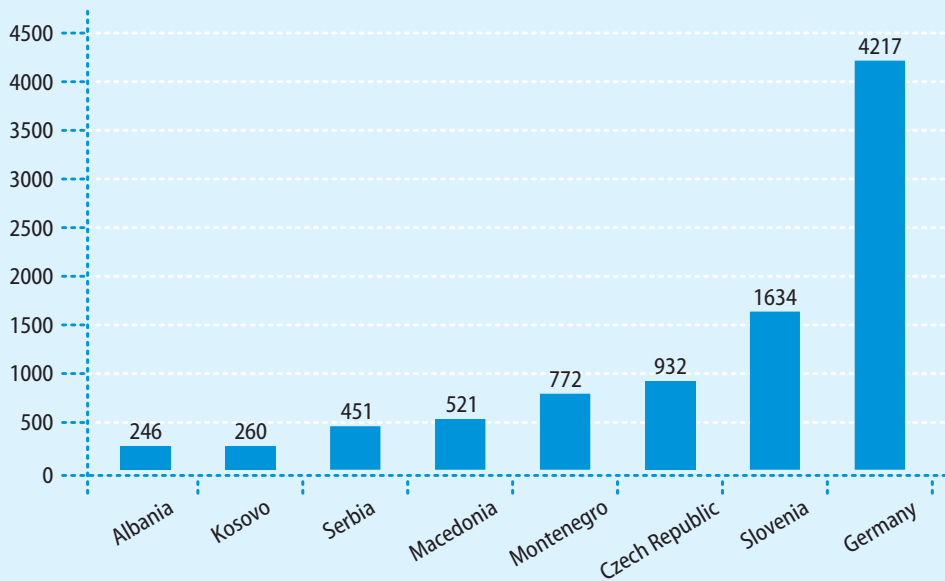
Sector	Description	Sector	Description
A	Agriculture, forestry and fishing	L	Real estate activities
B	Mining and quarrying	M	Professional, scientific and technical activities
C	Manufacturing	N	Administrative and support service activities
D	Electricity, gas, steam and air conditioning supply	O	Public admin and defence/ compulsory social security
E	Water supply, sewage, waste management and remediation activities	P	Education
F	Construction	Q	Human health and social work activities
G	Wholesale & retail trade/repair of motor vehicles and motorcycles.	R	Arts, entertainment and recreation
H	Transportation and storage	S	Other service activities
I	Accommodation and food service activities	T	Activities of households as employers/ undifferentiated goods and services producing activities of households for own use
J	Information and communication	U	Activities of extraterritorial organisations and bodies
K	Financial and insurance activities		

Kosovo Tax Administration, Kosovo Pensions Fund  
 Note: data from sectors predominantly in public ownership were excluded

With low skilled service sectors contributing the most jobs, average monthly salary in the private sector in Kosovan companies is low, at around 260 EUR.<sup>33</sup> This level is not too dissimilar to that in Albania, but considerably lower than in other countries in the region. For instance, the average salary in Kosovo

is half of that in Serbia and Former Yugoslav Republic of Macedonia, and a third of that in Montenegro. This comparison of average salary across countries in the region and other countries in Europe is illustrated in Figure 1.8 below followed by Figure 1.9 which illustrates that – as was observed

**Figure 1.6** Average monthly salaries (in euros) in Central European and Balkan countries



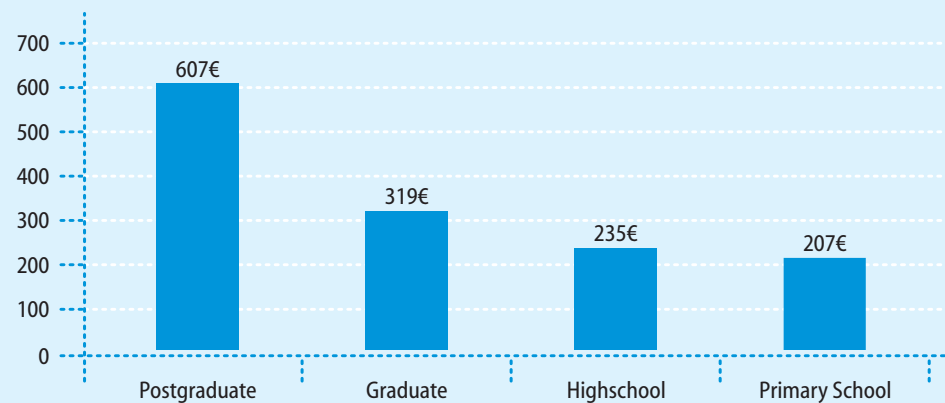
EuroStat 2010

for employment rates and level of education attained - there is a strong relationship between average salary and level of academic qualification in Kosovo. The average salary increases for those who have attained higher levels of education, particularly tertiary education.

Despite generally expanding growth in employment in Kosovo, the

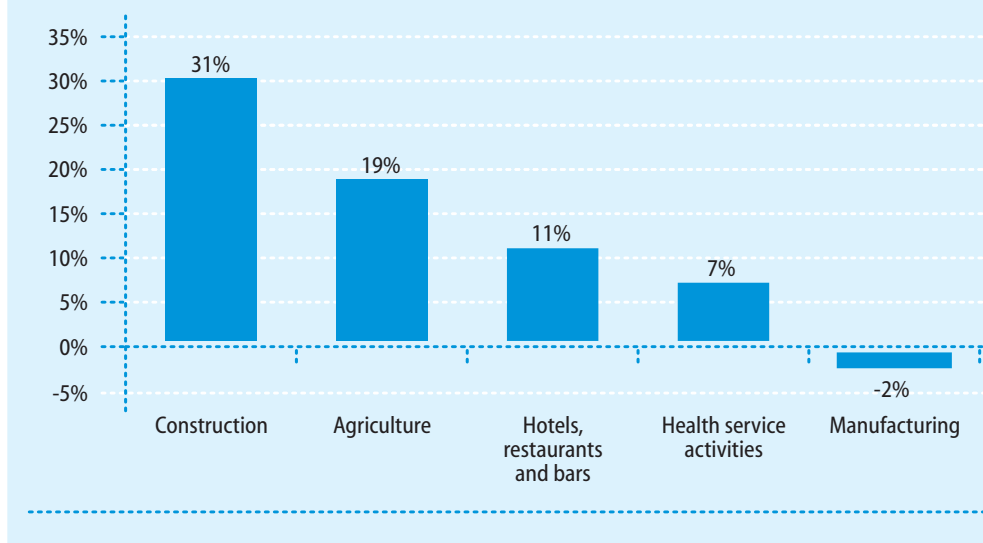
*employment growth by sector* varies significantly. In 2010, the private sector employed 12 percent more full-time workers than it did during the previous year. Sectors which contributed the most to increasing employment include construction (31 percent increase in employment), agriculture (19 percent increase) and service sectors such as hotels,

**Figure 1.7** Average salary by level of academic qualifications



Riinvest Enterprise Barriers Survey 2011

**Figure 1.8** Firms' employment growth by sector



Riinvest Enterprise Barriers Survey 2011

restaurants and bars (11 percent), and health services (7 percent). Conversely, the manufacturing sector declined during this period – seeing a 2 percent decrease in the number of full time workers employed.

The following sections will consider in further detail, a number of the sectors – illustrated in Figure 1.8 – which have seen significant growth or decline in recent years, paying particular attention to the construction, agriculture and manufacturing sectors.

The **construction** boom in Kosovo has been due mainly to large public investments in recent years and the reconstruction phase after the war of 1999. For the past three years, governmental expenditures have been concentrated on infrastructure projects — primarily for roads and schools. These constructions were distributed across Kosovo, and affected a large number of firms. Moreover, in 2010, Kosovo was engaged in a contractual agreement for the construction of a highway between

Vërmica and Merdare (72 km long) at a cost of around 25 percent of the GDP. Data from the Ministry of Finance (MoF) show that capital investments from the Government of Kosovo have increased from 154 million EUR in 2007 to 510 million EUR in 2011, thus stimulating high demand for construction firms, and hence the growth in employment in this sector. In addition, construction has been increasing due to large movements of migrants to urban areas, in particular towards Pristina, increasing the demand for apartments. According to data available from the Municipality of Pristina, for the period 2006–2010 there were 200 licensed apartment buildings built, with an average of 7 floors, and some as part of complexes of 2-4 buildings. In addition to the construction of a significant number of apartment blocks – the construction rate of individual properties has also almost tripled over the past ten years.

However, it is important to highlight that construction as a sector is prone

to boom and bust. When employment reaches the level of the poorest, it often provides insecure, low-paid and often hazardous work. Construction is also a highly male-dominated sector in Kosovo, which affords relatively few women the opportunity for full participation.

Growth in *agriculture* has been more promising, starting as it has done from an extremely low base. The agricultural sector underwent a period of dramatic decline during the 1990s – falling from 25 percent of GDP in the 1980s and early 1990s to approximately 12 percent. Subsistence farming – defined as self-sufficient farming in which farmers focus on growing enough food to meet the basic needs of their families without producing any surpluses for sale in the marketplace – has dominated in the post-conflict period. Hence, any growth in the agricultural sector results in relatively impressive percentage numbers in terms of growth in the number of people employed. However, despite a number of medium-sized agricultural firms having recently formalized their operations, the sector is considered to be highly informal in terms of employment. Part of the increase in employment seen in the sector is due to this shift from the informal to formal sector. It has been driven by considerable increases in subsidies from several international organizations operating in Kosovo, as well as from governmental funds, pushing firms in agriculture to register their workers. Nonetheless, the agriculture sector offers opportunities for a sustainable source of private sector employment with potential to increase internal trade, promote livelihoods and human dignity in poor rural areas and allow even the smallest

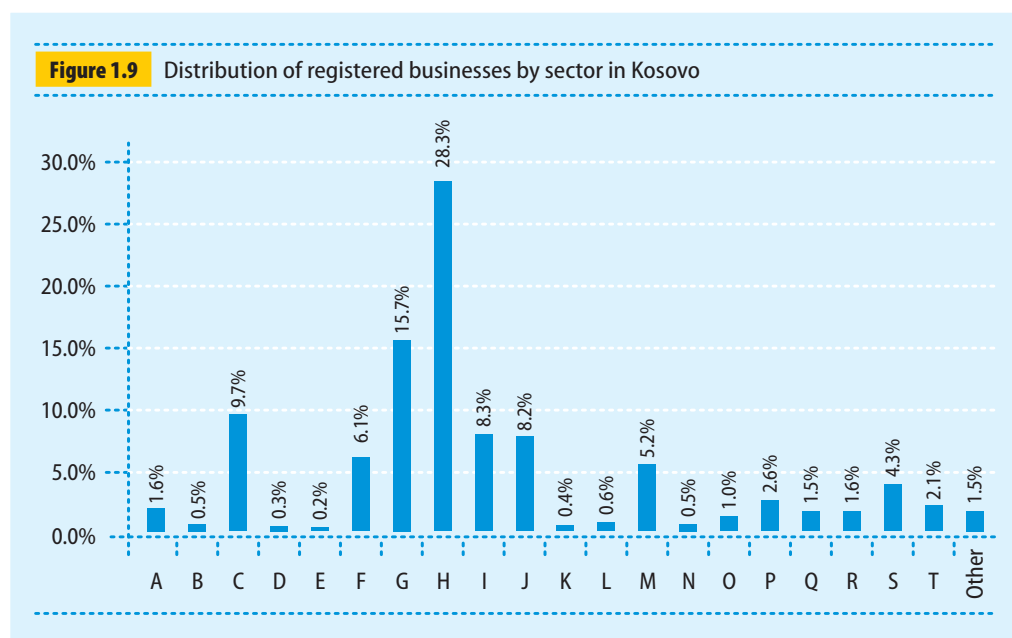
farm-holdings and rural industries to benefit from economies of scale.

A real handicap for the Kosovo economy is the fall in employment which has been seen in the *manufacturing* sector, particularly since it accounts for such a relatively large proportion of current private sector employment (as can be seen in Figure 1.8 above). Kosovan goods have often foundered when faced with regional competition. Given the substantial trade deficit, any trend that hampers Kosovo's exports is concerning. A large proportion of enterprises (greater than 86 percent in the food processing sector) report zero export activity in the last three years. Of those that do export, their activity tends not to be systematic; rather they are temporary or incidental exporters rather than having a business plan focussed on exports as a primary market. The decline in manufacturing is a prime example of an economic pattern that favours income over inclusive growth: an import-heavy economy provides government revenue sources through taxes and helps large corporations sell higher priced items to wealthy clientele, while local industry and jobs decline.

*Business distribution by sector* in Kosovo reveals a significant weighting towards the tertiary (service) sector. Using the NACE system (outlined in Figure 1.5 above) for the classification of economic activities in the European Community, to one digit level of disaggregation<sup>34</sup>, approximately 80 per-cent of businesses are classified within this tertiary sector, which accounts for two thirds of Kosovo's total GDP. In addition, approximately 2 percent of businesses are registered in the primary sector (agriculture/extraction) and 16 percent in the secondary sector (manufacturing). These sectoral

gaps might be narrowed if informal agricultural businesses were taken into account; however, the findings remain significant when compared to Figure 1.9 below. There are some interesting points to highlight from the Figure, for example, nearly one third of all businesses are registered in a service sector (transportation and storage) that provides only a tenth of Kosovo's private sector jobs. Kosovo businesses are

Unregistered business owners are thereby shut out of supportive markets and many of the informally employed excluded from protections such as pensions. This highlights the untapped potential of this market for growth and the current fragile and insecure state of this sector when it comes to providing decent, regulated and sustainable employment.



Kosovo Tax Administration (see Figure 1.5 above for sectoral descriptions)

under-represented in sectors such as the water (E), electrical (D), and mining (B) sectors. This no doubt reflects the high start-up cost involved in sectors such as mining; however, it may also reflect the difficult regulatory framework for market entry. Skilled sectors such as IT (J), and financial services (K), are also under-represented. Just 2 percent of all businesses registered in Kosovo are agricultural – even though employment growth in this area has been high (19 percent growth in the number of full time employees in the period 2009-2010, referring back to Figure 1.10). This should not indicate that Kosovo has few agricultural businesses, but that it has few *formal* agricultural businesses.

In summary, Kosovo has growth-ready sources of decent work, but they need to be supported and prioritized from a pro-people perspective. Growth projections for next year seem less impressive than this year's, with only 6 percent of firms planning to increase the number of staff. Of these, 81 percent are in need of low-skilled workers, 10 percent require technical staff and only 8 percent need staff with managerial skills. Growth in employment across all sectors needs to be matched with more enforcement of employment protection legislation, to ensure that even these few new jobs reaching the marketplace play their part in reducing poverty.

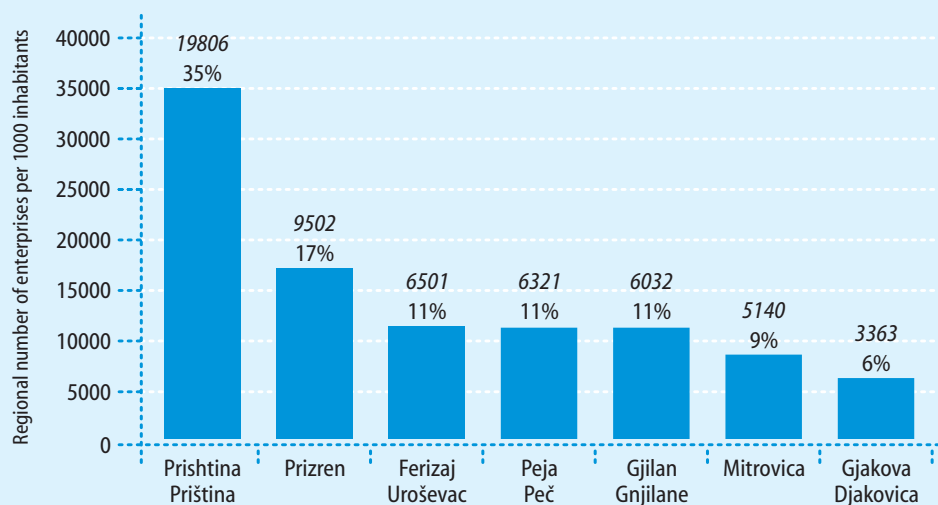
## 1.4 Creating labour demand: Kosovo's enterprise culture

Are Kosovo's private companies structured to take on challenge of inclusive expansion of the labour market? This section briefly reviews the fundamental characteristics of Kosovo businesses, looking at regional distribution of companies, size-class breakdown and enterprise life-cycles.

The *geographic profile* of Kosovo's enterprise culture is strikingly unequal, with a strong concentration of businesses in the vicinity of large towns and cities.<sup>35</sup> The overwhelming majority (more than one third) of formal enterprises operate in and around Pristina, which as the most populous city has the largest market, as well as relatively better infrastructure and other

logistical advantages. As shown in Figure 1.10 below, the second biggest concentration of enterprises is located in Prizren, followed by Ferizaj/Uroševac, Peje/Pečand Gjilan/Gnjilane, each with a similar number of enterprises. Largely, the number of enterprises follows the same pattern as the size of population, with slight over-representation of the Pristina region (KAS 2011). However, one must note that businesses are predominantly in urban areas, accentuating inter-regional differences in growth rates and development levels. On average, there are 32.3 registered enterprises per 1,000 inhabitants in Kosovo. The regions of Pristina (41.6), Gjakovë/Djakovica (35.7), Ferizaj/Uroševac(34.9) and Gjilan/Gnjilane (33.4) have higher levels than the national average, while those of Peje/Peč (29.03), Mitrovicë/Mitrovica (26.6) and Prizren (24.6) have below average number of enterprises per 1,000 inhabitants.

**Figure 1.10** Regional distribution of enterprises

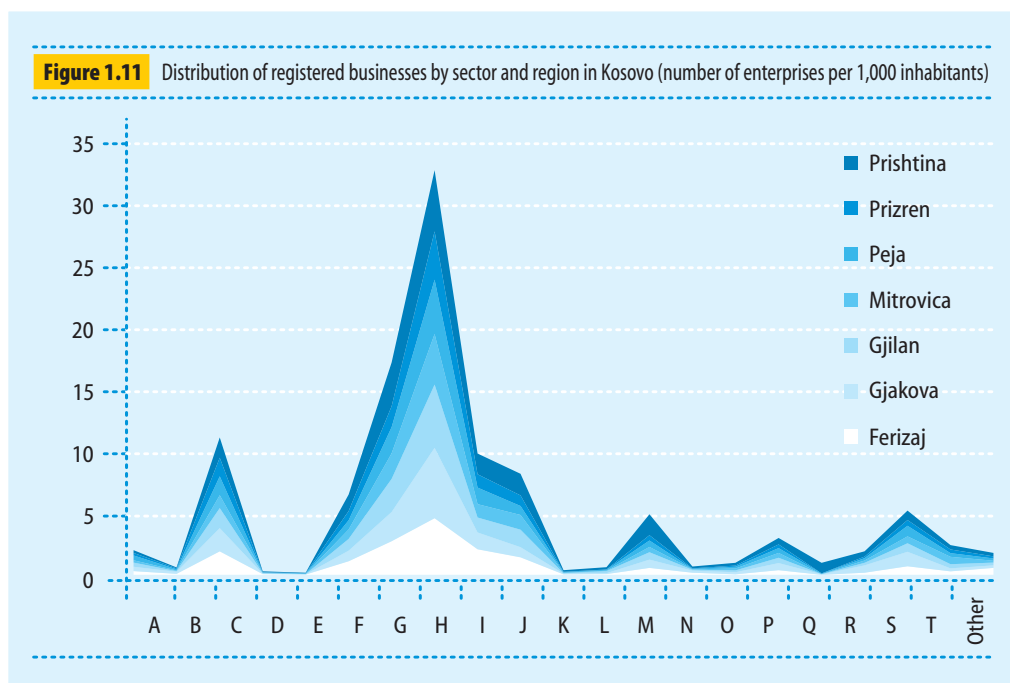


KAS; Kosovo Tax Administration

Kosovo's business distribution pattern suggests that businesses have not been able to take advantage of the potential clustering effects of having high concentrations of businesses from particular sectors in a particular location. Research argues (Bellandi 1989) that geographic concentration of business activities enhances productivity. Regional clustering has been found to be profoundly valuable for businesses, their clients and their employees. Regional business concentration can enhance economies of scale, build industry-specific skills and facilitate worker capabilities. Workers residing in close proximity are more likely to participate in joint trainings - which may in turn lead to formal education

systems teaching industry-specific skills. Accumulation of such skills fostered by the concentration of similar businesses within a particular region contributes further to the creation of a fertile business environment, which is more attractive to foreign investments.

However, the distribution of companies in Kosovo follows a similar pattern across all regions and sectors alike, suggesting that no regional clustering of companies exists, and that there is no strong region-sector relationship. Therefore, companies in Kosovo cannot (or only to a relatively limited extent) exploit the benefits of clustering.



KAS; Kosovo Tax Administration 2011

From a *size-class profile* perspective, almost all of Kosovo's businesses are micro-enterprises, with 96 percent having one to nine employees. In comparison, small enterprises constitute approximately 2 percent of Kosovo's registered businesses, the

proportion of medium enterprises is less than 1 percent, and there are only 450 large enterprises in Kosovo in total. However, despite constituting a relatively small percentage of the total number of businesses in Kosovo, the medium and large enterprises

make a much larger contribution to employment in relative terms. Although together they represent about 1.7 percent of enterprises in Kosovo, medium and large enterprises, with more than 50 employees each, contribute 33 percent of the total employment (KAS 2008).

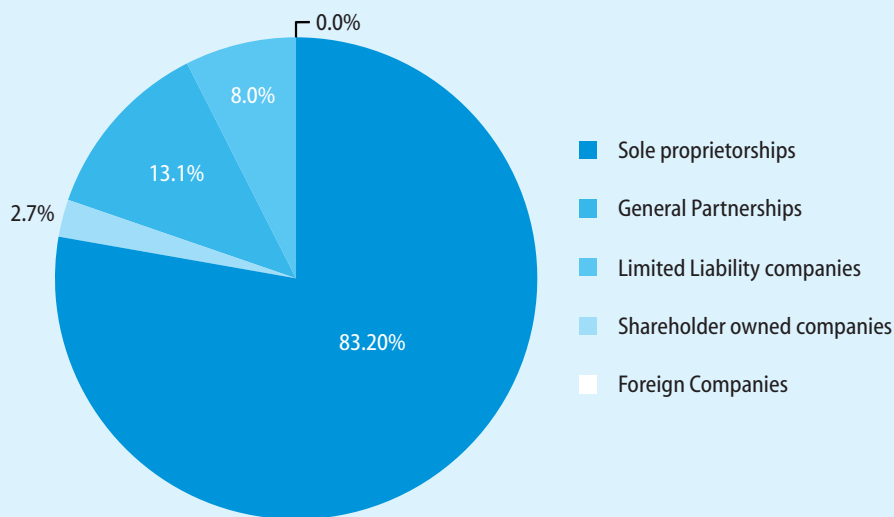
The tiny average size of businesses in Kosovo is linked to their ownership profile. More than 80 percent of enterprises in Kosovo are sole proprietorships – owned and run by one individual and in which there is no legal distinction between the owner and the business – with regular limited liability companies constituting only 13 percent of Kosovo’s total enterprises.

TABLE 1.3 Size-class breakdown of registered companies in Kosovo			
Classification by size	Number of employees	Number of enterprises	Percentage of total
Micro	1–9	54,411	96.0
Small	10–49	1,303	2.3
Medium	50–249	504	0.9
Large	> 250	448	0.8
<b>Total</b>	-	56,666	100

Kosovo Tax Administration 2009

Partnerships and fore-ign companies together account for around 3 percent of Kosovo’s busi-nesses (foreign investment in Kosovo businesses is extremely limited), with shareholder owned companies representing 8 percent.

**Figure 1.12** Breakdown of the legal form of companies registered in Kosovo



KAS, last five years (averages of Kosovo Tax Administration quarterly data) 2011

The *enterprise life-cycle* in Kosovo determines, to a great extent, a business’ capacity for growth. The entry of new businesses into sectors has been shown to stimulate competition and innovation.

In this respect, Kosovo is very paradoxical case. Statistically, Kosovo records a steady increase in the number of enterprise births: approximately 7,000 enterprises

are born each year, most of them in the tertiary sector and along the same lines as existing enterprises.<sup>36</sup> This is despite a challenging new business climate. The cost of starting a business in Kosovo (expressed as a percentage of GNI per capita) was reported at 29 percent in 2010 (World Bank Doing Business Report 2011), while Kosovo is ranked for the year 2012 in 168<sup>th</sup> position relative to



*Even if you are well qualified you will not be taken into consideration for open positions. Appearance is very important. The only way for disabled people to work is to open their own business and be self-employed.*

**Focus Group with people with disabilities**

other countries worldwide (3 places below the 2011 ranking of 165<sup>th</sup>). The main observations from the World Bank Doing Business Report relate to the presence of many transaction points, which not only increase the number of days dealing with licences and permits (and therefore operating costs), but also expose the presence of many bureaucratic procedures within public administration, most of which produce, or may be related to, corruption. These barriers tend to discourage new entrepreneurial initiatives.

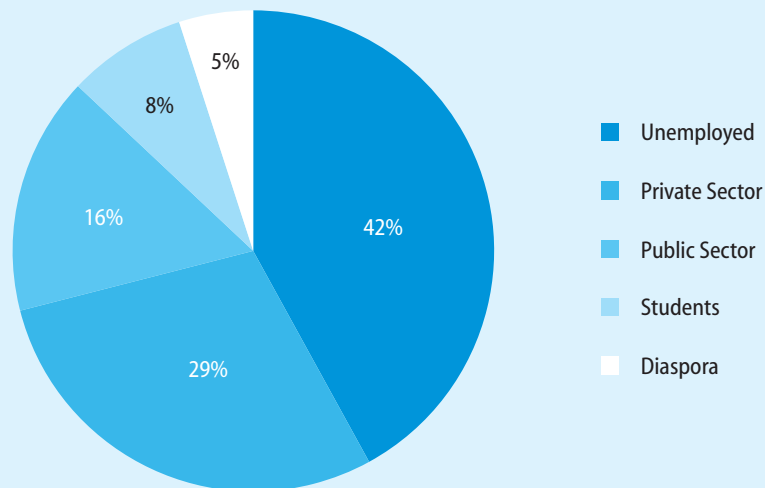
This may be one reason why Kosovo's positive entrepreneurship does not contribute significantly to either economic development or enhancing the amount of decent employment available. Another is due to the causes behind entrepreneurship in Kosovo. Most new businesses are not being opened out of choice but out of perceived necessity; according to focus group respondents, entrepreneurship is frequently viewed as the only way to escape unemployment. The implication is that people become entrepreneurs through lack of better alternatives (necessity

entrepreneurship), rather than because they have identified an unexploited or underexploited business opportunity (opportunity entrepreneurship). This is particularly true for the most vulnerable in Kosovan society - the poor, the disabled, women, youth and RAE. Acs and Varga (2005) found that, in general, the effects of necessity and opportunity entrepreneurship upon economic growth and development are very different: necessity entrepreneurship has no effect on economic development while opportunity entrepreneurship has a positive and significant effect.

Figure 1.13 below shows that the majority of entrepreneurs were unemployed before starting their businesses. Approximately 42.5 percent of responding firm owners were unemployed before starting their business, 16 percent were employed in the public sector, 29 percent in the private sector, eight percent were students, while only 4.5 percent were from the diaspora.

Comparing the number of enterprise deaths in Kosovo to the number

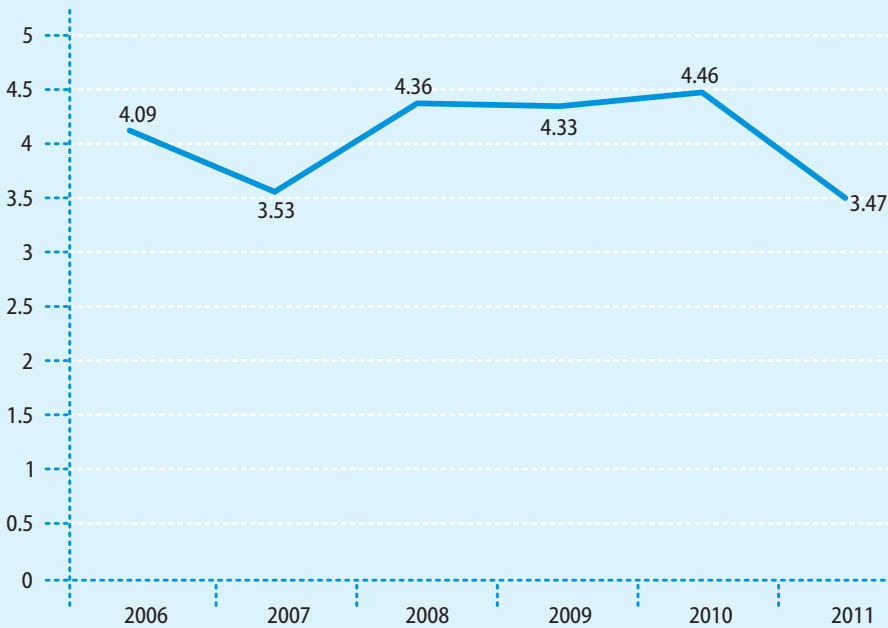
**Figure 1.13** Entrepreneur employment status before starting up their business



KAS, last five years (averages of Kosovo Tax Administration quarterly data) 2011

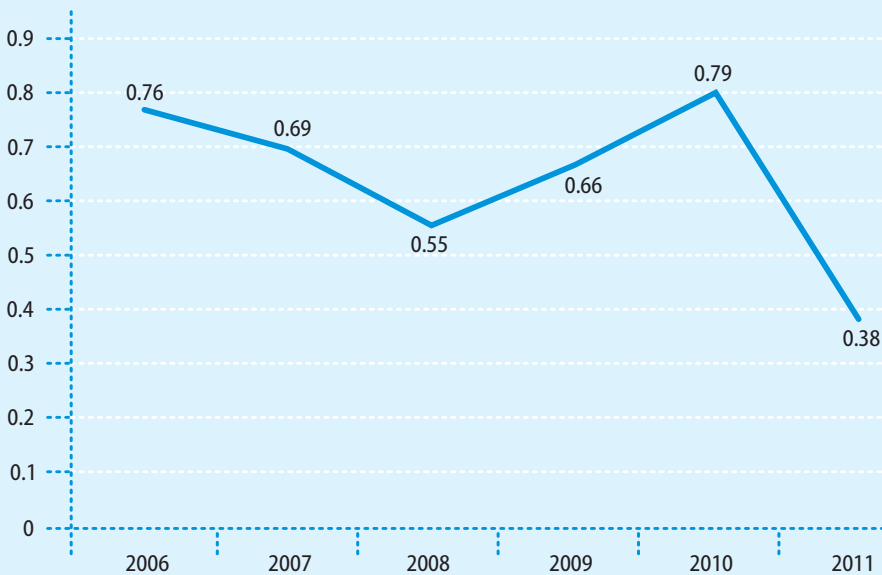
of enterprise births, the overall number might be underreported,<sup>38</sup> given that many companies go out of business without formally terminating enterprises averages around 1,200 annually.<sup>37</sup> However, this enterprise terminations by sector

**Figure 1.14** Enterprise births 2006-2010 (per 1,000 inhabitants)



Riinvest Enterprise Barriers Survey 2011

**Figure 1.15** Enterprise termination 2006-2011 (per 1,000 inhabitants)



Riinvest Enterprise Barriers Survey 2011

follows a very similar distribution to the distribution of existing registered business by sector, illustrated in Figure 1.9 above.

In summary, these findings suggest that Kosovo's enterprise culture has energy without organization. Businesses are regularly coming and going, without taking advantage of any regional or sectoral clustering. The vast majority of these businesses are likely to be individually owned and employing less than ten people. The creation of labour demand – and decent work – in such a climate requires a clearer understanding of the barriers to stability and growth which are being faced by these enterprises.

## 1.5 Marketplace and labour policy implications

*In essence, nearly three quarters of Kosovo's working age population are not currently employed.*

Kosovo aspires to a future in which it may enjoy the same rights of trade, competition and international market participation as members of the European Community. While Kosovo's sui generis status creates a range of unique barriers to international economic integration (inter alia restricting access to markets, confining business travel and discouraging Foreign Direct Investment- FDI), much can be done from within Kosovo to bring the country closer to being a thriving economy, from a human development perspective. The analysis of this chapter suggests that Kosovans would benefit as people, as enterprises and as a society, more from smart, people-focussed labour market policies than from pure macro-economic wealth creation policies. This, in turn, indicates the following policy recommendations:

- **GDP growth should be pursued within the context of labour market policies.** Kosovo has not matched its GDP growth with employment growth, creating income inequalities across society. While such inequalities are not abnormal in post-conflict contexts, they should not still be widening 13 years after the end of active hostilities. Revenue and income sources have become distorted by Kosovo's current growth pattern, its large international aid basket and external remittances coming in from the diaspora – allowing a major trade deficit to emerge and appear falsely to be sustainable. GDP growth needs to be remapped against living standards and employment creation, to contribute to a more viable economy and flourishing human capital, rather than an end in itself.
- **Participation in Kosovo's labour market should be encouraged from an exclusion perspective.** Human capital is being wasted in Kosovo on a dramatic scale. Unemployment data of 43 percent masks a shocking reality when added to the low labour force participation rate: in essence, nearly three quarters of Kosovo's working-age population are not currently employed (see *labour force participation rate*, section 1.1 above). Many of those not participating in the labour force are no longer seeking work as a result of their long-term and seemingly irreversible exclusion from the job market. Therefore, job creation alone is not the answer for them. They require special support to return to active job-seeking, particularly where cultural

and practical constraints (such as children to care for, or gender-biases) are at play. Women are the most obviously excluded from labour force participation, at rates not found across other European contexts. In addition, programmes to encourage women into the workforce will be self-defeating if decent work does not appear to be accessible. From a basic employment standpoint, the young are a clear policy priority. While young people are not often family bread-winners, a young person unemployed for a period time can be affected for life, diminishing their freedom to build a dignified life, support a family and participate in the body politic. They are more likely to leave Kosovo, drop out of the labour force or turn to informal or even illegal sources of income. From a post-conflict stabilization perspective, a large group of unemployed young people foster resentment and deepen social fractures. Kosovo cannot afford its young people to lose faith in the potential of their society.

the market, pulling in the poor and desperate. For example, this chapter suggests that while agriculture's share of GDP has been shrinking since the 1980s, its share of the employment market has not declined correspondingly (see *employment growth by sector*, in section 1.3 above). Therefore, agricultural workers are being paid out of a rapidly decreasing amount of income for the sector, and the value of work in agriculture – in terms of income, security and human dignity – is falling, increasing by definition the equality gap between agricultural and non-agricultural workers. Creating more jobs in agriculture will not create more decent work, unless ways are found to help the businesses in the sector become more profitable, more protected and more cooperative. Equally, Kosovo's services sector is characterized by large differentials in earnings and concentrated in terms of location only in a few large cities, increasing further the inter-regional differences in growth rates and development levels.

- **Labour demand will require effort to capitalize on growth-ready sectors.** Policy-makers must look beyond business creation towards sectors capable of providing intensive employment growth, such as manufacturing or agriculture, or human capital development, such as the skilled services sector. Promoting growth must also be balanced with incentives to formalize businesses, to prevent large numbers of informal, unregulated and unprotected jobs appearing on
- **An equitable Kosovan labour marketplace means a better balance between business sizes and business sectors:** Since 1999, low value-added, low barrier-to-entry service sectors have come to dominate Kosovo's enterprise climate (see *employment rates by sector*, in section 1.3 above). This is in close alignment with the predominant business size – micro (1-9 employees), and individually owned. However, in Kosovo as elsewhere, the service or tertiary sector is not generating

employment in proportion to its output growth. In Kosovo, this is particularly true. While many developed economies also have a predominant service sector, they have also usually undergone a period of industrialization that creates both the infrastructure to deliver services and the demand for them. Kosovo has not gone through this phase. Its service sector is low-skilled and already far outstrips the internal demand for services. In addition, Kosovo currently has a significant excess of consumption over production with regard to many commodities, and is therefore heavily reliant on imports. Kosovo imports a large number of goods and services from abroad, but is not currently able to export significant volumes of goods or services, nor find markets internally to create a viable macroeconomic balance. Therefore, commodity prices are already inflating (high demand, low supply), and services remain under-priced and over supplied. This suggests that to realise the direct and indirect benefits the private sector presents for human development in Kosovo, it will be essential to focus on sectors currently not over-supplied, that can create internal self-sufficiency and that have the potential to expand human capabilities – such as industry (particularly manufacturing), agriculture and the skilled service sectors. Of these, manufacturing has the greatest capacity to generate employment and sustain larger-sized, formal companies (see *employment growth by sector*, section 1.3 above).

- **Enterprise stimulation is not the primary challenge:** Decent private sector work in Kosovo, that reaps true human development benefits, does not depend merely on encouraging more self-started companies. Kosovo already has a flourishing enterprise culture (see *enterprise life-cycle*, section 1.4). However, these businesses are struggling to expand and achieve sustainability. Most are being created in the already saturated tertiary sector and in addition, it is not clear the degree to which these new businesses within Kosovo's flourishing enterprise culture are accessible to those excluded from the labour market, or how they affect the income standards, rights and dignity of the very poor. The challenge is to understand more thoroughly the context into which new businesses emerge – how they can find room to grow, how they can reach out to the poorest and how they can add dignity and social value locally and regionally. The next chapters will examine these issues in further detail.

## Barriers to Inclusive Growth

*“Governments can’t create wealth, but they can create the conditions for free enterprise to flourish”*  
**U.S. Congressman Bill Owens**

There is no automatic link between a successful market economy and tangible human development benefits. Forging this link is a joint responsibility of governments and private sector participants. Governments are responsible for setting the institutional, legal and regulatory frameworks that allow businesses to thrive within a socially responsible context. Private sector participants must use their own initiative as to how they use their resources (such as property, human capital and financial capital), and how they approach their contractual relationships and obligations. Finally, the two must cooperate to produce an environment in which there is both transparent compliance on one side and fair, systematic enforcement on the other – a healthy partnership. This chapter examines Kosovo’s business environment from a cooperative perspective, while the next looks at its impact on a pro-people marketplace.

In June 2011, Riinvest (a Kosovan non-profit research institute with a mission to promote modern economic development in Kosovo based on a philosophy of entrepreneurship) conducted a survey of 600 respondents to obtain a general picture of critical barriers to private sector development.

*There is no automatic link between a successful market economy and tangible human development benefits*

To complement and strengthen this survey, a round-table discussion was organized with Kosovan entrepreneurs from various sectors and interviews were held with business associations (Kosovo Chamber of Commerce - KCC, Alliance of Kosovan Businesses - AKB; and American Chamber of Commerce ACC). The results from the primary data which has been obtained provide perceptions on the primary institutional and cultural barriers to private sector entry and growth in Kosovo.

This perception data is critical – even where it, on occasion, may differ from other sources of reporting. It outlines the world in which business owners feel they operate, the environment that guides their practices and informs their willingness to comply with their broader obligations. It also indicates where there may be bias and self-limitation even within current businesses, highlighting where current private sector direction and human development strategies for Kosovo may be at odds.

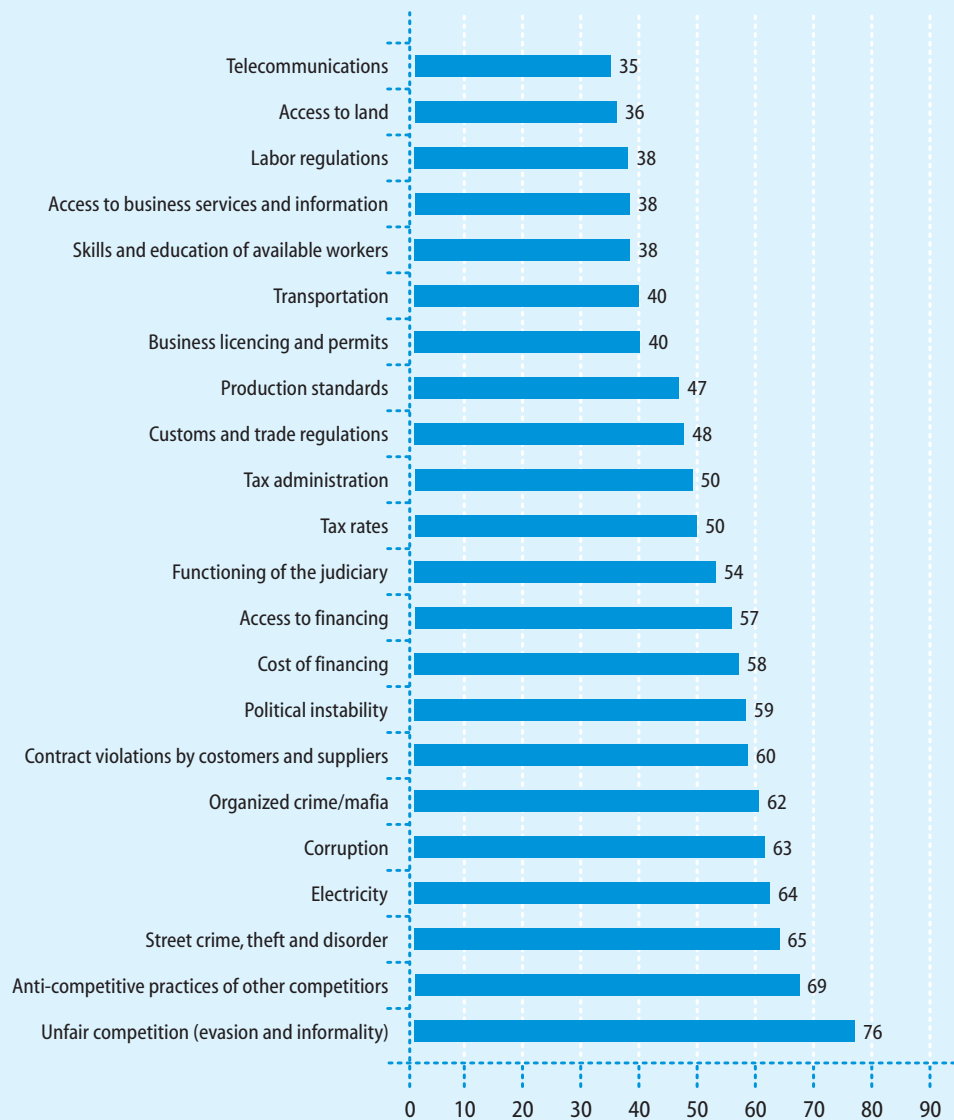
## 2.1 Business barriers ranked by intensity

In order to identify the main barriers that affect the work of businesses in Kosovo 22 categories of barriers (as classified in Business Environment and Enterprise Performance Surveys, BEEPS<sup>39</sup>) were listed and businesses were asked to rate each barrier in terms of intensity.<sup>40</sup> Rating of barriers ranged from one (low intensity) to five (high intensity). With this assessment system, scores

for each barrier can range from a minimum of 20 up to a maximum of 100.

According to Figure 2.1, an unequal enterprise culture is a greater hindrance to Kosovo's private sector than regulatory frameworks. Four of the top five barriers relate to the reality of the Kosovo environment: weak enforcement, unfair business practices, crime and corruption.

**Figure 2.1** Perceived intensity of business Barriers in Kosovo



Riinvest Enterprise Barriers Survey 2011

## 2.2 Viewing business barriers through a development lens

In the following sections, the barriers and obstacles identified in Figure 2.1 above are clustered around five principal themes: enterprise culture barriers, operational barriers, infrastructural barriers, regulatory barriers, and internal skill barriers. Each of these thematic areas is then discussed in further detail.

**Enterprise culture barriers** top the list of perceived private sector constraints, indicating a major challenge for Kosovo's social cohesion. Barriers related to inequity, whether perceived or real, are particularly damaging to private sector - human development interactions. Unfair, unsafe and unpredictable business environments undermine trust in the body politic and in the equity of governance. In a climate where special interests are seen to dominate, people are forced back on traditional allegiances to family, clan or ethnicity – rather than urged towards inter-cooperation. Unequal business practices and enforcement are perceived – often rightly – as an effort to redistribute public revenues towards preferred members of society. In Kosovo's case, this frequently comes down to issues of unsystematic and weak enforcement rather than unfair laws *per se*.

Inequality in business has several profound human development costs, particularly affecting Kosovo's most vulnerable communities. First, an unequal business environment encourages inefficient firms to remain in the market by operating with below-average costs compared with a compliant business – often targeting low-income families with inferior goods while forcing general market prices to stay high. Second, many firms operating informally will tend to stay small and “under the radar”, thus missing opportunities from

formal markets such as bank loans (see **operational barriers**). Third, such companies become effectively invisible with regards to independent monitoring of worker protections, reducing the relevance of labour and wage laws across the entire marketplace. Fourth, Kosovan firms tend to compensate for an unfair position vis-à-vis institutions by noncompliance with regulations – for example on taxation, having a dramatic effect on public revenues and revenue redistribution. Finally, in a context of weak and inefficient institutions, such noncompliance with regulations and other unfair behaviour tends to have peer-to-peer effects on other business, risking the possibility of creating the general social norm of unfair behaviour. Practices of this kind are likely to mean that the Kosovan economy has higher barriers to entry for businesses into the marketplace, fewer decent jobs, less competition and higher prices.

Mistrust of governance and enforcement is also reflected in the high “barrier” rankings given to crime and political instability. Perceptions are at play here; Kosovo has a relatively stable political climate and crime rates no higher than many developed countries. However, the uncertainty caused by Kosovo's status dispute, the confusing (to average businessmen) bundle of legislation being driven through to ensure compliance with EU standards, and a sense of being isolated and “on your own” when it comes to premises security and dispute resolution all have an impact on the cost of doing business. Business owners appear prone to fearing unpredictable policy and regulatory changes, as well as discretionary interpretation and enforcement of laws by officials – including harassment associated with corruption and extortion. All of these factors drain capital, drain trust, and reduce competitiveness. In this climate, business owners are less likely to take risks, ensure employee protections, invest in public goods (or being aware of their Corporate Social Responsibility – CSR

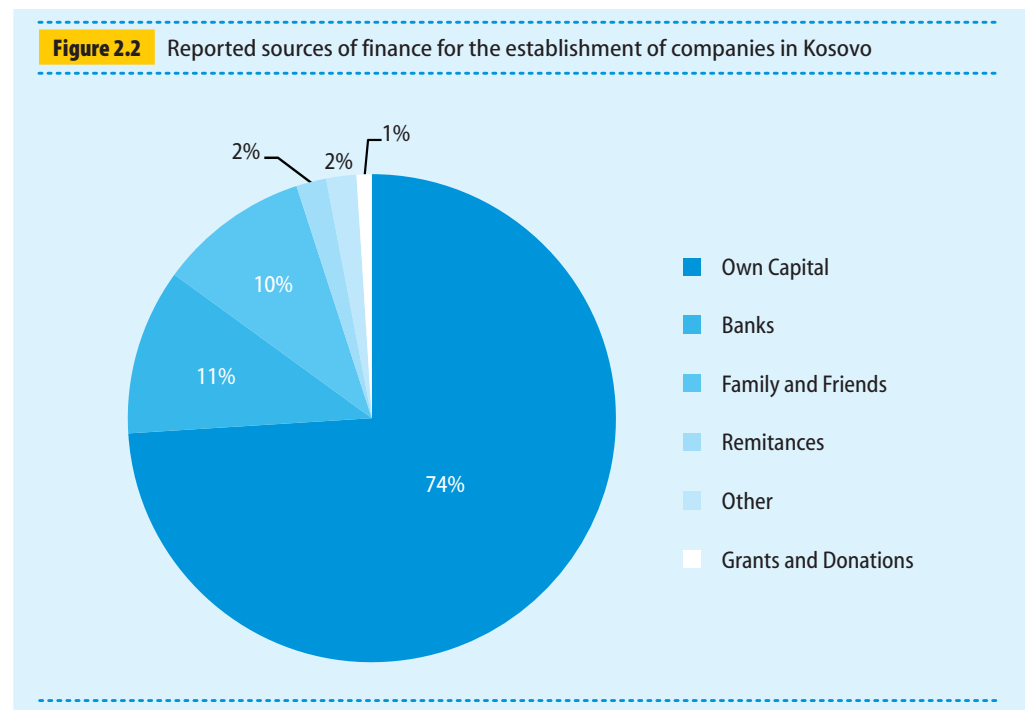


*Inequality in business has several profound human development costs, particularly affecting Kosovo's most vulnerable communities*

- more generally), use fair hiring practices to recruit new employees, or produce other benefits of healthy private-public interactions.

**Operational barriers** - including access to financing – ranked moderately in terms of their negative impact on business. However, further analysis suggests that access to finance challenges are particularly prominent for two of the parties most in need of support – medium enterprises looking to grow and the capital-poor enterprises seeking start-up costs, particularly in rural areas. Surveys conducted for this analysis show that in 2010, less than one in three firms which applied were successful in obtaining a loan from a bank. These results show that, of these companies which applied for bank loan financing, medium sized companies had the highest rejection rate. A breakdown of the access to finance data by sector reveals that only 1 percent of the primary sector (agriculture and extraction) had access to loans (underlining the great vulnerability and informality of the agriculture sector), 18 percent of the

secondary sector (manufacturing) and around 81 percent of the tertiary sector (services). Building on this analysis of access to bank loan financing, the survey conducted obtained data on how Kosovan companies financed their establishment. As illustrated in Figure 2.2 below, the data revealed that Kosovo firms tend to rely heavily on retained earnings and their own funds, with 74 percent of firms reliant on this kind of financing for their establishment. In comparison, the number of firms which reported reliance on bank lending to finance their establishment was very low (around 11 percent). The data further suggest that an information gap on working adequately with banks is constraining the poorest businesses from accessing finance. Only a relatively small number of firms (approximately 44 percent of the companies surveyed) reported that they circulate their sales through the banking system.<sup>41</sup> A higher awareness of the importance of working with banks will facilitate increased access to financing, while improving financial reporting would also increase the banks' trust towards businesses.



Riinvest Enterprise Barriers Survey 2011

The financial sector in Kosovo covers the banking industry, insurance industry, pension funds and other financial institutions such as micro-credit schemes. The banking sector has developed successfully and is seen by many as a success story (EU Progress Report on Kosovo 2011). The value of banking sector assets and liabilities in Kosovo in September 2011 was 2.63 billion EUR, equivalent to approximately 48 percent of Kosovo's GDP. Since the end of 2000, when the first bank was established after the conflict, the value of total banking sector assets has increased by approximately 26-fold. This rather impressive exponential increase heavily underlies the strong establishment of one of the most important sectors in Kosovo. The sector is characterized by a large presence of foreign capital (89 percent of total assets) with the majority of Kosovo's banks either completely or majority capitalised by foreign capital.

The presence of foreign financial institutions in Kosovo has contributed towards the modernization of the financial system by bringing more advanced financial practices to the management of banking operations. The Kosovo banking sector remains highly concentrated with the market share of the three largest banks accounting for approximately 74 percent of total banking sector assets, 74 percent of deposits and 72 percent of loans as of the end of September 2011. Such a landscape, with a high concentration among a small number of large players within the market, acts to seriously limit possibilities for competition within the banking sector.

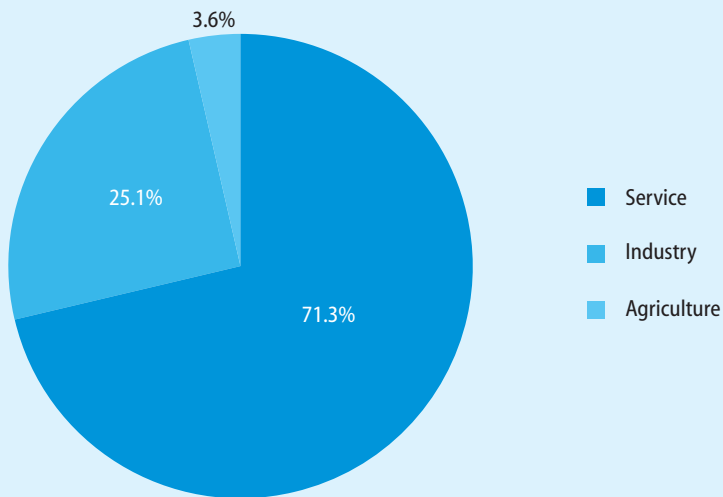
The lending activity of Kosovo's commercial banks represents one of the main sources of financing for consumption and investments in Kosovo. The slow recovery of financial markets in foreign economies, improvements in the commercial banks' perceptions of the economic environment in Kosovo, and higher level of deposits have led to relatively rapid growth in lending by the banking system in Kosovo in recent years. According to Central Bank of Kosovo (CBK) data, the total value of outstanding loans issued by the banking system was 1.6 billion EUR in June 2011 (equivalent to approximately 34 percent of Kosovo's GDP). Loans to enterprises (in comparison to other types of loan such as household loans) were responsible for a large proportion of the total loans, accounting for approximately 1.1 billion EUR in June 2011 (approximately 69 percent of the 1.6 billion EUR total).

The Kosovo financial and banking sector generally possesses a good quality portfolio. Despite the fast credit growth seen in recent years, in September 2011 the share of non-performing loans (NPLs) to total loans (including loans classified as 'doubtful' and 'loss') was only 6 percent, far below the average of 15 percent recorded in other countries in the region.

The landscape of loans to enterprises in terms of economic activity has remained similar for several years. Loans to the services sector account for the majority of total loans to enterprises, with a share of 71 percent (Figure E1). Within loans to the services sector, the trade sector accounted for the largest proportion, accounting for 53 percent of total outstanding loans to enterprises

in June 2011. A share of 25 percent of total loans to enterprises is represented by loans to the industry sector (including mining, manufacturing and construction).

**Figure A1** Enterprise loans by sector



Riinvest Enterprise Barriers Survey 2011

One of the sectors with the lowest share of total loans remains the agriculture sector, accounting for only approximately 4 percent of total outstanding loans to enterprises in June 2011 (slightly down from June 2010). This suggests that the conservative lending approach of the banking system towards the agriculture sector fails to mark any improvement over time. Loans issued to this sector, in addition to low volumes, are characterized by highest interest rates, reflecting the perceived uncertainty of this sector by banks. The high level of interest rates for loans to agriculture is likely to discourage the demand for loans and contribute towards the current low level of lending and borrowing in the sector.

The landscape of bank lending in Kosovo is in line with the general landscape of businesses in Kosovo and developments in Kosovo's economy. The economy is largely driven by trade businesses which contribute significantly to Kosovo's trade deficit which stood at around two billion EUR in 2011. Kosovans are less oriented towards investments in manufacturing activities, and with restrictions imposed by the banking sector in lending for this sector, the trade imbalance is destined to increase further. On another note, the modest investments which are seen in Kosovo's manufacturing sector are also related to the larger sums of capital required to start up or operate such businesses compared to those in the services sector. Again, given the conservatism of the banking sector to finance non-trade businesses, the cycle of economic recuperation through production and manufacturing based activities seems to be relatively closed.

The World Bank's Doing Business Report rates Kosovo relatively well on access to finance, and Kosovo's businesses have given an uneven picture over the years of their difficulties in this regard. There are likely to be many reasons for this: not least the type of businesses surveyed, the excluded perspective of those not considered credit-worthy, and the relatively unsteady nature of Kosovo's economy since 1999. The relevant question here is – does Kosovo's finance climate preclude human development benefits from private sector growth? In this case, the answer is yes – because finance is hardest to access by those most able to deliver employment (medium size enterprises) and those without access to traditional forms of collateral such as income, property or land.

**Infrastructural barriers** are topped by electricity supply with an intensity of 64 (with telecommunications, access to land, and transportation perceived as much less intense obstacles to doing business in Kosovo, as illustrated in Figure 2.1 above). Over the past eleven years, electricity has always been perceived and ranked amongst the top barriers, and even today it remains strongly near the top. Increased costs of production and manufacturing due to frequent interruptions in the electricity supply are still causing competitive constraints to firms across Kosovo. This driver has resulted in many such firms choosing to invest in alternative sources of electricity supply, with the majority investing in large costly electricity generators.

Today, despite new reforms in the energy sector, the electricity supply in Kosovo remains generally insecure. Kosovo is primarily reliant on two power plants,<sup>42</sup> both of which are old, and one of which is 50 years old and

on the verge of collapse. Together, both plants fail to supply half of the electricity needs of Kosovo during the winter and cold periods, leaving Kosovo reliant on importing electricity during these periods. This solution is both costly and, with a lack of funds, often therefore unattainable. In 2012, due to lack of budgetary subventions for energy supply (driven by financial constraints and high budgetary deficits at the level of the Kosovo Government), an increase in electricity costs in the region of 25 percent is expected. This, in turn, will affect operational costs for businesses across Kosovo and across sectors. While new power plants (with approximate capacities of 600 MW) are being planned, no other solution, apart from importing electricity, is provided.

Lack of electricity is a broad human development barrier in Kosovo, affecting services as significantly as businesses. However, from a private sector/human development correlation perspective, it particularly hinders the creation of any significant industry that might expand employment and create more sustainable wealth. It hinders growth-ready sectors, such as manufacturing, and deters Foreign Direct Investment (FDI) into Kosovo. Since the electricity supply is notably more reliable in the cities, this barrier also further aggravates urban-rural income and productivity divides. In comparison to the significant challenges associated with the electricity supply in Kosovo and the barrier that this presents to businesses, the picture is much better for other infrastructural barriers, with transport, access to land, and telecommunications barriers remaining at the very bottom of the list in Figure 2.1 above, with intensities of 40, 36 and 34, respectively. Kosovo's investments in telecommunications

infrastructure have proven to be a significant stimulus for businesses, given the strong need for technological advancements. However, it is important to highlight that these benefits are still largely limited to urban and peri-urban areas.

**Regulatory barriers** are ranked moderately, with tax rates, tax administration and customs and trade related barriers in 12<sup>th</sup>, 13<sup>th</sup> and 14<sup>th</sup> positions respectively. These barriers have tended to decrease over time, a positive point for Kosovo's administration. In 2002, tax rates were perceived as the top barrier to enterprise.<sup>43</sup>

Reforms implemented at the end of 2009 halved taxation on profits, which has proved to be a significant incentive driver for businesses in Kosovo. Now, the primary criticism of taxation in Kosovo is oriented towards an inefficient tax administration, with special reference to Value Added Tax (VAT). As is the case with many transition economies, taxes are often unduly high because of inefficiencies in service delivery, poor tax collection capacity and a narrow tax base due to the existence of a large informal sector. Interviews with business associations exposed several needs for reducing the tax burden from VAT collection, particularly the VAT rates in specific industries (most notably agriculture). Business associations have also complained about arbitrary interpretation of obscure tax regulations, selective enforcement and associated extortion by the tax administration. These practices were increasingly highlighted in recent years as the Government has felt pressure to fulfil income forecasts due to heavy involvement in capital investments. As such, an inefficient tax administration - a characteristic of poor governance - contributes to

both costs and risks faced by firms and may also affect investment decisions. According to business associations, tax administration is a synonym for bureaucratic harassment through disruptive and costly tax inspections.

Moreover, fair taxation plays a critical role in revenue redistribution, as one of the indirect benefits of private sector growth for human development. Public sector taxation is, in the common parlance, robbing Peter to pay Paul. The government is simply paying itself to recall its own revenue. The private sector tax base, however, has the potential to provide additional revenues for capital budgets and can have a dramatic impact on social budgeting. A government that cannot or does not collect taxes in a fair and efficient way while squeezing social budgets is doing all its stakeholders a disservice.

**Internal skill barriers** are not rated highly as perceived barriers to business. Production standards, and the skills and education of available workers, rank relatively low down on the list of high priority business barriers identified and illustrated in **Figure 2.1.** above. This gives a fascinating, if saddening, insight into Kosovo's business climate and its contribution to human potential. Combining this perception data with objective data on the low level of knowledge and skills amongst Kosovan adults (see **Introduction: Kosovo's human development context**) and education standards among Kosovo's young people indicates once more that Kosovo is settling for low-skilled, low-value enterprise. There is simply not enough demand for the kind of skills that predominate in a modern, flourishing market economy. This also indicates a lack of concern

by businesses to invest in the capacity and potential of workers, and drive towards a more productive business model. People engaging in Kosovo's private sector are, more often than not, engaging in low-paid work that keeps them within sight of the poverty line and gives them only limited potential to expand their knowledge and capabilities.

In summary, the barriers identified by businesses show both the challenges and the perceived limitations facing employers in Kosovo. The barriers identified as the most significant are highly concerned with the equity of the marketplace in which businesses operate, and less concerned with the capacity of those which they employ. It is natural, perhaps, that business owners should be more concerned with barriers arising from weak governance and an unreliable social contract than with the hindrances facing their own staff. However, both are fundamental to a progressive business climate, as well as to a dignified society which realises the potential of those within it.

Of all the barriers identified, the first – an unequal enterprise culture – has the most profound and far-reaching implications for Kosovan society. This will be explored in more detail in the following section.

## 2.3 An uneven playing field – economic and human costs

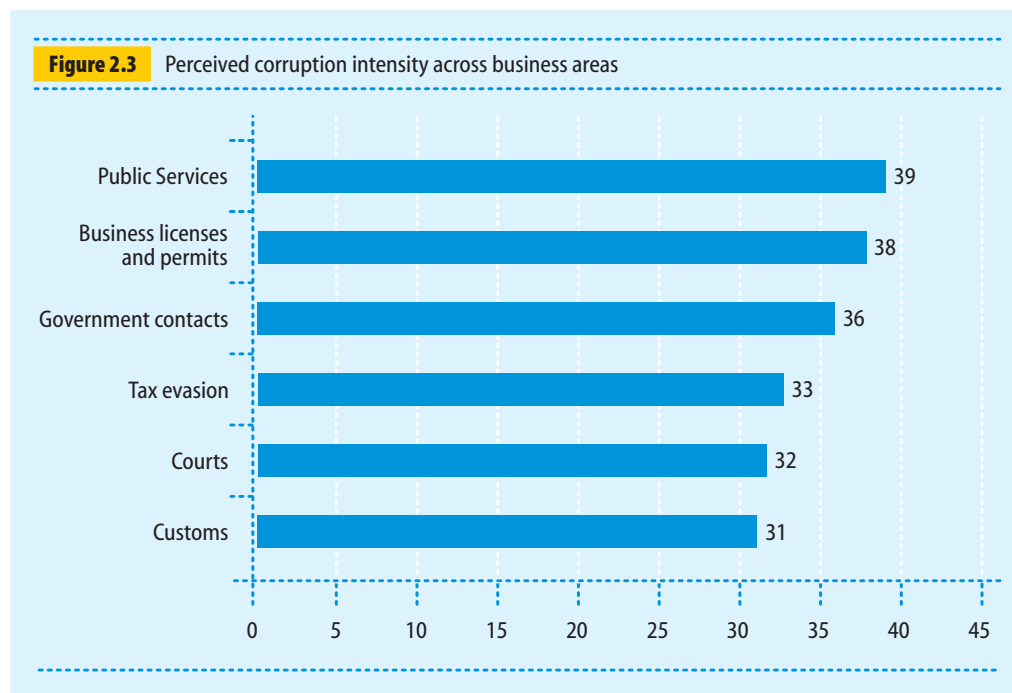
The ranking of “unfair competition” as the top barrier is novel in the Kosovan environment, surpassing energy supply as the leading barrier over recent years (Riinvest SME surveys 2001, 2002, 2004,

2006 and 2008a). To further elaborate the understanding of unfair competition, the Riinvest team organized a round table with Kosovan entrepreneurs in September 2011. This round table was organised as part of a Private Sector Development Round-table Programme organized jointly with the Friedrich-Ebert-Stiftung Foundation<sup>44</sup> and around 40 business representatives from various sectors participated in the event.

The vast majority of the businesses represented at the round table event declared unfair competition as an output of two common phenomena – a lack of integrity in the marketplace and weak institutional enforcement of rules. These two are perceived as linked across the public-private divide, *i.e.*, a lack of *integrity* is reinforced by a lack of *accountability* from both private businesses and government officials concerned with compliance. They highlight the presence of an unbalanced and unequal business environment in Kosovo, built upon special, informal relations rather than the rules of fair competition. These two factors are analysed in more detail below, focussed on their detrimental impact on the benefits of human development.

### 2.3.1 Lack of integrity in the marketplace: corruption, evasion and informality

*Corruption* is an excellent indicator of a lack of integrity in the marketplace - ranked among the top five business barriers by Kosovo business owners. The latest data from Transparency International<sup>45</sup> rank Kosovo as the country in the region with the highest level of corruption, with a coefficient of 2.8 (0–3 are countries where the level of corruption is widespread). In recent years, Kosovo has seen an increase in the Corruption



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Perception Index, despite a marginal fall in the general ranking (from 110 in 2011 to 112 in 2012). According to the Global Corruption Barometer (Transparency International, TI, 2010), 73 percent of surveyed Kosovans believe that the level of corruption in Kosovo has increased over the last five years.

What business areas are most affected by corruption? Businesses surveyed for this chapter were asked to rank their experience of corruption across a range of types of interaction – from engaging in public services to the basic tax and customs functions of daily business life.

Such a high intensity of perceived corruption may affect public-private partnerships is a dark cloud overhanging Kosovo's local development potential. Government spending represents the bulk of Kosovo's economic growth, and anomalies such as corruption prevent the normal flow of money towards efficient businesses, towards those businesses with more growth potential, and ultimately towards job creation. In

a healthy interaction with the private sector, public services should subcontract efficiency enhancing functions to the best private contractor around (see *Introduction*), thereby reducing the cost and the burden of delivery, empowering local companies and benefiting local people. When contracts are awarded by any other measure than merit, lower quality works and services alongside rising prices are a common result. In cases where essential service delivery itself is sub-contracted to a preferred party without a transparent process, the cost to the poor and the excluded is even more severe. Facing higher prices and often lower quality of services that they depend on, their income, their capacities and their choices are all reduced.

While quality public services are affected by corrupt government contracting, decent work is also affected by corruption in private spheres of tax, licensing and contracts. The costs of corruption, globally estimated to add 10 percent to the cost of doing business

(Lambsdorff, 2003), hit Kosovo's Small to Medium enterprises (SMEs) hardest. These account for 99 percent of all firms in Kosovo. With lower cash flows and tighter profit margins, they carry a heavier burden when they have to pay bribes in corrupt markets for such basic requirements as customs clearance or operating licences. They are also less likely to be able to attract finance and investment, including FDI, where corruption is seen as an unofficial tax on business operation. Thus, corruption may negatively affect Kosovo's productivity and its prospects to create decent work. Estimates by Lambsdorff (2003) suggest that an increase in corruption in the Transparency International Corruption Perception Index (CPI) by one point lowers a Kosovo's productivity by 4 percent of GDP.

People have a powerful role to play in the fight against corruption. In Kosovo, this fight needs to be reframed as a battle for the health of society, for decent work and for better services. As with any battle, corruption is hard to fight alone. Around 15 percent of those surveyed declared that they or someone related to them had given bribes in different forms to institutions in Kosovo. According to the Global Corruption Barometer, 61 percent of Kosovans surveyed think that anti-corruption measures from the side of the government had no effect. These people feel on their own tackling corruption. However, when asked, 70 percent of respondents declared themselves ready to report any corruption case and participate in the battle against corruption. Therefore, the individual will to fight corruption is present, if only it can be harnessed in such a way as to make people feel safe and empowered to make a stand against corruption.

**Tax evasion** in Kosovo is equally damaging to the public purse, to market expansion and to the social contract which bonds society together by mutual consent to abide by common rules. It is primarily a result of two factors – the high financial and psychological costs of complying with highly convoluted rules, and a large informal economy that operates safely outside the system. Kosovo Chamber of Commerce (a leading business association in Kosovo) considers tax evasion to be the single most important generator of unfair competition (Rukiqi 2011). The firms interviewed in this study also report that they face significant unfair competition from competitors who do not pay taxes and who, as a result, are able to sell their products at significantly lower prices.

Kosovo does not have high taxes relative to many countries. However, the real tax burden on businesses is significantly increased due to the way in which these taxes are collected. On average, businesses have to allocate significant time resources each day to interpreting and managing compliance with regulations and laws. In addition to this, limited capacities within the tax administration sometimes lead to ambiguity in the interpretation of the law and estimation of the tax base, and as a result, tax-paying businesses often end up paying fines because they were unable to appropriately estimate their tax liabilities.

In order to assess the tax compliance level in Kosovo, this study utilised a technique developed by the Institute for Management Development (IMD) *World Competitiveness Yearbook* and the World Economic Forum *Outlook*, which takes account of multiple survey questions investigating indirect measures of tax compliance. Accordingly, this study derived the tax compliance

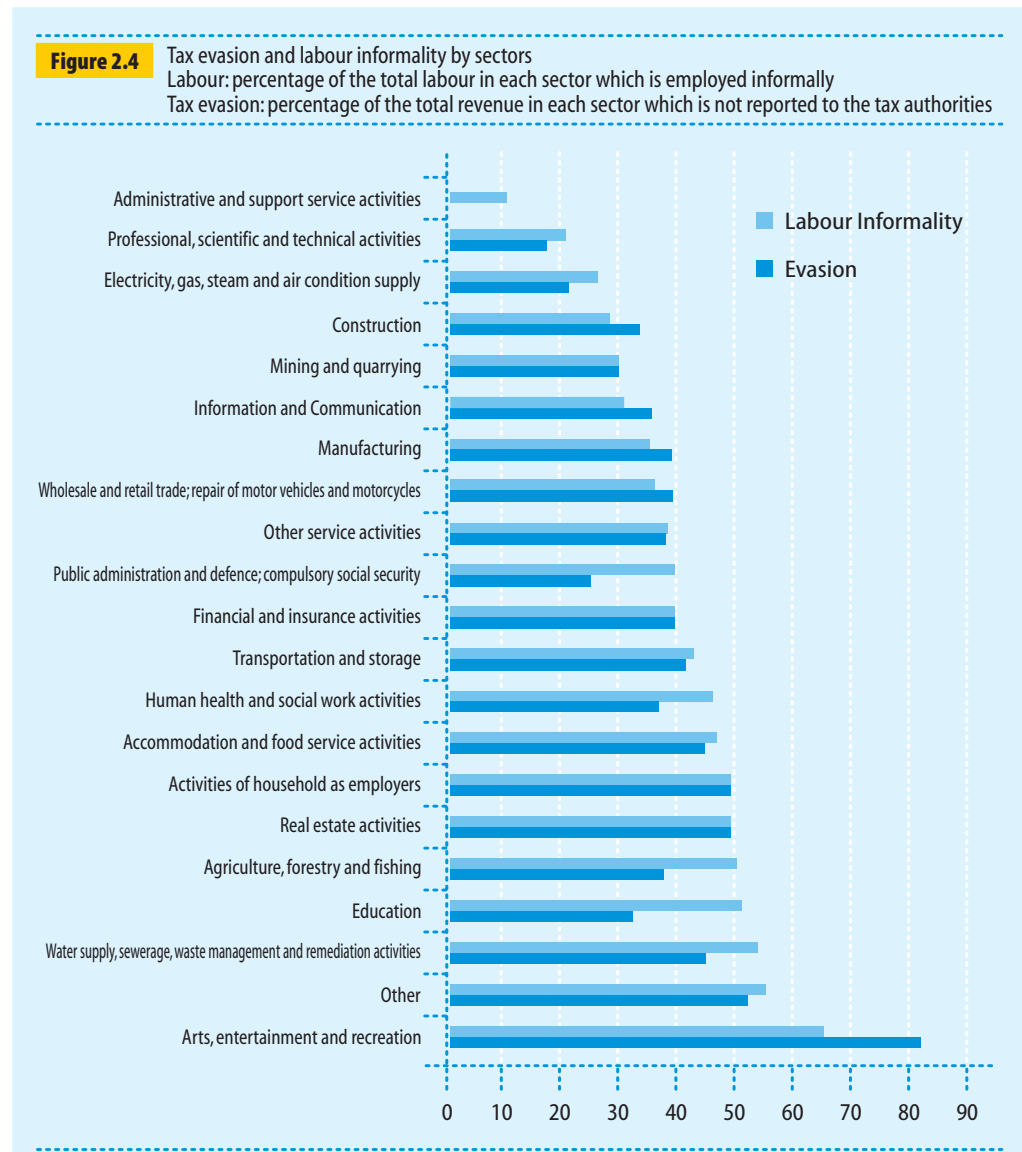


level by averaging responses to the following survey question:

**Q.51** *What percentage of the sales of a typical firm in your area of activity would you estimate is reported to the tax authorities, bearing in mind difficulties with complying with taxes and other regulations?*

The survey findings show that the level of tax evasion in Kosovo is approximately 39 percent – approximately the same level as was seen in other countries, most notably Albania and Bosnia, during the period 1999–2005. However,

this level of tax evasion is considerably higher than the average of 12.4 percent which is seen in well-established post-transition countries. Firms that generally deal with less visible, cash-focused transactions (given the lack of sufficient audit and penalty / fine mechanisms in Kosovo) are the most common evaders – and evasion correlates very well with the degree of informality in a sector. The greatest degree of evasion is seen in the tertiary sector (by far the largest sector in Kosovo) and in the primary sector – indicating again the challenges facing agricultural growth and the protection of rural workers.



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Upon analysis in further detail, the findings also show that tax compliance has a positive relationship with firm size, where larger firms tend to be more compliant than small firms. In addition, women entrepreneurs

tend to be less evasive of taxes than their male counterparts, businesses with higher proportions of cash transactions evade more, and corruption tends to significantly decrease levels of tax compliance.

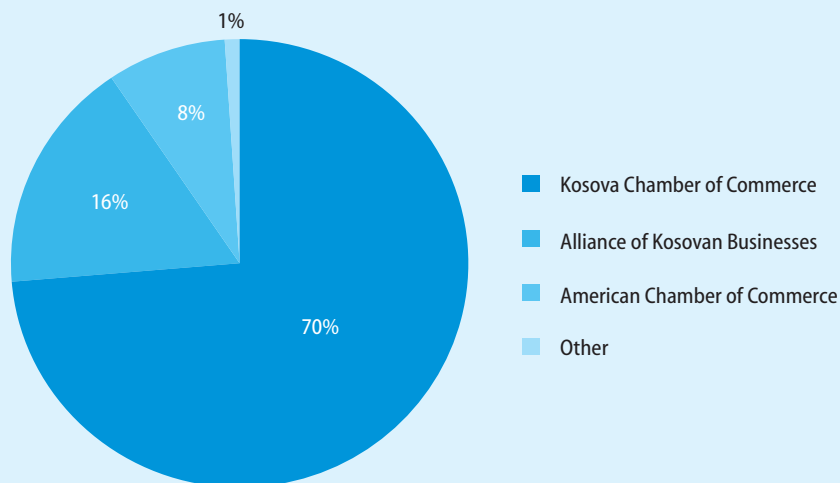
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## B

### PARTICIPATION IN BUSINESS ASSOCIATIONS

According to the Riinvest Enterprise Barriers Survey 2011, only 12.5 percent of the private sector enterprises in Kosovo are members of business associations. Of these, the majority (around 70 percent) report they belong to the Kosovo Chamber of Commerce (KCC 70 percent), followed by the Alliance of Kosovan Businesses (AKB 16 percent) and the American Chamber of Commerce (ACC 8 percent).

**Figure B1** Membership of Business Associations



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The low participation rate of Kosovo enterprises in business associations appears to be mostly a result of lack of information, as reported by 60 percent of the firms interviewed that do not belong to any associations. Of the firms that are informed about the existence and activities of business associations but have decided not to join one, 20 percent cited lack of trust in these associations as a motivation for their decision. The remaining 80 percent reported that their decision not to join was based on the perception that they would not benefit anything from joining (or for other reasons such as lack of time, which again implies that they do not find membership worthwhile).

The low participation rate and the fact that most businesses do not find it worthwhile to join a business association appears to be to some extent justified if we consider the reported experience of current business association members. Consistent with the perceptions of non-members, more than half of current members of business associations do not appear to be particularly satisfied with the activities of their business association, either reporting that they are not satisfied (20 percent), or that they share a neutral opinion on this (60 percent). The rest (i.e. the other 40 percent) of the business-association members report satisfaction with the benefits accrued from their membership.

*Around 9 percent of businesses consider tax evasion as always justifiable given the current economic and business environment.*

Institutional weakness undermines tax compliance. On average, a business is only inspected for approximately four days per year by the tax administration, two days by customs and five days by municipal officials. In alignment with this, Kosovo has the lowest number of tax inspectors per 1,000 inhabitants in the region, and only 350 of these inspectors work in the field. Kosovo has recently embarked on a costly and complicated process of decreasing tax avoidance by aiming to equip all businesses with a cash register machine – a scheme much objected to by many business owners and still less than a quarter of the way through a long implementation phase.

Failure to pay taxes critically affects Kosovo on a number of human development levels. It reduces the capacity for the government to distribute revenues effectively, and make capital investments. It creates an unfair advantage for non-compliant companies, widening incentives to operate outside the law and having a knock-on effect on worker protections and decent job creation. It is also an indicator of the quality of the relationship between the private sector, governance and society. In Kosovo, 9 percent of business taxpayers consider tax evasion as always justifiable given the current economic and business environment.<sup>46</sup> These businesses see non-compliance as a form of protest statement against unfair or ineffective governance. However, less than 2 percent of women entrepreneurs consider tax evasion as always justifiable. In addition, business owners with higher levels of education were more inclined to pay taxes as well as being more likely to link taxes to benefits and services provided by the state - underlining again the critical importance of education to economic

growth in a healthy social context. In addition, older business owners in Kosovo have higher rates of tax morale than their younger counterparts, perhaps because they may have acquired more social capital and often have stronger links to the community.

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

Informal economic activities are not necessarily damaging. In many countries, the informal sector of the economy is an essential source of employment for marginalized groups in society. OECD (2006) argues that the informal sector of the economy comprises 42 percent of the entire economy in Africa, 41 percent in Latin America and 35 percent in the transition economies of Europe and the former Soviet Union, compared with 13.5 percent in OECD countries. The informal economy provides employment and income for many who lose or cannot find work in the formal economy, and it includes a disproportionate number of women, young people and others from disadvantaged groups.

However, at Kosovo's current stage of development, informality has become a form of exclusion and is holding back solutions for business equality and poverty reduction. In an economic climate of low per capita income, many households look to the informal economy for short-term cash solutions. They do not realize that creating a market with more formal enterprises and more formal, decent jobs is essential to ensure long-term welfare, stability and poverty reduction.

Informal enterprise costs society a great deal, but it also has a significant cost which is borne by the workers who engage in informal labour. These workers are far more likely to be under-employed and have pro-rata wages lower than their formally employed peers. Thus, they must work longer hours to attain the same income. They fail to benefit from pension contributions due to lower reported salaries, leaving them unprotected in old age and burdening their families. They are also far less likely to pay personal taxes – contributing to the social cost of low private sector tax compliance. Data from the Riinvest Enterprise Barriers Survey 2011 (as shown in Figure 2.4 above which illustrates the percentage of labour which is employed informally in different sectors of the economy) provide similar figures on labour informality to those for tax evasion, and it is estimated that around 30-40 percent of labour in Kosovo is informal. Tax evasion and informal employment choices are linked; they both prioritize personal or family wellbeing over long-term social benefits. Similar findings in the levels of tax evasion and labour informality also serve for robustness checks and the validation of both results.

### **2.3.2 Weak institutional enforcement**

If unfair business practices undermine trust within between businesses, then weak and unaccountable enforcement undermines Kosovo's entire body politic. The unsatisfactory level of regulatory enforcement in Kosovo has been identified by independent surveys as one of the key challenges facing private sector growth (e.g. Riinvest 2011; EU Progress Report on

Kosovo 2011). The perception survey conducted for this report reinforces this message. Business owners again stress that they feel "alone" in managing disputes over contractual obligations; that Kosovo's administrative authorities are inefficient, slow and unreliable and that the regulations designed to protect them thereby end up being a burden without providing the intended benefits.

The lack of accountable and timely regulatory enforcement hinders the development of Kosovan businesses in many respects. Firstly, businesses face losses due to the failure of their buyers or suppliers to meet contractual obligations - for which, without institutional enforcement, there are no consequences. For example, an interviewed dairy processor reported that it obtained a loan from an international financial institution to buy cows that were distributed to farmers in return for an obligation that they would repay a part of the loan and supply the processor with milk. However, the farmers in question never satisfied this obligation and the dairy processor reports that the consequent lawsuits it filed eight years ago are still open. Unfortunately, the severity of the consequences of problems like this extends beyond the cost of the direct losses incurred by the firms involved. Namely, the uncertainty that the lack of contract enforcement introduces is likely to prevent firms from entering into business transactions altogether. This is also likely to be one of the reasons why the levels of purchasing on credit and the extension of credit to clients by Kosovan firms are much lower than those reported by other transition economies in the region, as well as those in Europe and Central Asia (ECA) in general (World Bank 2010). This reluctance to make purchases using

credit and to extend credit to clients acts to make purchases and product sales more difficult for Kosovan firms. Weak enforcement is also partially responsible for a culture of impunity around environmental compliance, aggravating Kosovo's dire conditions of pollution and environmental degradation.

Inability to enforce contracts affects the level of firms' investment in their innovative capacity and the skills of their employees. Firms in some sectors report employee poaching as a major problem. Due to the lack of a mechanism to enforce employment contracts, firms that invest in expensive employee training often end up losing their employees to competitors. As a result, Kosovan firms are far less likely to invest in employee training compared to firms in other transition economies (World Bank 2010). This is particularly worrying because it directly affects the competitiveness of Kosovan firms in the marketplace and it hinders the development of high value-added products and services, which are relatively skills intensive.

Enforcement is, at least in part, responsible for the limited levels of FDI in Kosovo. For example, the clear inability to successfully litigate against infringements of patents, intellectual property rights (IPR) or copyrights more generally, is perceived as a significant obstacle by the American Chamber of Commerce in Kosovo (Musa 2011), and particularly by companies in the ICT sector. Kosovo is seen as a high-risk venture for any high-skilled, high value-added enterprise such as software developers – who may be attracted by a relatively inexpensive, eager and IT-savvy young generation but who are unwilling to transfer their

protected know-how and intellectual property to Kosovan subsidiaries.

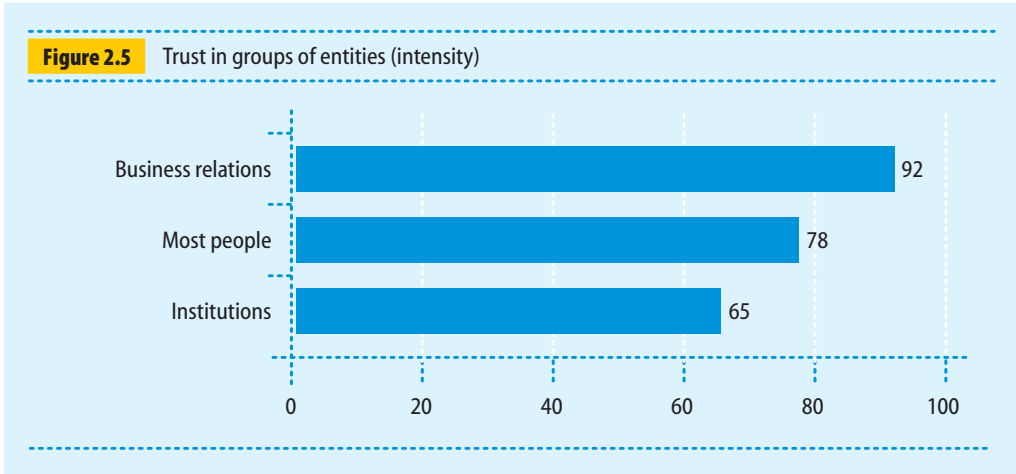
As a result of weak enforcement around corruption and evasion, public trust in Kosovo's institutions is weakening. Numerous studies have found that in transition countries social capital in form of civic participation and trust in public institutions has a significant impact on growth (Putnam 1993; Fukuyama 1995; Knack and Keefer 1997; Dasgupta and Sergaldin 2000; Zak and Knack 2001). In the political realm trust has been shown to contribute to democratic stability (Inglehart 1999; Uslaner 2003), to political and civic participation (Knack and Keefer 1997), and to the solution of collective action problems<sup>47</sup> (Levi 1998; Uslaner 2002; Rothstein 2003b). Thus, general trust seems to have effects on the quality of government in a manner difficult to separate from economic growth. Conversely, corruption undermines the legitimacy of the state and the rule of law, and may weaken a state's ability to defend its system of values. Once a governance situation has deteriorated it becomes extremely difficult to restore the rule of law, good governance and trust between citizens and the state.

Kosovo is currently experiencing relatively low trust in its public institutions compared to trust in businesses and people in general. As illustrated in Figure 2.5 below, on average, respondents' trust in Kosovo's public institutions received an intensity score of 65, in comparison to their general confidence in people ('most people') and in business liaisons/staff/competitors, which received intensity scores of 78 and 92 respectively. This perception measure to some extent contradicts the finding (illustrated

in Figure 2.1 above) that unfair business practices *as implemented by businesses themselves* are one of the most significant barriers to business growth in Kosovo. This paradox has an explanation: in the view of respondents, it is the job of the government to

who report that these institutions can be trusted.

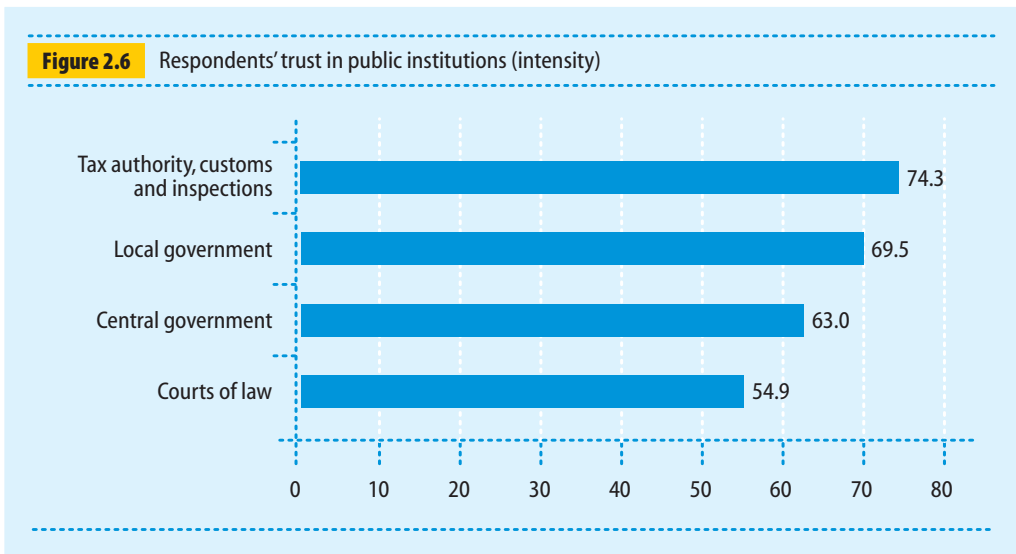
Unfortunately, as shown in Figure 2.6 above, it is precisely the courts of law and the wider judicial system (which are supposed to set a level playing



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stamp out unfair practice – and until the government acts, businesses only interact very cautiously with trusted and proven partners.

field for businesses and protect them from unfair practices by the public institutions or their business liaisons), that is the least trusted by the business



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Figure 2.6 summarizes the levels of confidence in a variety of public institutions as measured by the percentage of business managers or owners

respondents. At first glance, this finding may seem contradictory to the BEEPS survey (World Bank 2010) which reported that the percentage

of firms reporting that courts are not a problem in doing business is ten percentage points higher in Kosovo (at 56 percent) than the average of other SEE economies in the region and in the ECA transition economies. However, reading this figure in light of the finding that only three percent of Kosovan firms (BEEPS 2010) have been to court in the past three years compared to the average of 32 and 27 percent in SEE and ECA transition countries respectively, a more appropriate conclusion seems to be that Kosovan businesses do not have faith in the judicial system, and do not even take it into account in their decision making.

*Kosovo has the potential to translate its uneven enterprise culture into a pattern of growth with wide ranging rather than narrow benefits.*

Weak enforcement, therefore, is extremely costly to Kosovo's enterprise culture. In fact, it is a fundamental human development challenge for Kosovo more generally, encompassing all sectors of governance. It would be ludicrous to suggest that enforcement can be strengthened for private enterprise while it remains weak elsewhere. A culture of accountability is still missing from a system of government that prioritizes legislating over implementing. There is also a serious mismatch between the burden of regulation and the financial and human capacity and resources available to operationalize these regulations.<sup>48</sup>

As a result, the lack of enforcement in enterprise provides Kosovans with a double disservice: first, it undermines the services, choices and freedoms available to them in their communities; and second, it undermines the potential for economic growth that

might be able, outside of government, to expand choices and freedoms for all. This weak institutional enforcement is a critical factor in creating the "unfair" and uneven playing field that many businesses feel are their greatest sources of struggle. It stifles the *impetus* for growth and constrains the *expansion* of growth, when it does occur, to privileged catchments of society.

## 2.4 Private sector barriers - policy implications

Kosovo's economy is growing in pockets. Favoured parts of society, with the right connections, are more likely to thrive, in a largely informal climate where rules and regulations are not systematically enforced.

Inclusive growth, however, is not happening. Inclusive growth means, in essence, a pattern of growth that opens opportunities to the poor and the marginalized, that opens the door of mainstream markets to women, the young and ethnic minorities, that allows companies to compete openly based on performance and merit, and that – in short – increases dignity, social cohesion, income and life-enhancing choices across the entire reach of society.

The reason for the lack of inclusive growth in Kosovo is captured in the primary barriers facing private sector development: unfair business practice married with poor enforcement. However, these barriers present opportunity as well as constraint. Kosovo has the potential to translate its uneven enterprise culture into a pattern of growth with wide ranging rather than narrow benefits.

If this potential is to be realized, some profound changes will be required, and this chapter will conclude with a number of important policy recommendations to work towards the realisation of this potential:

- **Increase transparency in relationships between the public and private sectors:** Most of the critical barriers identified by business owners had to do with the interplay between enterprise culture and governance – issues of fairness, equity, transparency and accountability. The barriers identified as the most critical are far less related to the macro-economic issues of trade barriers, visa issues and foreign direct investment that tend to dominate dialogue over Kosovo’s private sector regeneration. Kosovo’s decision makers need to focus inward, to explore the dynamics that make businesses distrustful of each other and of administrative fairness from regulatory authorities. A more open, fluent dialogue on issues is required, across all sectors of the economy, including with businesses currently outside the formal economy. Translation of Kosovo’s informal economy into the mainstream marketplace would do a great deal to foster equity, improve options for decent work and spur the expansion of growth ready sectors.
- **Mainstream greater governance accountability across the public and private sectors:** barriers to inclusive growth are linked very strongly to Kosovo’s broader human development barriers – lack of accountability, weak social protections and a sense of being “unsheltered” by authorities. These

factors act to throw business owners and workers back on their own resources, tighten their reliance on ethnic loyalties and lead to unwillingness to cooperate for the public good. Over the coming years, Kosovo needs a concerted focus on the accountable implementation of its policies in both the public and private spheres. Accountability in the private sector sense includes timeliness; business is fast moving, and slow implementation of, for example, contract dispute resolution through the courts, is no better (if not worse) than no implementation at all - costing the public purse without providing any viable growth benefit. Accountability strengthens the relationship between individuals and governance, and builds public trust. Accountability also implies consultation and visibility, including at the local level, where business owners could benefit from a closer and more systematic relationship with municipal authorities during development planning cycles. This is particularly true for under-developed sectors that remain highly informal – such as agriculture.

- **Support education and initiatives to promote business-social alliances:** lack of social cohesion in Kosovo is reflected in its business relationships, where individuals do not feel comfortable waiving immediate private advantage for longer-term social benefits. Where their peers in other countries wish to contest such strategies as tax evasion or corruption, business owners in Kosovo feel insufficiently supported or protected to do so.



There needs to be a far more rigorous system supporting a public-spirited approach to business, educating owners on the value of their contribution to public revenues, particularly focussed on demonstrating the value these public revenues create in the local communities where the vast majority of Kosovo's SMEs source their revenue streams.

- **Foster desire for skills and innovation:** the priorities and perceptions of business owners may differ from those they employ. However, employees are rarely able to find fora to express their views and concerns. Their potential is also undervalued in the marketplace, where there is very limited demand for higher skills, knowledge and capabilities, despite the fact that

the linkage between a more educated workforce and higher levels of fairness and compliance is well documented. Both business owners and workers need more information on the opportunities available to them and their responsibilities to each other. Given the high level of individual business ownership and the large numbers of unemployed youth in Kosovo, education on the social context of entrepreneurship should start in schools.

Kosovo's business barriers are not equally applied across all enterprises. They affect different classes of business in different ways. The next chapter will look at how those most in need of support to join Kosovo's marketplace experience the highs and lows of uncertain business climate.

## Impact on a Pro-People Marketplace

*"All virtue is summed up in dealing justly"*  
**Aristotle (Ancient Greek philosopher)**

This chapter explores how the general barriers to business identified in the last chapter (illustrated in Figure 2.1) affect different types of business and segments of society. It asks whether business barriers as perceived in Kosovo affect business only, or have wider implications for Kosovo's socio-economic structure. The chapter first examines the impact of barriers on business of different sizes and across the urban rural divide, before focussing on the broader impact of these barriers on gender equity, entrepreneurship and the social contract within Kosovan society.

### 3.1 Impact on inclusive expansion and job creation

*Enterprise expansion* is a critical Kosovo business priority. Over 96 per cent of Kosovo's businesses are micro enterprises, employing less than ten people (see Table 1.11, Chapter 1). Therefore, it should not be surprising that the experience of business barriers becomes more intense as firms increase in size. Companies with between 10-50 employees and more, are more likely to suffer from unfair business practices than companies with less than ten employees. Larger

companies suffer more than smaller ones in terms of accessing the very lifeblood of business expansion – financing, infrastructure, administrative procedures and skills.

Access to financing for medium-sized enterprises (defined as those employing 50-250 staff) is a good case in point. A large body of literature suggests that access to financing is an important determinant of a firm's investments. Cabral and Mata (2003) argue that the expansion of firms is hampered by financial constraints, resulting in a lower firm-size distribution. Indeed, Table 3.1 indicates there is a clear and significant change in the cost of financing and access to financing as firms get bigger (barriers 2 and 8 in the table). Cost of financing scores 83.3 for medium sized firms, compared to 59.4 for small, and 57.8 for micro firms, while access to financing has an intensity of 75 for medium sized firms, and 59.4 and 56.5, respectively, for small and micro firms. The fact that it received a score of 83.3 means that cost of finance is the reported as the most intense barrier for medium sized firms (50–250 employers), surpassing unfair competition, which was ranked highly across all sizes of business. The positive relationship between size of firm and cost of financing comes as no surprise. Firstly, smaller firms tend to have lower capital needs and hence are less involved in loan applications,

i.e. are free of weighty financial burdens concerning the cost and access to finance. Moreover, given current interest rates the debt burden is much smaller and more affordable for this group of firms. Secondly, larger firms not only have proportionally higher interest rates, but, contrary to small firms, they also have more significant capital needs, and are more inclined to perceive burden in terms of costs of or access to finance. Thirdly, with respect to access to finance, smaller firms have more alternatives on financing their

each year in Kosovo (CBK 2011). These institutions are specifically designed to finance enterprises with relatively small capital requirements, as is the case with micro enterprises.

Similarly to the situation which is seen for the cost of financing and access to financing as firms get larger, a linear relationship is also observed between corruption and the size of firm. Larger firms are subject to public procurement tenders and hence face institutional corruption far more often

TABLE

3.1

Perceived intensity of business barriers, across different sized businesses in Kosovo (the size of business which has the highest intensity for each barrier category is highlighted bold, where 20 represents the lowest intensity and 100 the highest)

		Micro	Small	Medium
1	Access to business services and information	37.9	<b>44.6</b>	35.7
2	Access to financing	56.5	59.4	<b>75</b>
3	Access to land	35.5	40.5	<b>50</b>
4	Anti-competitive practices of other Competitors	67.8	<b>76.8</b>	75
5	Business licensing and permits	40.1	42.8	42.9
6	Contract violations by customers and Suppliers	58.8	65.1	<b>75</b>
7	Corruption	62.1	66.9	<b>70.8</b>
8	Cost of financing	57.8	59.4	<b>83.3</b>
9	Customs and trade regulations	47.6	<b>55.6</b>	53.6
10	Electricity	63.2	<b>70.3</b>	68.8
11	Functioning of the judiciary	53.1	62.2	<b>67.9</b>
12	Labour regulations	37.5	43.5	<b>46.4</b>
13	Organized crime, mafia	61.5	64.7	50
14	Political Instability	58.5	68.4	70.8
15	Production standards	46.9	<b>53.6</b>	41.7
16	Skills and education of available workers	37.4	46.7	<b>60.7</b>
17	Street crime, theft and disorder	65.5	<b>65.7</b>	62.5
18	Tax administration	49.4	51.6	<b>57.1</b>
19	Tax rates	49.9	54.8	<b>57.1</b>
20	Telecommunications	34.9	36.2	<b>39.3</b>
21	Transportation	39.5	45.8	<b>60.7</b>
22	Unfair Competition (evasion and informality)	75.7	<b>84.9</b>	78.6

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needs as, beside banks, Kosovo has several well established micro-finance institutions, which account for up to 20 percent of the total loans awarded

than micro or small firms. Institutional barriers, such as tax administration burdens, are also proportional to the size of a firm with medium sized firms seeing tax administration and tax rates

*As a business expands and seeks to increase its skillset and integrate with wider EU economies, it suffers a range of hurdles ranked far lower by smaller enterprises*

as considerably higher barriers than small or micro firms. This reinforces the general belief that the tax administration in Kosovo targets larger companies due to insufficient human resources at their disposal, with the aim of optimizing revenue collection with fixed resource constraints. Interviews with business associations in Kosovo reveal that larger companies complain far more about unfair treatment, long inspections, or even unjust penalties, in comparison to small firms who are rarely in direct contact with tax inspectors. With regard to tax requirements, larger companies underline the significance of VAT collection as a barrier to their expansion. Under Kosovo's current VAT laws, the majority of investments and raw materials are obliged to carry a 16 percent VAT burden at the border, before any operation occurs or any investment yields outputs. According to business associations, such a burden increases difficulties with cash flow in businesses and, consequently, the need to enter into loan obligations with high interest rates (14–16 percent on average). This, in turn, obstructs cash flow sustainability, growth potential and the creation of new jobs. Such a burden, however, is present less among small firms, as Kosovo (similarly to other transition countries) has a simplified tax system for smaller businesses which requires them to pay a lump sum tax and exempts them from other taxes. For example, businesses with turnover less than 50,000 EUR are not required to declare VAT. For this reason, tax rates and tax administration appear at the bottom

of the list of barriers for small firms, and have a much higher ranking among larger firms.

A large disproportionality also exists between firm size and the level to which the functioning of judiciary is perceived as a barrier, with medium sized firms scoring this barrier at an intensity of 75, compared to 59.4 and 56.5 for small and micro enterprises. Understandably, contracts, property rights and other legal issues are present far more in larger companies than in small firms. In addition to this, by nature, bigger companies have more stakeholders (contractors, employers, buyers etc.) in their operations, and hence more legal obligations, which, in the event of any legal dispute, will require referral to the courts which have demonstrated low capability with regard to addressing business cases. Similarly to the functioning of the judiciary, contract violations by customers and suppliers are evaluated at exactly the same intensity (75) by larger firms, acting as a robustness check for the above findings.

A very notable issue appears to be the considerable rise in the importance of the skills and education of available workers as the size of the firm increases. A score of 60.7 among medium firms, compared to 46.7 and 37.4 in small and micro firms, respectively, shows that as businesses expand there is an unmet need for a more qualified and skilled workforce. For medium sized businesses in Kosovo, the lack of a qualified workforce is identified as more restrictive than tax rates and tax administration. In this regard, Riinvest contacted eight medium sized companies to obtain their perceptions on this issue. Almost all business owners declared their willingness to separate ownership from management

due to the expansion needs of their business, though none was able to find trustworthy individuals with confirmed managerial skills. Such willingness to separate ownership from management is novel to the Kosovan business tradition, as the majority of large businesses are still run by family rules and hierarchy. However, the lack of skilled and qualified individuals has prevented the owners from passing full managerial competences to someone outside the family circle. Based on the perceptions of the medium sized firms interviewed, the educational background of potential workers is very disproportional to their current business needs. One owner declared, "It requires at least a year and a half for them to understand the real nature of the business environment, which after all is not something they came through with in class." For others, if a qualified workforce is available, it is very costly.

Medium sized firms also experience larger infrastructure hurdles, including transportation (ranked with a score of 60.7 for medium sized enterprises, 45.8 for small and 39.5 for micro firms). Larger businesses in Kosovo seek integration with European markets rather than seeking merely to serve local clients. The majority of imports of goods and services (worth around 2.6 billion EUR) into Kosovo are conducted by medium-sized enterprises. Similarly, around 900 million EUR worth of exported goods and services are undertaken by medium and large enterprises. In regard to imports and exports and increased integration with European markets, Kosovo's status resolution issues do cause significant hindrances. Several medium-sized businesses interviewed had to use official documentation from other countries (e.g. driving licence, passport, vehicle number plates),

which in turn increased their operating costs. In the period since Kosovo's declaration of independence in 2008, these costs have been even higher given the unilateral blockade of Serbia and Bosnia to all products bearing Kosovan Customs Stamps, which are an obligation for every exporter.

**New business creation** is always a potential source of new jobs. A growing body of literature on labour market performance emphasizes the role of entrepreneurship and firm dynamics. In an environment conducive to entrepreneurship, and where starting up a business is relatively simple, labour market outcomes, such as the employment ratio, tend to be significantly better than in an environment where there are restrictions on entrepreneurs and where it is difficult to establish a firm (Krueger and Pischke 1997; Boeri and Martins 2000; Scarpetta et al. 2002; Lopez-Garcia 2003).

*Enterprise creation is limited to those with personal capital to spare, excluding those who could be most empowered by business ownership and hampering decent job creation*

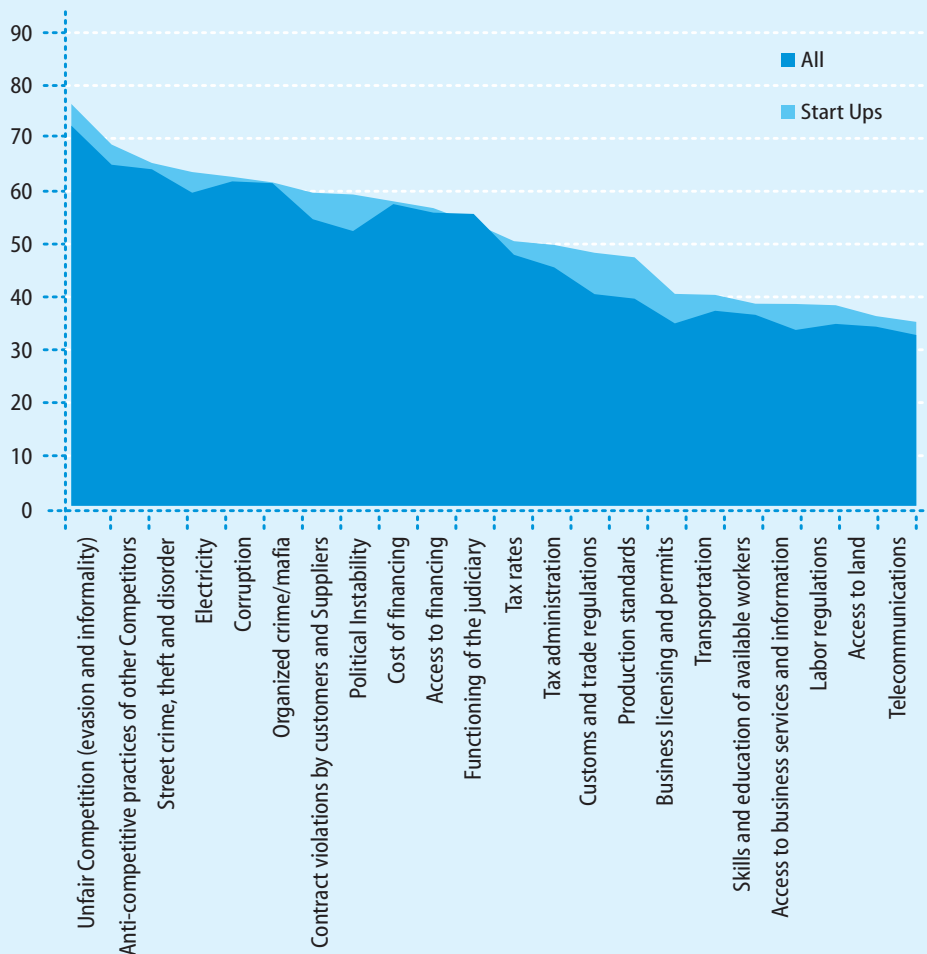
As argued in Chapter 1, Kosovo's enterprise culture already has a high business birth rate (as illustrated in Figure 1.17 which shows the number of enterprise births per 1000 population in the years 2006-2010). However, if creation can be combined with expansion, there is more opportunity for workers to enter the marketplace, grow their skills, and move into more complex and higher value-added businesses. To further investigate barriers to start-ups, this report looks more deeply at the firms that have been established over the past two years. These firms account

for 14 percent of the total firms surveyed and provide a sufficient basis for statistical representation.<sup>49</sup> When comparing start-up barriers with general barriers for businesses in Kosovo we note a broad tendency for the perceived intensity of barriers to be reduced in firms which have been recently established. The majority of barriers for start-ups are less restrictive than for established firms – particularly those established firms seeking to expand. The functioning of the judiciary and access to finance are ranked relatively highly as barriers for start-ups.

Meanwhile, unfair competition and the cost of finance remain largely at the same level as for other non-start-up businesses.

Financing is bound to be a greater concern for those wishing to make initial capital outlays to get businesses going. The lack of reliance on banks prejudices new business creation against those without ready capital – the poor, women and the young. Nearly three out of every four start-ups have used their own capital (see Chapter 2 Figure 2.2) to get businesses going.

**Figure 3.1** Perceived intensity of business barriers, across different sized businesses in Kosovo (the size of business which has the highest intensity for each barrier category is highlighted in blue, where 20 represents the lowest intensity and 100 the highest)

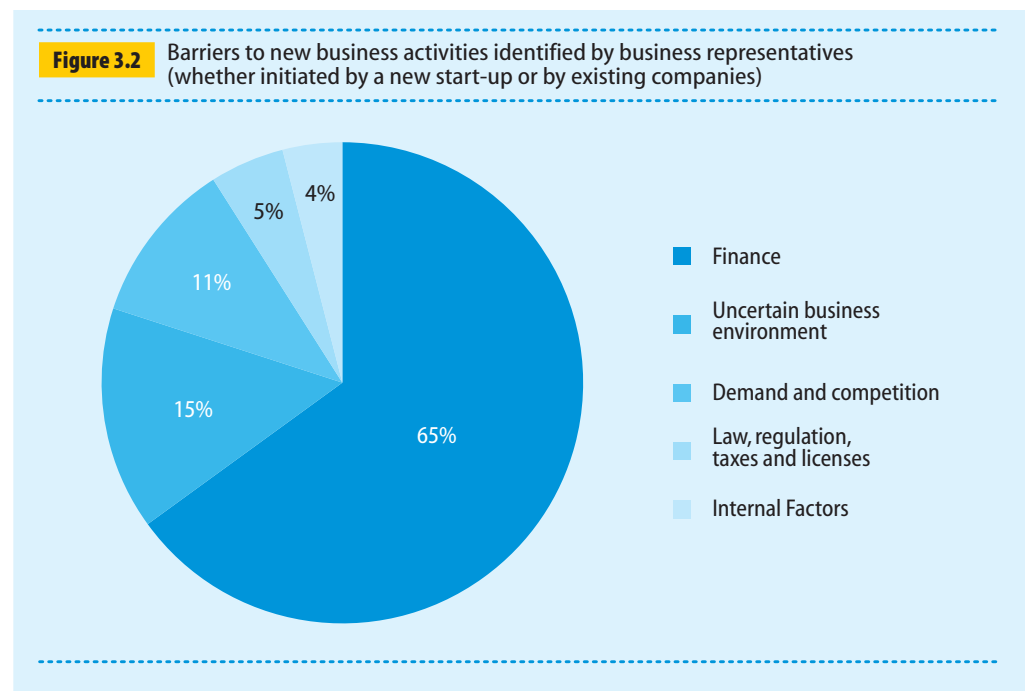


Interestingly, financing from banks scores a similar frequency to that from friends and family (around 10 percent). Remittances comprise just 2 percent of start-up financings, suggesting that this major proportion of Kosovo's GDP is not being reinvested in growth, but used for survival, savings or basic needs.

Financing seems also to weigh proportionately heavily on the introduction of new business activities - whether initiated by a new start-up or by existing companies. Survey

respondents said that firms in Kosovo are operating at the limits of their profitability, without having many options (i.e. internal funds) to facilitate expansion. This has an impact on both business creation and business expansion. Enterprise creation is limited to those with personal capital to spare, excluding those who could be the most empowered by business ownership, and hampering the creation of decent work.

In summary, business expansion in



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Kosovo is an extremely costly and risky exercise. As a business expands and seeks to increase its skillset and increase integration with wider EU economies, it suffers a range of hurdles ranked far lower by smaller enterprises. From a labour demand perspective, this is bad news. Medium-sized enterprises are essential to build labour demand in Kosovo and to increase the incentive for young workers to skill-up for more competitive businesses. The analysis conducted here of barriers to business

expansion reinforces the degree to which Kosovo's enterprise culture favours small and informal businesses, run by those with pre-existing capital. While these types of business have advantages, relying on them to the virtual exclusion of other enterprise denies Kosovo many of the direct and indirect benefits of private sector growth and human development. It also limits the participation of those who are already denied opportunities to enter Kosovo's marketplace – once

again separating growth from human development gains.

## 3.2 Impact on geographic-social divides

Analysis of how business barriers are experienced across Kosovo's six principal regions (Pristina, Prizren, Peja/Peč, Mitrovicë/Mitrovica, Gjilan/Gnjilane and Ferizaj/Urosëvac) suggest that they are deepening divides rather than aiding market coherence. Overall, the highest intensity of barriers was observed in Pristina, with Prizren and Ferizaj having the lowest intensity (see Table 3.5).

Regions with large urban centres and a dominant K-Albanian majority follow the general trends for Kosovo's

*The unequal business environment tends to concentrate investments in the Pristina region, leaving other parts of Kosovo potentially underdeveloped*

business barriers – citing unfair business practices and corruption as the biggest obstacles to enterprise. However, two types of area present a

very different profile (i) rural areas; and (ii) areas with high non-Albanian ethnic enclaves, both of which experience more intense infrastructural challenges. Electricity is a major challenge in the highly contested region of Mitrovicë/Mitrovica with its large K-Serb population (where it is given an intensity score of 81.8), as well as in the very rural municipality of Peja/Peč (intensity score of 75). This is in part because the energy supply in Kosovo has become very selective, with rural areas being far more affected by unreliable supply than urban regions, and where “favoured” groups get more reliable supplies. This selection process derives in part from the percentage payment of electricity bills, as a result of which three categories (A, B and C) of consumers were created. Category A, which gathers top payers has the priority of supply, while category C (which gathers consumers in areas with the worst payment records) has several serious supply restrictions during the year. Pristina is widely perceived to fall under Category A. In terms of regional development, such restrictions are divisive and create development disparities. Unequal business conditions across different regions of Kosovo tend to concentrate investments in the Pristina region, and thus leaving other parts of Kosovo potentially underdeveloped.



Perceived intensity of business barriers across Kosovo's regions (where 20 represents the lowest intensity and 100 the highest)

		Pristina	Prizren	Peja Pec	Mitrovicë Mitrovica	Gjilan Gnjilane	Ferizaj Urosevac
1	Access to business services and information	36.4	38.4	53.8	36.3	37.1	39.5
2	Access to financing	65.6	33.8	56.7	53.9	68.6	51.4
3	Access to land	34.6	38.2	38.9	27.6	40.4	38.5
4	Anti-competitive practices of other competitors	<b>86.4</b>	61.9	54.6	46.9	65.1	40.7
5	Business licensing and permits	38.0	40.3	48.9	27.0	47.1	43.5
6	Contract violations by customers and suppliers	<b>68.2</b>	57.9	61.9	51.1	58.0	40.8
7	Corruption	<b>75.9</b>	59.5	67.0	38.8	65.4	42.7
8	Cost of financing	<b>67.3</b>	37.4	55.6	57.8	66.1	51.5
9	Customs and trade regulations	49.2	49.7	<b>60.7</b>	34.8	46.4	42.9
10	Electricity	54.8	59.8	75.0	<b>81.9</b>	64.2	69.6
11	Functioning of the judiciary	58.3	45.4	<b>60.3</b>	43.0	60.1	46.6
12	Labour regulations	35.6	37.9	43.9	27.0	<b>49.6</b>	40.1
13	Organized crime, mafia	<b>78.2</b>	62.2	62.2	39.3	61.1	41.2
14	Political instability	67.2	54.8	<b>77.6</b>	58.8	41.2	45.4
15	Production standards	53.0	40.6	<b>60.3</b>	45.0	39.2	41.4
16	Skills and education of available workers	37.2	32.4	52.2	27.0	46.5	41.7
17	Street crime, theft and disorder	<b>78.4</b>	60.6	71.1	51.5	65.0	43.4
18	Tax administration	48.7	50.0	<b>64.9</b>	30.4	53.0	46.1
19	Tax rates	49.4	51.0	<b>66.6</b>	30.4	52.1	43.4
20	Telecommunications	33.5	31.7	39.1	30.0	38.5	<b>41.5</b>
21	Transportation	37.8	39.7	45.1	38.5	39.8	<b>45.6</b>
22	Unfair Competition (evasion and informality)	<b>92.2</b>	63.4	76.4	62.0	70.5	52.5

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There are a number of interesting points to highlight from Table 3.5 which considers in detail the varying perception of different business barriers across Kosovo's regions. For example, it is clear that street crime, theft, organized crime and mafia are ranked highly in the Pristina region relative to the others. Crime is indicative of wealth and opportunity disparities<sup>50</sup> across geographical, class

or other divides. In Kosovo's case, it is not surprising that crime gravitates towards Pristina – where the best of Kosovo's businesses, infrastructure, income and education indicators are clustered. Lack of opportunity in other regions, when compared to the Pristina region, increases the potential migration of criminals into the capital's urban and more developed areas, and hence increases the level of crime.

## 3.3 Impact on the gender equity gap

In addition to variation across the different regions of Kosovo, business barriers are also experienced and perceived differently by Kosovo's male and female entrepreneurs. In Kosovo, nearly all women business owners (99.9 percent) have micro enterprises. For these women business owners, cost of and access to finance remain the most intense barriers, with intensity scores of 60 and 61, respectively. This compares to intensity scores of 56 and 57 when considering the entirety of business owners and 58 and 56 when

considering male business owners in isolation. Therefore, given the fact that women entrepreneurs experience more intense barriers to finance, it is hardly surprising that women entrepreneurs tend to own smaller businesses and operate with lower levels of overall capitalization than do men. A more detailed breakdown of how different business barriers are perceived by male and female business owners is illustrated in Table 3.3 below.

Women have been recognized as a largely untapped pool of entrepreneurial talent by a wide range of regional, national and international economic development agencies in Kosovo. In alignment with this,

TABLE

3.3

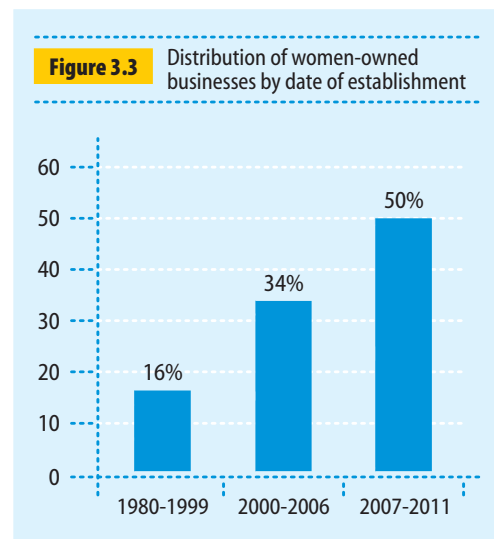
Perceived business barriers broken down by gender

		Male	Female
1	Access to business services and information	38.6	33.8
2	Access to financing	56.5	<b>60.3</b>
3	Access to land	36.0	33.3
4	Anti-competitive practices of other Competitors	<b>69.6</b>	60.5
5	Business licensing and permits	40.7	35.1
6	Contract violations by customers and Suppliers	60.5	50.5
7	Corruption	63.4	52.8
8	Cost of financing	58.0	<b>61.1</b>
9	Customs and trade regulations	49.4	37.0
10	Electricity	64.4	59.1
11	Functioning of the judiciary	54.5	48.2
12	Labour regulations	38.3	33.6
13	Organized crime, mafia	62.3	50.7
14	Political Instability	59.8	51.2
15	Production standards	47.4	41.0
16	Skills and education of available workers	38.6	35.3
17	Street crime, theft and disorder	66.0	57.6
18	Tax administration	50.2	43.4
19	Tax rates	50.8	45.8
20	Telecommunications	35.3	33.5
21	Transportation	40.5	36.0
22	Unfair Competition (evasion and informality)	<b>77.2</b>	70.3

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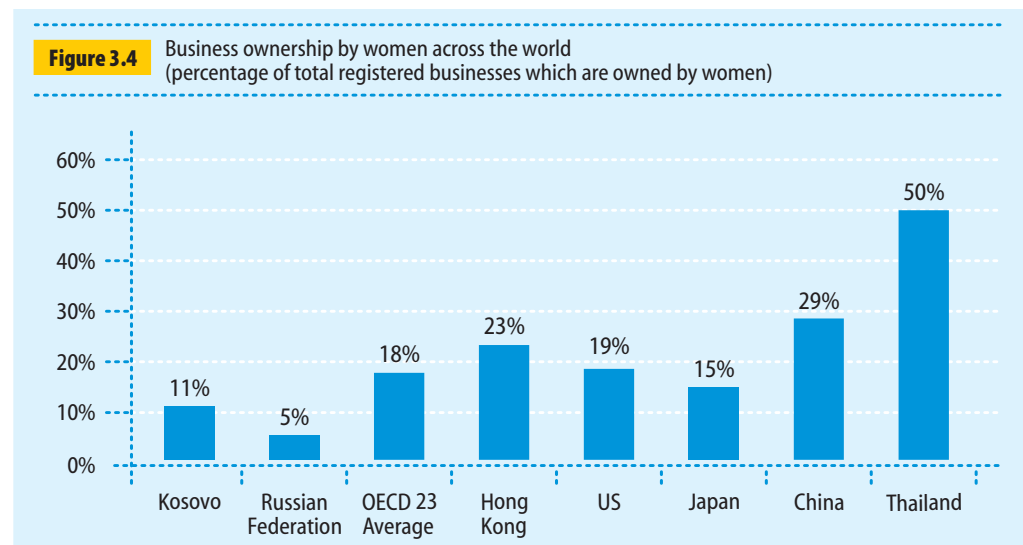
an encouraging increase has been seen in the number of female entrepreneurs since the end of the war in 1999. Their contribution to Kosovo's economy demonstrates the economic importance of this often overlooked group of entrepreneurs. Data reveal that half of current women-owned enterprises have been established in the past four years (see Figure 3.3).

to own smaller businesses, operate with lower levels of overall capitalization and start and manage firms in industries different from those run by men. In addition the growth rates of women-owned businesses tend to be lower. In Kosovo, entrepreneurial activities of women are still hampered by gender-specific constraints, including legal and institutional barriers, unequal employment opportunities and social conventions on the work-life balance for women. Further investigation into the gender characteristics of enterprise in Kosovo reveals considerable deficiencies and disparities across the gender divide. Only 11 percent of firms in Kosovo have female owners. While this figure may be on a par with other developing countries, it indicates a situation that – while an improvement on previous years – is still far from parity and equality. Female owners also tend to employ fewer staff: the average number of employees in female-owned companies is three, compared to five in male-owned firms. Figure 3.4 further highlights the small scale of female ownership, illustrating a direct comparison of the number of businesses owned by women in Kosovo with that in other areas of the world. Kosovo ranks well below the OECD



Riinvest Enterprise Barriers Survey 2011

In general terms, the research literature finds that women entrepreneurs tend



Gender Equality in Education, Employment and Entrepreneurship – OECD Gender Initiative 2011

average, though considerably higher than the Russian Federation.

Why do women struggle to compete equally in Kosovo's marketplace? Because cultural barriers prevent them from getting an adequate foothold. Across Kosovo an estimated 92 percent of the collateral assets needed to start businesses are registered to men (often male relatives of the women entrepreneurs who could be empowered to start businesses). This is in stark contrast to gender equity rights enshrined by Kosovo law which state that (amongst other things) the right of heritage and property should enable the equal and full participation of both females and males and that children of both genders are entitled to an equal share of inherited property. As a result of this, only 3 percent of business establishment bank loans go to women.<sup>51</sup> Even though microfinance in Kosovo has partly compensated for the marked gender bias in access to formal financial services it perpetuates the prevalence of women within micro-businesses and contributes to the fact that women entrepreneurs tend to own smaller businesses and operate with lower levels of overall capitalization. Once female-owned businesses are operating successfully, they experience barriers to the same degree as their male-owned counterparts.

Given the above analysis of the imbalance which exists in the ownership of

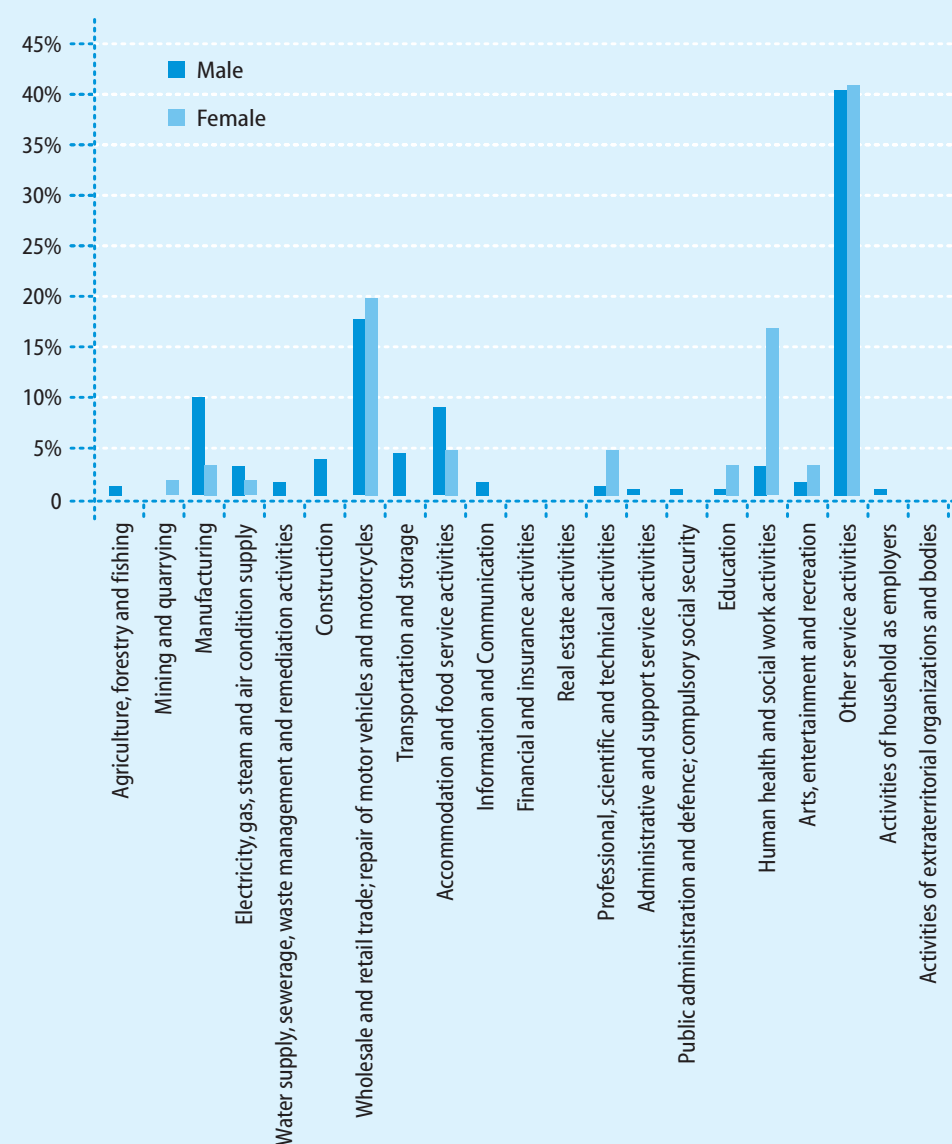
Kosovan businesses, it is no surprise to see that significant gender imbalances also exist in the employees and management of Kosovan businesses. Women's under-representation at the managerial level of firms not only provides them with less direct experience of managing businesses compared with men, but also it hinders the likelihood of female-headed start-ups. Moreover, women's lower average earnings reduce their ability to save income for starting a business. Undercapitalization at start-up has a significant negative impact on the survival rate and growth prospect of firms.

Occupational segregation reinforces the concentration of women-owned enterprises mainly in low added-value sectors and jeopardizes women's prospects as entrepreneurs in high-growth sectors. Survey analysis of cross-tabulation among sectors by gender shows considerable proportions between male and female owned businesses in the different sectors (see Figure 3.9). For instance, a higher proportion of male-owned businesses are registered in the manufacturing and construction sectors (which offer large potential for employment) compared to female-owned businesses. Conversely, a higher proportion of female-owned businesses are registered in service sectors such as human health and social work, education and professional/scientific activities.

*Why do women struggle to compete equally in Kosovo's marketplace? Because cultural barriers prevent them from getting an adequate foothold.*

*There is a clear correlation between the size of a business and its tendency to employ men*

**Figure 3.5** Gender distribution of business ownership across sectors



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Unfortunately for Kosovan women, employment is as restricted as entrepreneurship. Kosovo's dire labour market participation rate for women generally (less than three in ten, see Chapter 1) is compounded by the lack of opportunities for the very poorest, least educated and most marginalized women. To be a rural or an ethnic RAE woman in Kosovo is to be relegated to the back of the queue for every opportunity for participation

or employment. In addition to the deep cultural and attitudinal barriers weighing these women down, they are also hampered by a lack of skills. A 2004 survey by UNICEF indicated that nearly one in four rural women in Kosovo are functionally illiterate,<sup>52</sup> thereby further reducing their ability to compete with men for work outside the home. A 2006 survey conducted among female business owners by She-ERA, a local Women's Business Association,

confirmed these worrying trends. The survey analysis found that dependency among rural women respondents active in business was extremely high. Most operated their business out of their homes, less than 5 percent travelled outside their villages to work, 77 percent allowed male family members to make all important business decisions, and only 13 percent stated that they lived principally on their own personal income.<sup>53</sup>

Despite clear needs, catch-up learning course, vocational training and positive-discrimination hiring policies are not yet effectively targeting excluded women in Kosovo. In fact, there is a clear correlation between the size of a business and its tendency to employ men. The larger the employer, the greater the disparity between the proportion of men and women employed.<sup>54</sup> Small businesses are by far the biggest employers of women; however, they also tend to be the least secure, least regulated and provide the least opportunity for skill growth and expansion.

This analysis is an initial snapshot of the challenges facing gender parity in Kosovo's business environment, yet it clarifies that the rights of women to pursue their dreams outside of the workplace, expand their skills and opportunities and bring knowledge and income back to their families is fragile at best. Efforts to address this need to tackle the problem from both sides; *i.e.*, to assist the most vulnerable women in acquiring the skills and freedom they need to enter the marketplace, while also making that marketplace more welcoming for women seeking decent work and individual enterprise.

## 3.4 Impact on growth-ready sectors

Business barriers are experienced differently across Kosovo's primary, secondary and tertiary sectors. The degree to which these barriers are experienced gives some indication of why Kosovo's low value-added tertiary service sector is currently so dominant. As illustrated in Figures 1.11 and 1.7 in Chapter 1, the tertiary service sector (defined as covering all sectors with the exception of A-F which cover the primary and secondary sectors) accounts for in excess of 80 percent of the registered businesses in Kosovo and over 60 percent of total private sector employment.

The secondary sector feels the majority of barriers most intensely - reflecting Kosovo's significant industrial challenges. However, the primary sector - dominated in Kosovo by agriculture - is particularly hampered by electricity, customs and trade regulations, as illustrated in Figure 3.10 below. Translated into daily life, this means a constant battle to manage without stable electricity supplies in rural areas, and a sense of unfair treatment relative to foreign competitors due to inequalities in trade relationships. Last year, EU Trade Preferences<sup>55</sup> were removed for Kosovan producers, only to be reinstated for the year 2012, while the inability to move goods and personnel freely in Serbia and Bosnia has increased businesses costs. In regard to customs, requirements for Value Added Tax (VAT) payment at the border for imports of technological and raw materials have been acknowledged as a severe constraint for a number of sectors. The agro-production sector is an important example. When reta-

ilers in Kosovo purchase fresh food produce from Kosovan producers, they purchase them without VAT (if under the 50,000 EUR legal threshold). However, the retailer is responsible for collecting VAT from the final customer once the product is sold. On the other hand, when produce is bought from a distributor who has imported and thereby already paid some of the VAT burden at the border, the retailer carries a much lower VAT burden to pass on to the customer. This makes Kosovo fresh produce uncompetitive in terms of price compared to imported fresh food produce.

While Kosovo's agriculture sector has been able to circumvent these barriers

to some extent by operating informally, the secondary sector finds it much harder to hide within informality. As illustrated in Figure 3.10, the secondary sector is the most severely constrained of all sectors, explaining the deep and seemingly unresolvable weakness of Kosovo's industrial base and its inability to grow and provide sources of decent work. For firms in the tertiary sector, anti-competitive practices and unfair competition were perceived as the most important barriers for their existence. The majority of businesses in the tertiary sector deal with domestic markets and therefore are less con-fronted with international trade imbalances in comparison to

T A B L E

### 3.4

Perceived business barriers across the primary, secondary and tertiary sectors (where 20 represents the lowest intensity and 100 the highest)

		Primary	Secondary	Tertiary
1	Access to business services and information	33.33	<b>51.03</b>	36.75
2	Access to financing	43.75	<b>58.02</b>	57.23
3	Access to land	37.5	<b>42.86</b>	35.34
4	Anti-competitive practices of other competitors	43.75	66.9	<b>69.07</b>
5	Business licensing and permits	43.75	<b>47.4</b>	39.19
6	Contract violations by customers and suppliers	62.5	<b>65.14</b>	58.84
7	Corruption	56.25	<b>65.3</b>	63.34
8	Cost of financing	56.25	<b>60.49</b>	57.98
9	Customs and trade regulations	<b>75</b>	60.67	46.57
10	Electricity	<b>81.25</b>	73.51	61.96
11	Functioning of the judiciary	50	<b>54.93</b>	54.72
12	Labour regulations	31.25	<b>47.76</b>	36.89
13	Organized crime, mafia	43.75	<b>68.56</b>	61.62
14	Political instability	62.5	<b>67.39</b>	59.87
15	Production standards	41.67	<b>53.31</b>	47.07
16	Skills and education of available workers	31.25	<b>43.75</b>	38.06
17	Street crime, theft and disorder	50	<b>69.78</b>	66.27
18	Tax administration	50	<b>61.59</b>	48.15
19	Tax rates	50	<b>60.19</b>	49.06
20	Telecommunications	<b>37.5</b>	37.35	34.51
21	Transportation	37.5	<b>46.95</b>	39.14
22	Unfair competition (evasion and informality)	62.5	<b>81.51</b>	76.18

Riinvest Enterprise Barriers Survey 2011

firms operating in Kosovo's primary and secondary sectors.

Kosovo urgently needs a better understanding of sector-specific business barriers and their relationship to general barriers (which impact all businesses, across different sectors of the economy) – particularly for those sectors that have significant potential for inclusive growth, job creation and human development. Identifying sector-specific barriers may lead to sector-specific policies to address these. A “pro-people” analysis of potential growth-ready sectors in Kosovo should – to maximize economic and human benefits – focus primarily on the following **three criteria**: (i) tradability; (ii) labour intensity; and (iii) value-addition.

Why are these criteria the most critical for Kosovo's inclusive growth, and which human development benefits could accompany them?

*The objective of job creation should be to create a balanced portfolio of employment respecting human dignity and potential – allowing entry to the most excluded while also providing opportunities for growth and advancement*

*Increase human capabilities by allowing people to share skills, innovations and ideas*

**Tradability** of products and services is a vital consideration for Kosovo's business expansion, particularly from small and medium sized enterprises. Kosovo's huge trade imbalance and its import-dominated economy have

stifled incentives for inclusive growth (i.e. prioritizing national revenue streams over labour intensive, broad-based domestic growth). In this vein, it is important that any emphasis on job creation schemes in Kosovo through non-tradable sectors such as construction is balanced by support to tradable sectors.<sup>56</sup> Tradability is closely connected to sustainability, opportunity and choice in the marketplace; it is less dependent on boom/bust cycles, it opens the door to a wide range of workers and perpetuates growth by seeking to open up new markets. Kosovo's food processing, ICT, textile, agriculture and mining/energy sectors are highly tradable and, moreover, can connect different segments of the community with the marketplace. Together, they represent a balanced basket of basic, medium-skilled and high-skilled enterprise involving the rural poor, urban poor and urban skilled segments of the population. With the exception of mining/energy, these sectors also have a reasonable history of providing jobs for women as well as men. They represent the part of the economy most exposed to global competition, increasing opportunities for sustainability and growth. Exposure to markets outside of Kosovo could significantly increase human capabilities by allowing people to share skills, innovations and ideas, as well as increasing familiarization with other cultures.

**Labour intensity** is a critical factor in any inclusive economic strategy for Kosovo - which by definition should seek to expand both decent work opportunities and labour force participation as the primary route towards growth. Kosovo has significantly underexploited labour



resources and mounting employment pressures throughout its growing population of young jobseekers. These young people need to believe that jobs will be there for them if they are to be incentivized to finish school, acquire skills and compete in the marketplace. A critical question for Kosovo is, which sectors can produce the most jobs and what can be done to ensure that these job opportunities reach the most disadvantaged job-seekers? Sectors such as food processing, textiles, construction and agriculture usually exhibit a high labour to capital ratio.<sup>57</sup> Based on our data, the highest labour-capital ratio in Kosovo is in the textiles sector, followed by the food industry. Agriculture and construction are also highly labour-intensive, in comparison to sectors such as mining and energy which have a lower average labour-capital ratio, implying that operations in these sectors are capital intensive rather than labour intensive. As a caveat - labour intensity only measures the volume of employment potential in a sector, not the quality of jobs created. The objective of job creation should never be to fill the marketplace with low wage, insecure jobs but to create a balanced portfolio of employment respecting human dignity and potential - allowing entry to the most excluded at the lower end of the spectrum while also providing opportunities for growth and advancement.

**Value-added** businesses deepen the skills and capabilities of the marketplace. Kosovo's workforce is deeply under-skilled and desperately needs innovation around growth, environmental sustainability and governance. As a result, businesses thrive here that have low skills requirements. A situation has developed in which under-performance is the norm and

*A situation has developed in which under-performance is the norm and businesses no longer crave or miss the absent skills that have the potential to contribute so significantly to driving their growth*

businesses no longer crave or miss the absent skills that have the potential to contribute so significantly to driving their growth. This reflects forwards, into reduced household incomes and household capacities, and backwards into deflated education systems, into pessimism among the young and into resentment against a government seemingly unable to tackle such a vicious cycle. Sectors where potential exists to build skills and value into Kosovo's labour force include the ICT sector, the food processing sector, and some sub-sectors in agriculture. Conversely, textiles, construction and mining/energy are low value-added activities, demanding skilled labour only at the highest levels of management. However, it is important to highlight that, despite their low potential in terms of high value-added activities and contributing to building skills and value into Kosovo's labour force, the mining, energy and construction sectors all have the potential to generate large revenues from single ventures, and to provide the fundamental factors of production for other industries, without which, growth cannot occur.

One final, more subjective indicator of a pro-people, growth ready sector is **sustainability**. From a macro-economic perspective Kosovo has already experienced one post-conflict boom and bust, deeply damaging nascent businesses and international confidence. From the perspective of enlarging human choices, capacities and freedoms – a Kosovan worker who cannot rely on an income source, who

cannot be part of a steady, improving path of income and skill growth, is living in a state of permanent uncertainty. Her or his capacity to make investments – financial and personal (such as in education or skills, for example) – to take risks for personal or social advancement, and to engage in non-essential activities such a political activism are all diminished. In Kosovo, the food, textiles, ICT and agriculture sectors all have strong potential to offer sustainable growth that is also inclusive – open to a broad base of Kosovan society and able to widen formal labour force participation among the poor and the excluded. On the other hand, two of Kosovo’s current high priority sectors – mining/energy and construction – are less reliable in terms of their potential to offer sustainable, inclusive growth. As an example, the construction sector continues to offer intensive employment and has been critical to providing low skilled men with immediate income. However it shows many hallmarks of a deeply transient and insecure operating environment. Unfinished buildings and half-developed roads litter Kosovo’s landscape, signalling that the construction boom is at an end. Kosovo’s economic lens needs to be refocused, and its investment priorities seriously re-evaluated based on their potential contribution to the sustainability and equity of the marketplace as a whole.

This report does not have space for a truly comprehensive and detailed analysis of the barriers facing the growth-ready sectors identified. However, a summarised insight into three examples across the primary (agriculture), secondary (food processing) and tertiary (ICT) sectors are included in the Boxes.

The analysis in this section, focussed on growth ready sectors, stresses the need to focus on sectoral barriers and sector potential through a human development lens. Different sectors differ in their impact on particular segments of society, and human development benefits are highly dependent on achieving equal, inclusive and balanced growth. If Kosovo is to reap the full direct and indirect benefits of its growth-ready sectors, they need to be tackled as a portfolio rather than separately, with those offering the greatest people-focused, long-term benefits prioritized for support by government and by international partners.

### 3.5 A Pro-People Marketplace - Policy Implications

Analysis of the different weightings given to business barriers by different segments of Kosovan society suggests that Kosovo’s private sector is able to foster growth, but in a very selective way. Certain sectors can find room to profit, given the right conditions. This is particularly applicable for micro enterprises, informal ventures and urban-clustered tertiary sector companies – all of which have exhibited less difficulty than other businesses in overcoming the challenges in their path.

However, Kosovo’s private sector is not structured to promote *inclusive* growth – growth that opens participation, income and empowerment to a broad spectrum of society, and that tackles poverty at the root by giving opportunities to those traditionally excluded from the marketplace.

Creating new small or micro businesses is less challenging than expanding existing ones – limiting the potential of the market to create sustainable and value-added jobs. Entire segments of society – particularly the rural poor, and women, experience far higher barriers to entering the marketplace than their male and urban peers, perpetuating inequality and dependence. Boom sectors have, to date, either been exclusive by nature with tenuous sustainability (e.g., construction), or prone to informality and low labour intensity (e.g., urban service-related businesses).

To create a pro-people marketplace in Kosovo will require some clear policy steps tackling barriers to growth affecting the excluded. Whilst reiterating that these policy steps can only be implemented with the support of businesses themselves, the analysis of this chapter indicates the following policy recommendations:

- **Focus on the leap from small to medium:** analysis shows that business barriers are experienced at a far higher level once a company reaches a certain level of growth. This is indicative of the true nature of barriers in business. The larger a company is, the harder it is to hide inside informality and the more exposed it is to the challenges of regulatory compliance, taxation and financing. However, medium sized companies are Kosovo's most realistic chance to create three thriving business sectors beyond the current predominance of the tertiary sector, and to move from a fragmented economy to an integrated one. The practical and policy barriers hindering the expansion of small enterprises towards medium size, including

through new business activities, must be addressed and time-bound targets set for a healthier business balance.

- **Provide incentives and infrastructure for formalization, particularly in rural areas:** perverse incentives towards informality are one clear reason why Kosovo's primary and secondary sectors are so weak. Regulatory complexities (within taxation, licensing and financing systems) are not the only reason for Kosovo's large informal economy. A further reason emerges from a culture of permissiveness founded on intra-tribal allegiances, weak enforcement, private-public mistrust and the perception among would-be entrepreneurs of being "on their own" when it comes to raising capital and enforcing contracts. Incentives towards formalization are far weaker in rural areas, where the majority of primary sector growth is found, and where lack of infrastructure, education and basic government services - combined with punishing VAT systems - make formal businesses look virtually unsustainable. As a result, business owners, their employees and broader society miss out on many opportunities. Businesses fail to grow through cooperation and economies of scale, labour is more likely to be informal, under-paid and unprotected, and social benefits - whether direct (community income growth) or indirect (better choice in services, more incentives to learn) - are absent. Formalization of businesses in poorer areas needs to be a priority, pursued through positive approaches rather than punitive - and through methods that

educate, empower and support fragile communities who may be dependent on their informal businesses for survival.

- **Set targets for enhanced female labour force participation, prioritizing access to finance and training to increase employable skills:**

women are triply denied entry into Kosovo's marketplace - first, through an extremely low labour force participation rate, second through a markedly disproportionate unemployment rate and thirdly through higher-than-average challenges in establishing a business. The human development arguments for increasing women's knowledge, skills, capabilities and freedoms are so numerous that they need not be elaborated here. However, the economic arguments may be less clear to many of Kosovo's leaders, businesses and heads of household. Half of Kosovo's population are effectively being squeezed out of income generation - limiting household budgets, holding back GDP growth and impacting the prospects of future generations. It is a price that Kosovo simply cannot afford to pay if EU membership is seriously in its sights in any reasonable time frame. An economy-wide strategy is essential to tackle the primary challenge - labour force participation - while simultaneously improving women's employability via industry education, target-setting and

vocational training. Not all women will want to work - and that is also their right. However, those who are prevented from even trying, because of a closed market and closed attitudes, deserve policy and industry support.

- **Develop interlinked strategies to address barriers hampering growth-ready sectors, focusing on sustainable tradability, labour-intensity and value-addition:**

Kosovo's private sector cannot progress on all fronts, but neither is it economically viable to concentrate only on one sector at a time. Strengthening SOEs and providing "cash for work programmes" are an important part of any economic vision, and investment in such revenue - and infrastructure - providing businesses as mining/energy and construction are certainly central to growth. However, these industries alone cannot create *inclusive* private sector growth, nor generate the broad-based social benefits which this growth could realise. Inter-linked sectoral strategies could help ministries cooperate in reducing barriers affecting several growth-ready sectors that offer the maximum value for Kosovan self-sustainability, capacity growth and linkages with the international market. Such strategies could also support Kosovo's international partners in deciding where to allocate investment support.

Agriculture is one of the most important sectors in the Kosovan economy from a human development perspective. It contributes approximately 12 percent of the GDP and provides work (albeit informal) to about half of those living in rural areas (KAS 2009). The sector also provides a social safety net for a large number of poor people who are dependent on subsistence farming. It is estimated that more than 50 percent of agricultural production in Kosovo is consumed internally, by the household itself, while spending on food remains the biggest proportion of total household expenditure (KAS 209).

The formalization and strengthening of this sector could empower Kosovo's rural poor, open the door to education, services and development opportunities, promote cooperation across ethnic divides and build opportunity and capacity across Kosovo's entire society. In order to realise this potential, significant improvements in the competitiveness of domestic production are needed, which will require substantial investments in the sector and the associated financing to facilitate this. Despite its potential to be a source of growth, small average farm size, low productivity, low quality of products, poor use of inputs and technology and underdeveloped infrastructure, restrict the sector's ability to compete with production from neighbouring countries. Interviews with agricultural firms revealed that the main barriers in the agriculture sector in Kosovo are supply and production related and the following are seen as the key barriers to the sector's development:

#### **Barriers internal to the firm:**

- small average farm size and fragmented agricultural production
- limited application of new technologies and modern business and marketing skills
- insufficient cooperation among small producers and a small number of associations
- insufficient number of collection points.

#### **Barriers external to the firm:**

- limited access to finance
- lack of trade and fiscal incentives
- lack of food quality standards and control
- weak rural infrastructure.

In Kosovo, small farms account for 98 percent of all agricultural land with the smallest farms, under 1.5 ha, accounting for 38 percent (BAH 2010). Small farming has several disadvantages, from higher initial start-up costs, lack of market share and product distribution, through to low productivity, all of which do not allow small farms to compete with agricultural produce from neighbouring countries. The use of technology is also a key barrier and Kosovo's agriculture sector is characterized by a low level of mechanization

at different stages in the production value chain, few cooperatives to pool equipment purchases and a lack of certified repair technicians.

In many cases Kosovo's agricultural sector is facing a lack of management capacity in agri-businesses, a lack of will to change former practices, or the lack of a more market-driven approach. In some cases, technical assistance, particularly in training and support for marketing, is a good way to support development. Lack of coordination among small farmers is another obstacle. The capacity of existing cooperatives is weak and few focus on the full value chain of activities. Currently, there is also a lack of organizational responsibility for food safety and for the effectiveness of private laboratories in food quality testing.

A further key barrier for the sector is the lack of financial products currently available to small farmers in Kosovo. While Kosovo's banking system is robust, access to agricultural loans is very limited and small farmers with minimal collateral do not have sufficient access to investment capital. Alternative financial products are not available (though some food processors do provide some access to credit for their supplying farmers) and investment is limited by the lack of borrowing capacity in the sector (BAH 2010). Improving access to finance is a key element to support the development of agriculture and the rural economy in general. Currently, the main difficulties for those in rural areas seeking loans are associated with finding satisfactory collateral and with the fact that credit is normally given on a short-term basis, at relatively high interest rates. In addition, in cases where access is less problematic, the lack of business planning is often a major factor in the rejection of loan applications.

Challenges within Kosovo's agricultural sector could be reduced by increased coordination amongst the county's government and foreign donor agencies which, between them, are providing 15–18 million EUR per year in support of the agricultural sector. With effective coordination, this funding could become a major source for improvements in agricultural related infrastructure, input quality, productivity, crop diversity, product quality and export promotion (BAH 2010).

Finally, the current lack of trade and fiscal incentives is identified as one of the principal barriers in the agricultural sector. There is an urgent need to reduce the incentives for fiscal evasion and operating outside the formal economy and to embed the agricultural sector within legal activities. In this regard, the Government of Kosovo has implemented several reforms in order to increase productivity in the sector. The first reform, which was implemented in 2005, removed the general ten percent customs duty on imported inputs and capital goods for agriculture. However, most agricultural inputs came from neighbouring countries (Serbia, Montenegro, Albania, FYR of Macedonia), which already had duty-free arrangements with Kosovo. Therefore, this first reform had little direct impact on farmers. The second reform, which removed the obligation to pay VAT on critical inputs for agriculture, has had more impact on the sector's development by reducing production costs and enhancing competitiveness.

This sector covers manufactured food and beverages, the local demand for which is currently mostly covered by imports. This sector has significant human development correlation: it is labour intensive, thereby creating jobs and encouraging the participation of those excluded from higher-skilled markets. It offers greater price elasticity than other markets and a greater proportion of the final value of the product is generated in Kosovo, in comparison to some other sectors – expediting growth and export potentials. The food processing sector also has the secondary effect of connecting rural economies with international markets (rural food produce can be utilised as a production factor for the food processing sector, the products of which can then be exported), expanding choice and opportunity. Currently, it is estimated that approximately 70 percent of the Kosovan food processing sector's demand for food produce as factors of production is covered by imports. In addition to this, imports are estimated to cover 70 percent of Kosovo's consumer demand for processed vegetables and dairy products, 80 percent of the demand for processed meat and merely ten percent of that for processed fruits. These figures alone therefore illustrate the large potential opportunity for import substitution by local producers, without even considering export opportunities.

Further to this, the demand for processed vegetables as indicated by manufactured produce figures is likely to significantly underestimate the actual demand for processed foods, considering that a considerable amount of vegetables, fruits and, to some extent, meats, are processed by Kosovan households for their own consumption. This indicates that the potential demand for processed food products is in fact larger than current statistics suggest and this is likely to increase further as the standard of living and employment (especially of women) in Kosovo increase or as local producers are able to provide qualitative products at competitive prices.

Despite the current huge trade imbalance in this sector, the fact that the sector has, to some extent, managed to compete with imports means that the manufacture of food and beverages still exhibits significant potential. It is the largest manufacturing sector in terms of sales and employment, employing more than 23,000 workers (Riinvest 2010). Further, there are indications that the sector is growing, as indicated by the fact that that firms in the sector plan to increase employment in the next few years with a majority having also undertaken investment recently. These results are consistent with the finding that firms in the manufacture of food and beverages report, on average, the highest profit margin among manufacturing industries in Kosovo (Riinvest 2010), and pay employees a higher wage than the average in the manufacturing sector.

As jobs in food and beverage processing are traditionally seen as jobs for women, from a social perspective its development is advantageous because it is likely to create relatively more employment opportunities for women, who, as explained earlier, are less likely to be employed and active in the labour market. In addition, and perhaps even more importantly, the development of this sector has the potential to have significant multiplier effects, primarily

in agriculture as a supplier of inputs for this sector, but also in areas such as the packaging and labelling of products and services, something which is currently almost exclusively imported.

In terms of demand, the barriers to the development of this sector appear to be low. However, the success of the sector largely depends upon the business environment. Interviews with firms in the sector identified that the key barriers to the development of the food processing sector in Kosovo comprise:

**Barriers internal to the firm:**

- level of workforce skills
- level of investment in R&D, training, quality certification and product promotion.

**Barriers external to the firm:**

- energy supply
- unfair competition
- corruption
- access to finance.

Lack of a reliable supply of electricity was identified as the most important barrier to the sector by firms involved in food and beverage manufacturing. After this, the next most important barriers were identified as unfair competition and corruption, both of which act to increase operating costs, increase risk and hamper the competitiveness of businesses in the sector.

Access to finance is another key success factor that is currently unsatisfactory. Three-quarters of the value of investment undertaken in the manufacturing of food and beverages was financed by businesses own funds, and the businesses interviewed identified that the conditions and cost of finance are currently unfavourable.

Finally, two barriers identified in this study as key to the development of this sector are the low level of workforce skills and lack of investment in R&D, training and quality certification. A closer look at the skills levels and training needs of the workforce in food and beverage manufacturing has identified major deficiencies in the key skills demanded by firms, often making it necessary for major firms in the sector to seek expertise from elsewhere in the region, thereby increasing their operating costs (UNDP 2011). Coupled with the inability of current education and training systems to compensate for these shortcomings, these skills shortages should to be a major source of concern for policy makers. Similarly, the situation is sub-optimal when considering the levels of investment in R&D, training, and certification made by businesses in the food and beverage processing sector. It is observed that, on average, these firms only allocate approximately 5 percent of their total investments to these key areas which are important factors for increasing the level of quality of local products and, together with effective promotion, their competitiveness in the local market, and for potential export markets.



The ICT sector in Kosovo is small but growing fast. It has enormous potential for a young generation of Kosovans which overall has high IT skills and, currently, low employment prospects. The sector encourages skills education and a focus on innovation, and has the potential to generate significant FDI. According to USAID (2007), Kosovo's ICT sector was growing (in terms of sales turnover) at a rate of 20–25 percent annually in 2007. Meanwhile, USAID (2011) argues that there are an increasing number of vacancies for ICT professionals in Kosovo, reflecting the increasing progress of the industry in general, and that there has been improvement in the education and training of IT specialists in both public and private universities. According to this study, employment in the ICT sector is rising, though at a slower rate than sales, with an estimated employment annual growth rate of four percent during 2010.

From a social perspective, the development of this sector is important because it provides job opportunities for Kosovan youth, which, as explained previously, is an age group that suffers disproportionately from unemployment. However, as explained below, potential employment opportunities in ICT require a highly skilled workforce, which is a key success factor for this sector. It is important to highlight here that, in comparison to the general business environment, where staff skills and education rank at the very bottom of perceived business barriers, in the ICT sector this is ranked amongst the most important barriers.

Compared to the perceptions of the private sector in general, and those of the other sectors analysed in this report, the ICT sector appears to experience a different set of obstacles. In order to gain more specific information on the sector-specific barriers, an interview was conducted with the Kosovo Association of Information and Communication Technology (STIKK), which operates as part of the Kosovo Chamber of Commerce. This interview identified the following as the key barriers to the ICT sector's development:

**Barriers internal to the firm:**

- insufficient skills in the workforce.
- Barriers external to the firm:
- unfair competition arising from public procurement procedures
- lack of intellectual property rights (IPR) protection
- uncompetitive treatment by trade, VAT and custom policies.

The nature of unfair competition in this particular sector appears to be somewhat different and more pronounced than in other sectors. According to STIKK, the main buyer of ICT products in Kosovo is government, constituting around 90 percent of the total market. While this could arguably change as the private sector grows, STIKK argues that

given the importance of government to IT firms, irregularities in public procurement remain a top barrier. A principal contributor to this problem arises from the lack of human capacity in Kosovo's government ministries to compile effective terms of reference for public tenders. This lack of clear and well defined requirement specifications creates possibilities for wide interpretation by procurement bodies, often leading to the provision of tenders to firms closely related to the decision makers.

Fiscal requirements in Kosovo are considered uncompetitive with those elsewhere in the region, mainly due to unfavourable trade policies, customs policies and VAT. Other countries in the region have, for example, a zero percent import tax on technological products such as computers and laptops, in comparison to the ten percent customs duty for technological products which is applicable in Kosovo. In addition to this, in Kosovo, technological products are subject to the application of 16 percent VAT, while in the other countries VAT is as low as five percent. This makes other markets in the region (such as that of FYR of Macedonia) more attractive for the purchase of such goods, hampering immensely the Kosovan market.

Lack of intellectual property rights (IPR) – and of a comprehensive and enforceable system to protect those rights – is perceived as an obstacle by the American Chamber of Commerce in Kosovo (Musa 2011), particularly for companies in the ICT sector. In software development, for instance, it is difficult for firms to prevent (ex-)employees from transferring software developed in the firm (or slightly modified versions) to a competitor, who then sells it on as their own (Çavolli 2011). In this case, the problem lies not only in enforcement, but also in the inability of the original developer to patent the software. IPR issues may affect relatively few Kosovan businesses currently, but addressing these issues is a crucial precondition for the development of high value-added activities and a key factor in the current and potential future willingness of foreign investors to transfer know-how to their Kosovan subsidiaries.

ICT companies are also hampered in that they have to allocate significant resources to the training of their workforce due to the deficiencies of the formal education system in Kosovo, which does not supply a qualified labour force for the sector. Existing education programmes are not adapted for the constant developments in the information technology sector and more emphasis needs to be put on improving conditions for students in order to stimulate advancement and innovation. In the meantime, skills development gaps seem to be bolstered by professional ICT trainings through international companies such as Cisco, Microsoft and Oracle.



## Private Growth in the Social Context

*"The good we secure for ourselves is precarious and uncertain until it is secured for all of us and incorporated into our common life."*

**Jane Addams (social and political activist, founder of the Women's International League for Peace and Freedom - WILPF, and Nobel Peace Prize Laureate 1931)**

This final chapter seeks to explore in more detail the critical intersection between Kosovo's private sector and its social context. Private sector growth and human development gains can be mutually reinforcing. If the ultimate goal of private sector growth is a healthier, more empowered, self-reliant and happier society then it is relevant to ask how private growth enables the capacities and rights that intrinsically define such a state. Three key issues in this regard are (i) the intersection between private growth and human capabilities and skills; (ii) the relationship between private growth and the delivery of fundamental rights and protections inside and outside the workforce; and (iii) the link between private growth and environmental sustainability in what is one of Europe's most polluted regions.

### 4.1 Fostering human capabilities

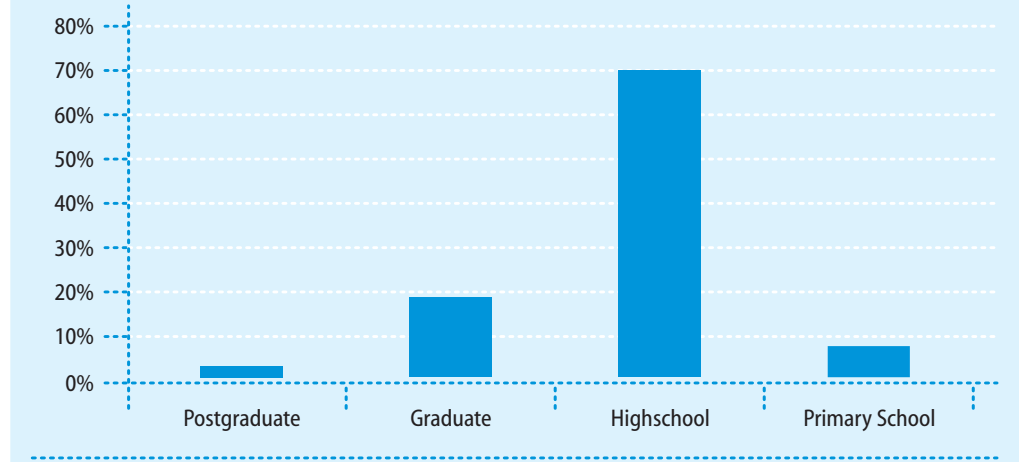
This report has several times noted the paradoxical finding of businesses having relatively high satisfaction in the skills of their employees despite the low-skill climate which exists in Kosovo. This is evidenced in Figure 2.1 which identified that the skills and education of the available workforce

was perceived as a relatively low barrier to businesses in Kosovo, with a score of 38 – approaching the bottom of the list of critical business barriers. This can be seen as an indicator of an underperforming marketplace. However, it is important to highlight that - as illustrated in Table 3.1 - concerns over workforce skills and education increase alongside the size of businesses. Micro companies (which account for an estimated 96 percent of enterprises, with many of these involved in low value-added activities) reported a skills and education barrier intensity of roughly 38 (scored on intensity scale of 20-100 with 100 being the most intense barrier), small-sized companies around 46 and medium-sized companies 61. Overall, the results of the analysis revealed that the lack of skills and an educated workforce is more of a problem for larger enterprises (medium sized and larger), and for those firms operating in the secondary sector and the higher value added tertiary sector. Businesses also reported taking twice as long to fill positions for which high skills are required, than to hire for jobs further down the skills chain.

How unskilled are Kosovo's workforce? As illustrated in Figure 4.1, it seems that the great majority of Kosovo's formally employed workforce is educated to at least high school level, with one in 5 holding a graduate degree.

**Figure 4.1**

Academic qualification of employees (Percentage of the Kosovo's total formally employed workforce which have attained different levels of academic qualification)



Riinvest Enterprise Barriers Survey 2011

However, with much of Kosovo's employment informal, and low labour force participation generally, these figures paint a rather distorted picture of the total basket of skills among Kosovo's working age population. At 11.3 expected years of education, Kosovo has the lowest anticipated education levels in the region. In addition, the quality of learning has been seriously questioned by previous Human Development Reports,<sup>58</sup> with a lack of synchronization between the subjects learned in school and the skills needed to participate in the job market. There is no more recent report on overall working age skills than the European Training Forum analysis of 2007, referred to in the Introduction, which assesses that two out of every three adult Kosovans have low levels of education. A Ministry of Labour and Social Welfare report from the same year indicates that 76 percent of women registered unemployed were unskilled or semi-skilled.<sup>59</sup> The report also indicates that nearly 70 percent of all those unemployed in Kosovo were semi-skilled or lower.<sup>60</sup>

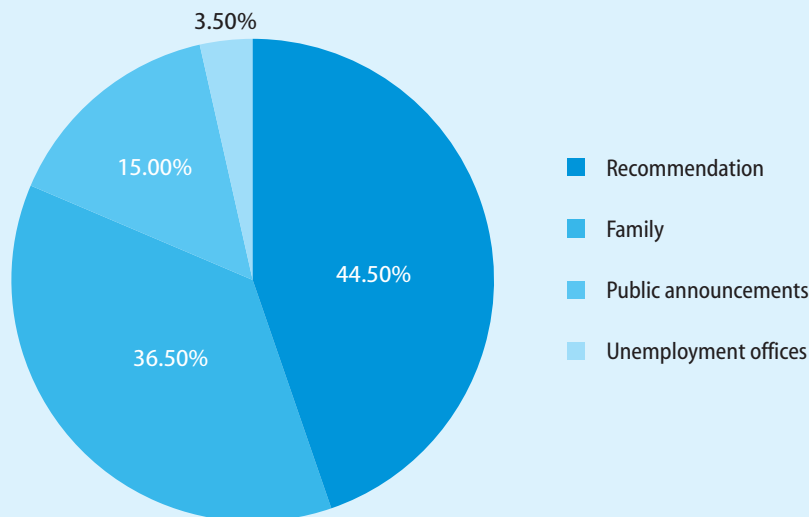
Ironically, a jobseeker's skill levels seem to be less important than other factors

when it comes to securing a good job in Kosovo. There is evidence to suggest that employers in Kosovo are more likely to rely on informal recruitment methods. As illustrated in Figure 4.2 below, the majority of firms surveyed for this report (approximately 45 percent) engage workers primarily through recommendations from friends and partners. A further 36 percent of firms surveyed indicated that they primarily recruit from amongst their family. Between them these two sources mean that approximately 80 percent of Kosovo's businesses use primarily inner circles and recommendations to hire staff. Only 15 percent of firms reported that they primarily hire staff via public announcements, and even fewer, less than 4 percent, from public unemployment offices. When analysed by size of firm, the data revealed that, of all firms in Kosovo, small firms – which account for the majority of Kosovan employers – are the most likely to primarily utilise the connections-based hiring methods described.

Informal recruitment methods such as those described act to disadvantage the very sectors of society that are most in need of support: the

unemployed, the marginalized and the young. In areas of high unemployment impacts the ability of businesses to compete and grow.

**Figure 4.2** Primary source of staff recruitment (percentage of firms interviewed)



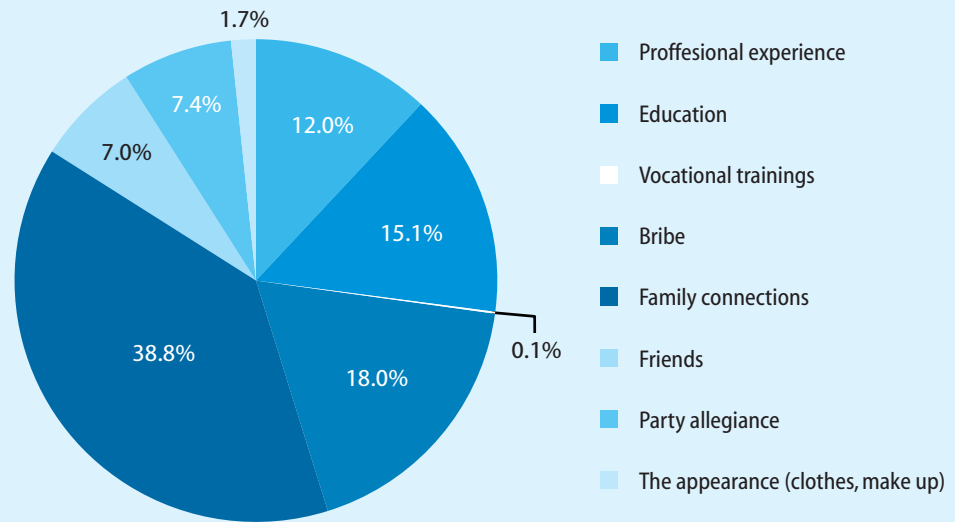
Riinvest Enterprise Barriers Survey 2011

and within deprived communities, the necessary networks and contacts for obtaining information about job vacancies are poor, and young people are further discouraged from staying in school, acquiring skills and competing in the labour market. The long-term unemployed are also much more likely to slip out of labour-force participation altogether if they believe they have become unemployable due to poor connections. Those who benefit the most from Kosovo's culture of nepotism are dominant ethnic groups, and those with economic or political power.

Nepotism also subtly alters the values which employers hold in Kosovo – indicated by focus groups discussions with employers that often prioritised loyalties over skills. The lack of a tendency to select workers from a level playing field based upon merit ultimately results in the selection of a less skilled workforce, which in turn

Young people in particular are very aware that Kosovo's hiring practices may leave them shut out and excluded from employment. It takes longer to connect a young person with the job market in Kosovo than it does in some of Kosovo's neighbours. For example, it takes approximately ten years for young Kosovan males to transition from school to work (measured by the time taken for 50% of the population to move from being enrolled in school to being employed), compared to four to five years in neighbouring FYR of Macedonia.<sup>61</sup> Jobseekers under 25 years old, when asked to rate the importance of various factors while seeking work overwhelmingly indicated connections as the most important factor (38 percent). In comparison, only 15 percent of those surveyed rated education as the most important factor.

**Figure 4.3** Factors perceived by youth as the most important in successful job seeking



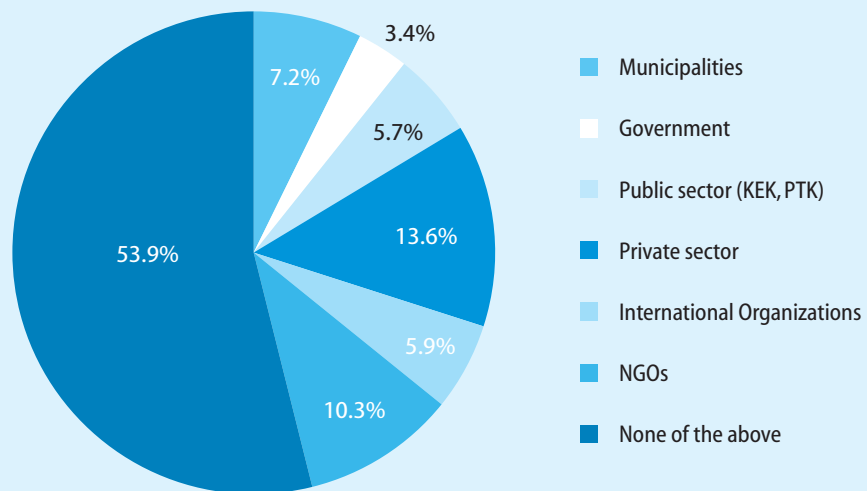
UNDP Public Pulse Opinion poll Nov-11

While the data gathered in the UNDP Public Pulse (2011) survey and presented in Figure 4.3 above is focused on public sector employment, qualitative interviews indicate that the perception of these factors does not differ significantly between the public and private sectors.

In fact, overall, Kosovo's private sector does little better than its public

sector in giving the impression of fair recruitment based on skills and merit. Nearly half (54 percent) of young people interviewed as part of the Rinvest Enterprise Barriers Survey (2011) said that fair hiring practices were not to be found anywhere in Kosovo. This is in stark comparison to the 14 percent of respondents interviewed who felt that private sector practices were fair.

**Figure 4.4** Which institution/entity do you think implements the fairest recruiting? (percentage of respondents)



UNDP Public Pulse Opinion poll Nov-11

It is possible – indeed essential – to increase the human potential of Kosovo’s working age population, and encourage a belief in the possibility of advancement through learning and skill. This can be most effectively achieved through the harmonization of government strategies for employment, education, and vocational training. Kosovo requires a culture of lifelong learning and a belief that fostering personal potential and investing in oneself will lead to a better standard of living.

*Currently, vocational training programmes do not seem to meet the needs of those most excluded from the workforce – the illiterate, the poor and highly dependent women.*

Currently, Kosovan young people feel very ambivalent as to whether education prepares them for life or not. In a series of focus group surveys conducted by UNICEF, over 40 percent felt that education was not useful in preparing them for the workforce, 30 percent felt it was and another 30 percent were unsure.<sup>62</sup> The same report indicated that across Kosovo, 36 percent of 15-24 year olds in school had no laboratories, 29 percent had no Internet and 19 percent had no computers. It is hardly surprising that 48 percent of these young people put unemployment at the top of their list of threats to their and Kosovo’s future - with poverty coming a close second with 30 percent of respondents ranking it as the most significant threat.

Currently, vocational training programmes and even catch-up literacy programmes do not seem to meet the needs of those most excluded from the workforce – the illiterate, the

poor and women who are in positions of high dependency. The Kosovo Ministry of Education, Science and Technology (MEST) has implemented a *Dritare Jete* (literally translated: *window of life*) programme, which allows women without primary school certificates the opportunity to acquire them. However, this programme has yet to be rolled out in the poorest areas, fails to take into account the challenges faced by women caring for children and is still of uneven quality.<sup>63</sup>

Data from 2003 indicated that a significant proportion (55 percent) of those enrolling in vocational programmes funded by the Ministry of Labour and Social Welfare (MLSW) had completed secondary school. This figure was even higher for those women participating, of which over 70 percent had a secondary school certificate.<sup>64</sup> Both of these statistics highlight the fact that vocational training programmes in Kosovo have not been adequately targeted at those most in need. Given the significant literacy gaps between men and women, particularly in rural areas, it seems that the most deprived have the least access to programmes that could transform their lives. Social transfers such as household benefits also do not, as yet, connect the unemployed with lifelong learning schemes, work readiness programmes or other creative initiatives that could bring employers and jobseekers together. Special training programmes should be considered for those least likely to be able to access traditional programmes – particularly rural women, the disabled and marginalized minorities such as the RAE.

A minimum standard of social services in impoverished communities is also critical to raise labour force participation and reduce dependence on remittances and benefits. Without



health, water, electricity and education services, families are reduced to survival strategies. Job seeking carries an opportunity cost, if job seekers have other time-consuming obligations such as subsistence farming or caretaking for sick relatives. Such investments, focussed on raising the standard of social services in Kosovo's poorest communities, pay long-term dividends by starting to break down cycles of deprivation and exclusion (UNDP KHDR 2010).

Education, learning, skills development, inclusive growth and political empowerment go hand in hand. Their benefits to the economy and to the health of society are profound and mutually reinforcing. Enlarged capabilities improve self-esteem as well as technical skills and lead to higher workforce participation and ideally to higher incomes. All of these factors contribute to incentivising business expansion and inspiring and equipping people to innovate, engage in new business activities and bring value-added entrepreneurship to a marketplace that badly needs it.

## 4.2 Linking workforce dignity and social protections

The link between work, dignity and social protection is extremely important and dignity and security in the workplace can affect entire lives. If work is not decent, and if worker rights are not protected, work can contribute to misery, inequity and resentment rather than an enlargement of freedoms and choices. In addition, the private sector has an impact on the capacity of government

to ensure broader social protections, as an engine of revenue redistribution. As the level of decent, formal, tax paying and income generating work increases, so does the potential to increase creative government support for those not in the workforce, geared towards lifting them out of dependency.

### 4.2.1 Workforce dignity

Does Kosovo's private sector growth model support workforce dignity? Kosovo has recently introduced fundamental changes to its Labour Law, affecting wages, maternity leave, pensions, and equal opportunities for the disabled. One such change is the increase in the maximum allowable maternity leave to one year, enacted into law in 2010.<sup>65</sup> In addition to this, in August 2011, the Government of Kosovo approved a decision of the Social Economic Council,<sup>66</sup> setting Kosovo's first monthly minimum wage at 170 EUR for employees aged 35–65 years and 130 EUR for those under 35. These laws are an admirable effort to protect the rights of the poor and of women in the workplace. However, their implementation across the marketplace, and their impact on society's most vulnerable, remains open to question.

Qualitative feedback indicates that businesses are struggling to understand and accept these new laws. Indeed, many appear likely to circumvent them by engaging in informal employment and hiring fewer women.

A striking 40 percent of firms interviewed reported that they were unaware that a minimum wage had been introduced. An absolute majority (91 percent) of such firms are micro enterprises, with only 9

percent being small firms. Medium-sized firms were all aware of the minimum wage requirements, indicating a clear tendency for larger firms to be more informed regarding legal requirements. Assuming that minimum wage protections mainly impact those workers with the lowest level of education, respondent companies were asked to identify salary levels for those with primary school education or less. Around one third indicated that they were paying these workers less than the recently introduced minimum wage. Since this law is relatively new, it will be important to find methodologies to assess its implementation and its impact on poverty rates among the employed over the coming years.

The impact of maternity leave protections on women's job security is more concerning. During a series of roundtables, participants noted the introduction of a new practice of issuing short-term contracts (one to two months) for female workers to help companies to avoid maternity leave obligations. Prior to the new legal provisions with regard to maternity leave, there were no significant differences in contract duration between men and women. A number of women interviewed felt that, because of the adverse effects of its introduction, the law has actually acted against their interest and position in the workplace. Many felt that they would now be pressured to accept informal, short-term contracts and miss out on pension contributions and other job securities. Young women are particularly at risk, more so than women already past the childbearing phase of their lives.

There is little quantitative data on the impact of the disability provisions in the Labour Law – which

states that for every fifty employees, a company must hire at least one disabled person.<sup>67</sup> Respondents in this survey indicated that the few medium-sized firms aware of this law have aimed to have only 50 people on their books, to avoid obligations in this regard.

There are clearly challenges arising from Kosovo's workforce protection policies. These challenges are particularly associated with the implementation of these policies rather than associated with the legislative foundation itself. These policies can – despite having been designed to protect the interests of working women and newborns – have the undesired effect of increasing the overall cost of labour and increasing the relative cost of hiring women. These laws therefore require highly sensitive implementation and monitoring policies.

Around the world, societies are still struggling to find the optimum balance between workplace protections and growth-enhancing business freedoms. There is no reason to believe that Kosovo will find the perfect formula. However, much can be done to help Kosovan companies see these laws as socially beneficial and even opportunity-providing – for example, maternity leave can be covered by promoting internally, adding to worker skillsets. Concerted engagement with businesses on these issues and a positive worker-employer relationship are critical to ensure alignment between laws and what actually happens on the ground, and to ensure that social protections increase dignity without decreasing opportunity.

*It is absurd for an employee to be away from the workplace for a year. If this law is not changed, we will not hire any more women for our firms*

#### 4.2.2 Social safety nets and growth-linked revenue redistribution

Social safety nets and transfers (often defined as the provision of income and public services to individuals and social groups who are in need, without payment, so that they can enjoy an improved standard of living) are sometimes viewed as the enemy of private sector growth – draining national economic resources without providing growth benefits. Is this true or untrue for Kosovo?

The 45 percent of Kosovans who are below the poverty line - many of whom are either not in the workforce or unemployed - depend heavily on a combination of government social welfare and remittances. These intersect with Kosovo's private sector prospects in a number of ways.

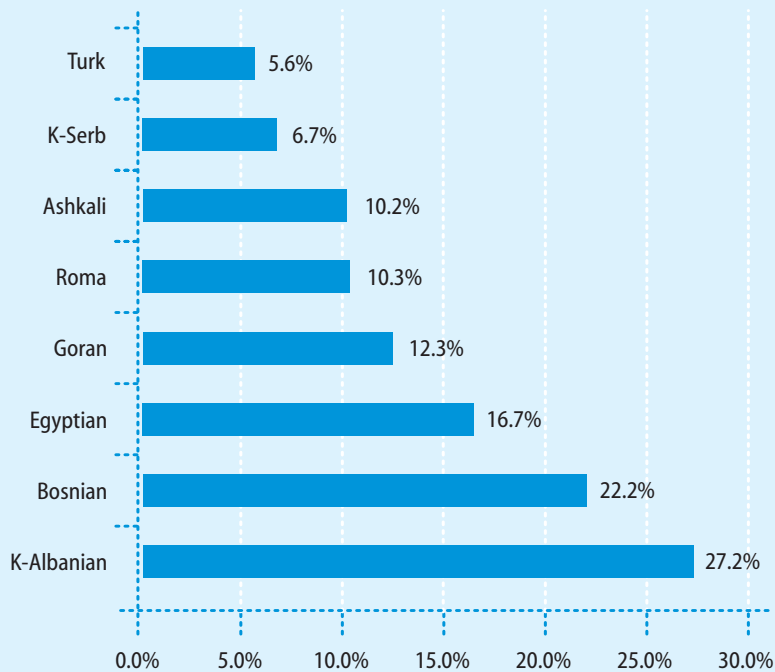
**Remittances** play a complex role in Kosovo's growth model – both good and bad. They can positively affect economic growth in a number of ways. One of the main effects is generated through multiplier effects where the way in which remittances are spent by the recipient household can have important effects on the broader economy, *i.e.*, by increasing aggregate consumption, production and investment. Studies show that there is a positive relationship between inflow of remittances and poverty reduction in developing countries (Brown 1994; Faini 2002; Mesnard 2004; Lucas 2005). These same studies also found that remittances make a significant contribution to savings and investments in developing economies, with households who have limited access to finance heavily reliant on remittances for any investment projects.

Political and socio-economic developments during the past three decades

have led to a significant outflow of Kosovo's population. In the late 1980s and the 1990s, emigration accelerated as the political situation worsened in the years leading up to the 1999 conflict. Many emigrants did not return to post-conflict Kosovo, particularly due to the lack of employment opportunities in Kosovo itself and due to the large income opportunity differences between Kosovo and many of the more developed countries where Kosovan emigrants had come to reside (Riinvest 2008b). It is estimated that around 25 percent of Kosovans (of all ethnicities) currently live abroad, and that approximately two thirds of this population visit Kosovo every year (Riinvest 2008b).

According to recent studies in Kosovo (UNDP 2010; Riinvest 2008b), approximately 20 percent of Kosovan households receive remittances from family members abroad. As illustrated in Figure 4.5 below, remittance inflows are more common amongst K-Albanians: with 27 percent of households benefiting from remittances in 2010, compared to 7 percent of K-Serb households and 12 percent of RAE households. Remittances are reducing the number of Kosovans living in poverty (World Bank 2011) but are not always reaching the poorest and those most in need (for example, the data show that a smaller percentage of disadvantaged RAE households receive remittances than among K-Albanian households). In 2009, one in every five households in Kosovo depended on remittances for over a quarter of their income, with the total received in remittances constituting 11 percent of Kosovo's GDP.<sup>68</sup> In addition to the effect of remittances from Kosovan family members living abroad, the annual influx of many of these emigrants into

**Figure 4.5** Percentage of households which receive remittances, disaggregated by ethnicity



UNDP Remittances Survey 2011

Kosovo during the summer months increases aggregate consumption during their stay, having a further positive impact on Kosovo's economy.

Remittances benefit Kosovo's business environment both directly and indirectly. Studies indicate that approximately 12 percent of Kosovan remittances are used directly for enterprise investments, 10 percent are used for debt repayment (some of which will be enterprise related), and approximately 12 percent are used for human investment such as education and training.<sup>69</sup> Studies conducted outside of Kosovo have identified that remittances act to reduce the credit constraint of the beneficiary household, and therefore facilitate increased business activity and private investment (Yang 2004; Woodruff and Zenteno 2004). In

addition to direct impacts on businesses and the private sector in Kosovo, indirectly, remittances are also helping to finance education and health services in Kosovo, helping to improve social and human development indicators and helping to support a healthy, skilled workforce.

However, despite the positive impacts outlined, remittance inflows on the scale seen in Kosovo also act to detract from the enterprise climate. Regardless of the impressive amounts of money entering Kosovo through remittances, the multiplicative effect on generating economic growth and new jobs is not proportional. Remittance inflows are mostly spent on imported consumer goods, imported inputs for housing construction and on health services (Rinvest 2008b). Remittances also widen the labour force participation

*Regardless of the impressive amounts of money entering Kosovo through remittances, the multiplicative effect on generating economic growth and new jobs is not proportional*

gap, disincentivizing job seeking by encouraging some beneficiary households to work less, reducing the labour supply and hence reducing Kosovo's prospects for economic prosperity and growth. In human development terms remittances increase dependency and constrain human growth and freedom, keeping people tied to the will, efforts and investment preferences of others. They also reduce government impetus to tackle the roots of poverty, adding to the gap between private interest and public good.

Could Kosovo introduce more effective strategies to direct its enormous inflow of remittances more effectively to private enterprise, in a manner that fosters human development? Currently, Kosovo is lacking remittance policies. Two that could be key are:

(1) a plan to increase the proportion of remittance inflows which are directed through formal channels. There is evidence, from the most recent UNDP survey (2010), that approximately 60 percent of remittances enter Kosovo through informal channels (which can provide much cheaper money transfers than via formal channels). However, a number of negative effects may arise from the operation of informal transfer channels, ranging from financial smuggling and money laundering, to macroeconomic consequences for tax collection;

(2) a strategy to incentivize the use of a greater proportion of remittances for productive activities, as part of participatory municipal development plans. According to Riinvest (2008b), physical and human capital investments are two key channels through which remittances could generate positive effects on economic

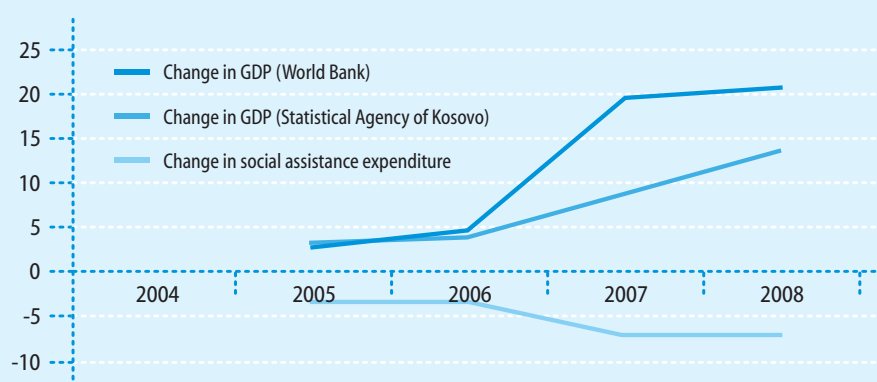
development. Foreign examples of best practice exist in which governments have developed appropriate training programmes to assist returning emigrants or remittance beneficiaries to make effective investment decisions. Kosovo's prior experience could be a great example, where emigrants formed associations to raise funds to help Kosovan society. Nowadays, the formation of similar associations could have a significant positive impact on infrastructure, healthcare and educational development. In such a scheme, individual contributions could be matched by government funds.

**Social welfare schemes** present an equally complex picture as remittances in terms of their relationship to private growth and human development. Kosovo's spend on social assistance has remained essentially static for many years – even decreasing in key poverty-targeting categories. While the targeting of Kosovo's household assistance programme is relatively effective (the World Bank estimates that only 7 percent of assistance spending goes to wealthy households), the categorization of social assistance schemes means that a significant proportion of the poor and extremely poor are missed.

As illustrated in Figure 4.6, Kosovo's slowly rising GDP over recent years has been matched by a proportional decline in social assistance spending. From 2006-2008, the number of beneficiary families of social assistance dropped from 40,569 to 34,307, translating into 25,000 fewer poor people receiving poverty-related assistance from the government.<sup>70</sup>

The decreases which have been seen in Kosovo's spending on social assistance

**Figure 4.6** Percentage change in GDP and social assistance expenditure in Kosovo



World Bank, KAS, Ministry of Finance and Gassman & Roelen 2009 (Reported in UNICEF Child Poverty in Kosovo 2010)

have been accompanied by an increase in the poverty rates (increasing from 43 percent in 2003 to 45 percent in 2008, according to the World Bank Poverty Assessment), and fewer poor people are being reached by social assistance every year that passes. There is also no indexation linking household poverty benefit to inflation – although the size of individual household benefit was recently increased from 40-45 EUR per month. Categorization issues continue to aggravate the targeting problem. Currently, households wishing to enter the social assistance scheme must not only have a low-income level but must also meet a number of criteria regarding the number of dependants in the household (such as pensioners, people with disabilities, and children under the age of five). Many families are simply ejected from the scheme when their youngest child turns six, regardless of their income level. As a result, the World Bank judges that only 23 percent of the poor and only 34 percent of Kosovo's extremely poor are receiving social assistance<sup>71</sup> – placing thousands of men, women and children in desperate situations.

Opportunities are being missed to reduce poverty in the short term and

encourage labour force participation in the longer-term, reducing dependency. Strategies that aim to support the very poor with an inequality-enhancing social welfare scheme and municipally-supported cash for work programmes do not deliver value for money in either poverty reduction or growth. Instead, there may be opportunities to link social assistance benefits to critical measures incentivising the development of human capabilities, job seeking and private enterprise. For example, benefits could be linked to measures to support unemployed members of households receiving social benefits to engage in jobseeker programmes, or measures to target catch-up schemes at those with learning or literacy issues, particularly women. Looking to Kosovo's future, it is critical to eliminate the age limit on benefits, which push families further into poverty just as their children approach school age. The introduction of child benefits beyond this point could be linked to school attendance. This would mean that the children of the poor would be more likely to stay in school, widening the skillset of the future labour force and reducing the risk of inter-generational dependency.

Effective revenue redistribution also

depends on adequate planning around such key areas as health and education – including catch-up learning for adults. Thus, improved essential service delivery should be integrated into strategic models for economy-wide, sustainable growth in Kosovo. Both direct social transfers (such as social assistance payments) and indirect social transfers (such as spend on services) have been shown to impact inequality in transition countries. Spending on education, for example, has been shown to correlate directly with income equality<sup>72</sup> worldwide (with increased spending on education acting to increase income equality).<sup>73</sup>

Overall, revenue redistribution acts to drive empowerment. People lifted first out of absolute poverty and then out of a cycle of dependency are more likely to feel invested in political processes and more able to make their voices heard. This is the way Kosovo can shift from a political profile dominated by privileged groups and ethnic enclaves to a more inclusive democracy in which ideas, not ethnicities, have the last say in governance decisions.

The private sector is the key to revenue redistribution in Kosovo, and to a reduction in poverty and dependency. Private sector growth brings wealth and opportunity into poor areas and the contribution which it makes to tax revenues can increase the basket of funds available for social transfers. Correspondingly, a more active and educated labour force, supported out of dependency by quality essential services and other public sector transfers, is fundamental to private sector growth. However, these advantages do not accrue automatically. They must be forged through active policies that seek to break cycles of dependency and

connect the poor with sustainable growth. This will be Kosovo's primary economic challenge for the coming years.

## 4.3 Supporting environmental sustainability

Concrete data on environmental trends in Kosovo and the relationship of enterprise and industry to the environment is relatively limited. However, research conducted over the decade immediately following the 1999 conflict has painted a dire picture of Kosovo's environmental status. Industry - particularly state-owned enterprise - has left a woeful environmental legacy in some of Kosovo's most vulnerable areas. Put simply, Kosovo for decades has had a high concentration of some of the most polluting forms of heavy industry - particularly the unregulated extraction and processing of toxic heavy metals and the virtually unfiltered burning of brown coal in sub-standard power stations. Even now, up to 85 percent of Kosovo's population relies on burning wood for their heat and basic power needs.

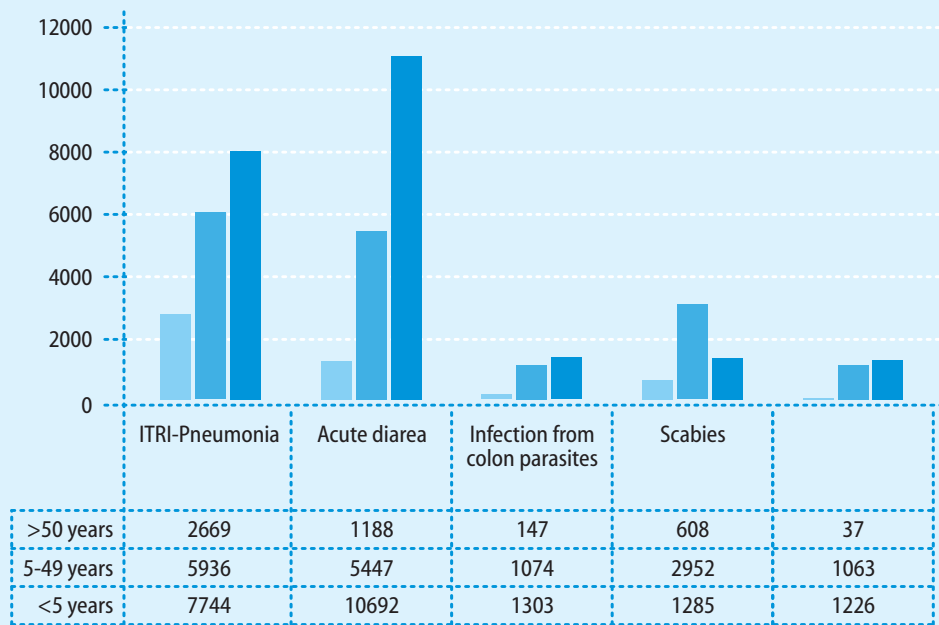
Today, Kosovo has atmospheric dust contamination 74 times European standards, and amongst the worst heavy metal contamination problems in the world – specifically lead contamination in the northern municipalities of Leposaviq/Leposavić, Zveqan/Zveçane and Mitrovicë/Mitrovica.<sup>74</sup> A World Health Organisation (WHO) survey of children under three years old in the Mitrovicë/Mitrovica and Zveqan/Zveçane municipalities indicated that at least a quarter had elevated levels of

*There may be opportunities to link benefits to critical measures incentivizing the development of human capabilities, job-seeking and private enterprise*

lead in their bloodstream (rising to 100 percent of RAE children surveyed). Lung diseases are also extremely prevalent among children and the working age population in Kosovo, eroding human capabilities with unmeasured cost to Kosovo-wide productivity.

Today, as in many growth-focused developing and transition countries, many Kosovans desire a free hand to translate their enviable natural resources into revenue. Kosovo is still rich with minerals, lignite coal, forests, water resources and arable land. It is also in the process of privatizing its

**Figure 4.7** Incidence of diseases linked to environmental pollution



Kosovo State of the Environment, United Nations Assistance Mission in Kosovo 2003

A longstanding lack of governance accountability on the environment has visibly infected the attitudes and behaviour of individuals and businesses in Kosovo. For example, littering by the public and local businesses is widespread, and anti-smoking legislation is not enforced in Kosovo's myriad coffee shops and supermarkets, regardless of the presence of pregnant women, children and infants. In the absence of necessary infrastructure such as a network of waste water treatment plants, industries in Kosovo are less incentivized to act to protect the environment by taking responsible actions such as treating the large volumes of waste water currently dumped into Kosovo's waterways.

major industries to boost opportunities for economic growth and international trade. This policy direction now poses some grave conundrums for Kosovo, as it seeks to balance the interests of private enterprise and the desperate race for GDP growth against the fragility of its natural resources and the health of its population.

*A longstanding lack of governance accountability on the environment has visibly infected the attitudes and behaviours of individuals and businesses*

The link between environmental sustainability and private sector growth is well established (Pearce, Barbier and



Markandya, 1989), while strategies for a “golden state” epitomizing the ideal balance between efficiency policies, growth and human welfare have been described and even trialed in a number of developing contexts (Ayong le Kama, 2001, Endress et al. 2005). Whilst this report does not focus in detail on all the potential linkages between environmental sustainability and private sector growth, there are three key factors which relate most closely to any prospects for such a “golden state” in Kosovo in the foreseeable future: Energy efficiency; Business responsibility and compliance; and Green enterprise. Each of these will be covered in further detail in the following sections.

**Energy efficiency** policies are perhaps the most fundamental of these. Kosovo’s primary sector companies placed electricity supply issues at the head of their list of barriers (Impact on Growth-Ready Sectors, Chapter 3, illustrated in Figure 3.10). In rural areas, an inability to meet basic power generation needs cripples growth, perpetuates subsistence living and widens urban-rural divides in income, education and health. In urban areas, power generation strategies currently add greatly to pollution and health concerns. In addition, should Kosovo’s secondary sector look to grow, and more companies within it seek to make the leap from small to medium size, energy needs for this sector will grow significantly. Kosovo’s Ministry of Energy projects that the share of energy consumed by secondary sector will increase over the coming years, from 25 percent in 2009 to 32 percent by 2018.<sup>75</sup> Kosovo has a number of laws in place on energy, energy efficiency, and electricity in addition to an energy efficiency strategy that seeks to tackle Kosovo’s energy concerns across a

number of fronts. Firstly, this strategy recognizes that energy savings can only be made in the context of a reliable supply. There are plans to increase overall electricity generation output through the construction of a new power generation plant, allowing the decommissioning of the antiquated Kosovo A power plant. Through the burning of lignite coal despite a filtration capacity that only approaches 50 percent of the plant’s output, the Kosovo A plant is responsible for the great majority of Kosovo’s atmospheric dust pollution.<sup>76</sup> In addition, energy efficiency strategy seeks to extend not just electricity access but education on energy efficiency strategies to rural areas. Currently, farming techniques in Kosovo are energy and land intensive, limiting the competitiveness and growth of the agricultural industries while costing the land and its inhabitants dearly in terms of health and wellbeing. The strategy also seeks to mitigate the current impact of poorly-run energy billing systems by the addition of new metering technologies and a fairer system for high demand and low demand periods. Finally, the strategy focusses on the exploration of opportunities for renewable energy resources in Kosovo. Kosovo’s potential to embark on wind energy, biomass and other renewable energy strategies have not been fully explored. All of the programmes envisaged by Kosovo’s energy efficiency strategy are laudable – however, they require detailed, well-financed and human-resourced implementation if their full benefits are to be realised.

**Business responsibility and compliance** is another key factor in mitigating Kosovo’s legacy of environmental damage and creating the conditions for responsible private enterprise

growth. Currently there is virtually no data to measure trends in the enforcement of companies' legal environmental obligations. Anecdotal information suggests that fines are easily avoided and, if incurred, very minimal (amounting to approximately 5,000 EUR for a medium-sized company). In addition, the true cost to the environment of such practices as deforestation for the purposes of logging, waste disposal into the rivers and allowing agricultural runoff is neither well studied nor well understood by Kosovo's businesses. The perceived benefits of such environmentally unsound activities still outweigh those potentially accrued by meeting environmental obligations. Current efforts to protect the Sharr National Forest from private logging activities are an example of how bitterly companies still fight to protect their economic interests - heedless of the damage done to Kosovo's present living conditions and its long-term economic potential.

Similarly to the progress described above with respect to energy and energy efficiency, Kosovo is already making significant efforts to boost a culture of environmental responsibility and compliance within the private sector. A key focus is on the mining and quarrying industries extracting and processing Kosovo's vast natural mineral reserves. Alongside the Privatization Agency of Kosovo, a number of Kosovo's international partners are actively exploring how the contamination created by Kosovo's mining heritage can best be mitigated and how a more competitive, environmentally compliant private system be established. However, a much more participatory approach is required with businesses to find the best balance between fostering

growth and protecting Kosovo's natural environment. Where environmental obligations are resented as being contrary to private enterprise interests without social benefits, there is the greatest risk of non-compliance - or of the associated costs being passed off onto workers and customers. In instances such as waste dumping or over-logging, it is important that mitigation strategies are explored at the municipal level, working with individual businesses to move towards common solutions. All things considered, Kosovo's government has a responsibility to show leadership and set the bar high on environmental compliance. In areas where waste is regularly collected by municipal services, where power is stable, where safe water is available on a reliable basis and sewage is managed in an environmentally responsible way, it is far easier to convince businesses that environmental compliance should be the norm than in areas where they are expected to take the lead in the absence of government leadership.

**Green enterprise** is the final core factor in building a healthy relationship between private growth and environmental sustainability in Kosovo. Currently, the demand for green enterprise in Kosovo is relatively limited and what does exist is largely stimulated by international aid partners. There is no deeply rooted local market and private sector landscape is dominated by micro-enterprises in very traditional service sectors which are often uncomfortable exploring new and untested fields.

However, there is still capacity to build demand for this kind of enterprise into the market, and to increase the

*The perceived benefits of environmentally unsound activities still outweigh those potentially accrued by meeting environmental obligations*

*There would be significant human development advantages in empowering rural and urban populations to cooperate on green ventures.*

number of “green jobs” in urban as well as rural areas. There is a clear human development argument for such a strategy: rural areas have the highest poverty rates and the lowest formal employment rates, while environmental awareness is particularly high amongst Kosovo’s young, urban population. There would be significant human development advantages in empowering rural and urban populations cooperate on green ventures. There is potentially a high capacity to stimulate the development of innovative new businesses focussed on environmental sustainability (in areas such as environmental research, eco-tourism, private sector engagement in waste management, renewable energy pilot programmes *etc.*). Kosovo is currently in the process of finalizing a multi-year Environmental Strategy and Action Plan that may tackle these issues. Once again, the devil will be in the detail. However, a multi-sectoral strategy for enterprise stimulation bringing “green jobs” to the labour market could pay long-term dividends for Kosovo’s marketplace and its standard of living.

## 4.4 Private growth and social context - policy implications

The prospects for private sector growth in Kosovo are deeply rooted in paradigm and attitudes of its people and businesses. Private enterprise is Kosovo’s primary hope for widespread wealth creation, but the character and quality of its growth – and the impact on Kosovo’s human development profile – depend on issues beyond economic considerations. These include considerations such as the impacts on Kosovo’s education systems, social and labour protection systems and

its environment. Regardless of how quickly businesses expand, the labour market can only come to full strength as the workforce serving these businesses grows proportionately in skills and energy. Only when private sector expansion is centered within a context of knowledge growth and social inclusion in the wider community can sustainable economic and human development truly occur. This formula is central to moving from an enclave-dominated culture in Kosovo towards a true democracy of conviction and ideas where all members are empowered to participate.

Key strategies to forge much smarter and more inclusive linkages between Kosovo’s private and social sectors include:

- **Link education and work readiness:** the development of a smart, competitive workforce starts at school. Kosovo’s young people need to feel more prepared for their working environment, and believe that skills count in the job market. Ultimately, Kosovo’s long-term development relies on the energy and skills of its youth. Not all of Kosovo’s assets are associated with exports in boxes, crates and cartons – some will undoubtedly be associated with the electronic marketplace, driven by a future IT revolution in Kosovo. Connecting Kosovan students with work readiness programmes will take collaboration between government (across ministries such as the Ministries of Education and Science Technology and Labour and Social Welfare) and business associations across Kosovo.
- **Create an Adult Learning Strategy that targets the most disenfranchised:** Programmes such as

the Ministry of Education, Science and Technology (MEST) *Dritare Jete* are extremely valuable, but to truly reach those most excluded from the job market, these must be integrated into a comprehensive adult education strategy. Too many Kosovans are operating in the work environment far beneath their potential – or else excluded by lack of skills. Adult learning, targeted at rural women, the disabled, ethnic minorities and the long-term unemployed can do a great deal to enhance the human and earning potential of some of Kosovo's poorest, stimulating income and enterprise growth.

- **Launch municipal investment-promotion schemes focused on remittances:** Kosovo's vast remittance inflows are reducing poverty but not yet being utilized to their full potential in terms of enhancing growth and job creation. Only a fraction of remittances are used for investment. Efforts made to increase this proportion need to be sensitively handled. Many remittance beneficiaries are still financially struggling. However, much could be done to stimulate a more sustainable, enterprise-focused use of remittances. If municipalities engage in participatory planning, bringing businesses and local families together to discuss needs and possibilities, various types of remittance-funded investment schemes could be developed. Each municipality can take an approach that best suits the enterprise models fitting their demographic profile. For example, rural municipalities might encourage investment in green schemes, while urban areas could encourage the development

of cooperatives of service sector businesses to allow the realization of economies of scale.

- **Link social welfare more closely to dependency reduction strategies:** Kosovo's current social welfare programme is badly in need of improvement – beyond the reforms currently being debated in Parliament. The current categorization of the social assistance programme has adverse impacts, particularly on child poverty due to the fact that children are effectively removed from the programme's support as soon as they approach school age. Dropping this particular barrier (the upper age limit on a dependent child) has cost implications that could be offset against better targeting of the social assistance programme. In addition, opportunities are being missed to break cycles of dependency by measures such as linking social assistance benefits to school attendance and connecting those receiving benefits with job-seeker schemes and catch-up adult learning programmes.
- **Implement new laws on energy and the environment in a participatory, education focused way:** Kosovo has some promising laws on its statute books to enhance energy efficiency and reduce costs for Kosovo's businesses, as well as promoting Kosovo's environmental wellbeing. These laws see an essential link between a responsible, thriving private sector and a sustainably managed environment. However, implementation continues to be a weak element of Kosovo's governance record to date.

Against such a long legacy of misinformation and poor environmental practices, the key to successful implementation will be adequate human resources allocated to education and engagement with business owners. These business owners will have to be convinced of the social and economic benefits of environmental compliance and sustainable resource management, with the government itself setting leading by example. Without careful and well planned implementation, these laws are in danger of remaining paper promises only, pressuring Kosovo's businesses without delivering any environmental or associated human development benefits.

- **Connect rural-urban populations for environmental enterprise ventures:**

The "green enterprise" mindset in Kosovo needs to be culturally ingrained rather than externally administered by well-meaning international partners. One area which offers great potential for promoting job creation, social cohesion and environmental wellbeing is the connection of technology-savvy urban populations and environmentally connected rural populations for the purposes of starting "green ventures". A Kosovo-wide programme could be driven through youth and universities, piloted using seed money from government or international partners. Such ventures could create traditions of cooperation across large social divides, spur innovation and eventually become self-sustaining, with job creation growing steadily – albeit at low levels – for many years. However,

despite the fact that such a scheme has little immediate potential for large-scale private sector growth (and will certainly not transform the labour market), taking a long-term view, it could sow a seed for future business models that can only be positive for Kosovo's continued development.

## Conclusion:

# Making Growth Work for People

*“This will not be a good place for any of us to live in until it is a good place for all of us to live in.”* **Theodore Roosevelt**

“People are the real wealth of nations.” This revolutionary statement, the foundation of the human development approach, was all the more remarkable for its timing. It sprang from a decade that dedicated itself, in most developed nations, to the art of wealth creation. The 1980s, saw the rise of new financial empires across Europe and the United States, the growth of speculative wealth from trading in stocks, shares and derivatives, and a passionate belief in the power of opportunity and personal initiative to shape lives. This great surge of free enterprise in one part of the world took place under the shadow of famine and war elsewhere. While thousands were becoming millionaires, millions – even billions – seemed trapped in lives gripped ever more tightly by poverty and hopelessness. The world had never been more unequal.

Humanity is not always quick to learn important lessons. However, in the three decades since publication of the first Human Development Report in 1990, many development specialists, economists and leaders have been rethinking how wealth creation contributes to human happiness and global security. Instead of asking “how much” wealth can be created, these visionaries began to see that how wealth is created and who benefits from it are far more central concerns for human progress.

The Millennium Development Goals (MDGs), the World Summit, the Kyoto Treaty and – most recently - the Europe 2020 Strategy are all visible manifestations of this paradigm shift. They all place people’s wellbeing first, ahead of all other goals. They prioritize fairness within strategies to achieve it. And they aim for an “inclusive” society where everyone has a place and the opportunity to thrive.

In linking its vision to Europe, Kosovo is also committed to these goals. But it has a very long way to go. After decades of repression, poverty and conflict, it is hardly surprising that economic growth by any means possible now seems the only solution to Kosovo’s ingrained socio-economic problems. However, unbalanced growth that fails to create decent jobs, that excludes large segments of society, that fails to unleash the full capacity of men and women, is not the end result that Kosovans truly seek.

This report has sought to understand how Kosovo’s private sector growth and human development objectives might reinforce and strengthen each other. It suggests that wealth creation and human equity in Kosovo, far from being opposed to one another, visibly depend upon each other. Kosovans – whether

public officials or individuals - are right to see the private sector development as their main engine of opportunity. It has the potential to drive progress through some of Kosovo's greatest development challenges – enclave mentalities, gender divides and a climate of economic and individual underperformance. At the mid-way point in the second decade after Kosovo's conflict, Kosovo needs to make headway against these challenges. The time is now, to prove to Kosovo's people – particularly its youth - that their aspirations are more than dreams.

There is no perfect formula for positioning wealth creation within a human development paradigm in Kosovo, or anywhere else. However, one thing is clear: finding the best possible formula for Kosovo will require the active engagement of government, business owners and Kosovans from all walks of life. This report hopes to inspire a dialogue on shaping such an engagement – and with this in mind, presents a synthesis of the report's findings and recommendations below:

## Main Findings

### (i) Kosovo's history and post-conflict economic trends have biased growth towards an "exclusive" and largely jobless growth model:

- Kosovo's private enterprise culture has been stifled by a combination of socialism, repression and the structure of post-conflict revenue generation strategies. For decades, Kosovan business was limited to small, family-run businesses – a predisposition that remains even as Kosovo seeks to move towards a free market economy. Today Kosovo's trade imbalance is the primary source of most of the government's revenues - easily collected at the border in import taxes, reducing incentives to invest in Kosovo's competitiveness. Wealth is still concentrated in the hands of the few, in an import-led economy selling priced foreign product to those that can afford it (including a large expatriate population providing development support).

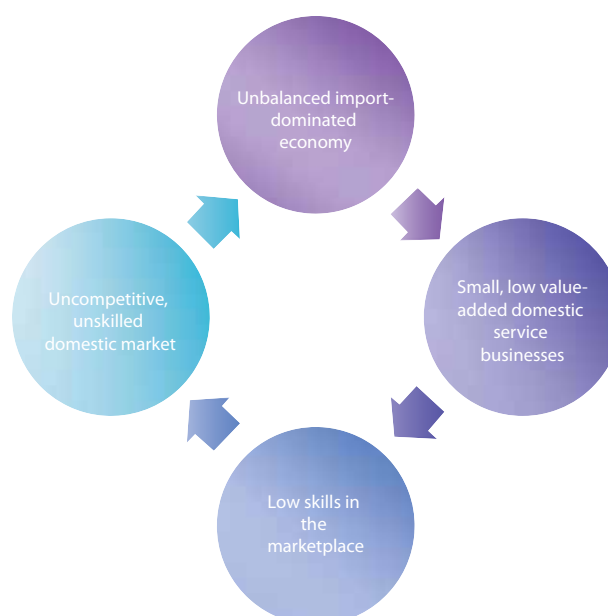


Figure 5.1 Kosovo's growth cycle

- This pattern of wealth creation has failed to impact poverty, despite rising GDP. Kosovo's absolute poverty rate, as measured by the World Bank, has remained relatively steady at between 35-50 percent of the population since 2004. GDP growth rates have generally increased over the same period – indicating widening social inequities.
- Kosovo's marketplace has become unbalanced as a result. Kosovo's private sector is now dominated by micro-industries (96 percent of all businesses) employing less than ten individuals each. Many of these firms – one third, by some estimates, are informal and unregistered; i.e., non-tax paying and not accountable for complying with legal worker protections. The vast majority of all of Kosovo's private enterprise exists in the low-value end of the tertiary sector. This sector represents over 80 percent of Kosovo's marketplace – accounting for two thirds of GDP. By comparison, the primary (agriculture) sector represents just 2 percent of registered businesses.
- The majority of Kosovans are not even connected with the marketplace: On average, one out of four working-age Kosovans is employed (a combination of labour force participation and general unemployment rates). Most unemployment is long-term. Exclusion is far higher among women – with only three in ten participating in the workforce and well over half of these unable to find work. Unemployment rates approach 73 percent among youth and 70 percent among RAE.
- Enterprise stimulation and job creation cannot automatically translate into less poverty and more decent work: Many of Kosovo's poor already have jobs. An estimated 30 percent of households unable to meet their critical needs have at least one employed member. New enterprises are also being born at a high rate – more than 7,000 per year (with closure rates far slower, at approximately 1,200 per year). In addition, the larger businesses become, the greater the equity gaps in their employment profiles. The male to female employment ratio is much worse in medium sized companies than in small and micro firms. This suggests that enterprise and work creation, as currently structured, are not delivering significant poverty reduction and human development benefits.

**(ii) Analysis of business barriers points to solutions in cultural rather than legislative change:**

- Primary barriers to growth lie in the intersection between government and businesses, perpetuated by weak enforcement. Instead of infrastructure, visa and trade restrictions, most businesses cite unfair practices among their peers (informality, evasion and corruption) as the main challenges to their operation and expansion. Enforcement of Kosovo's great raft of EU-compliant legislation is seen to be discretionary, incentive (corruption) driven and weak. Therefore, businesses feel on their own, and therefore prefer to act in their own interests rather than for the common good.



- Underperformance and evasion has become a business norm. Low value-added businesses seek, for the most part, low skilled workers. There is little incentive to build skills into the workforce, and most new jobs created are unlikely to require more than a primary or secondary school education. Incentives to build human capabilities are thereby diminished. Tax evasion and informality are widespread (estimated at between 30-40 percent of Kosovo's enterprises), diminishing the capacity for effective revenue redistribution from private sector growth. Indications are that lack of trust in the governance and judicial processes contribute greatly to this state of affairs. Government underperformance in delivery of essential services and such key enterprise services as contract enforcement through the courts enables and incentivizes lack of regulatory compliance among firms.
- Dialogue and education are key to driving change: A pro-people business climate must be incentivized and enforced. Informality, ignoring or getting around labour laws and other anti-development practices are the result of a misinformed or un-incentivized business community. There is a critical need for greater transparency and openness in government dealings with private enterprise, and a greater focus on education and outreach among business owners and workers at a municipal level.

**(iii) Investment and job creation models also require re-orientation to connect people with growth-ready sectors.**

- Equity-based adjustment is essential to remove biases against certain groups: Those that struggle to thrive in Kosovo's current enterprise culture include 1). medium-sized businesses, which cannot hide behind informality and tax evasion to maintain a healthy profit line; 2). women and young entrepreneurs, who struggle to access financing for business ventures because they are culturally excluded from sources of collateral that could back their enterprise; 3) rural poor, who live in areas without proper infrastructure and education services, perpetuating low human capacity and subsistence living strategies; and 4). some ethnic minorities, who at best do not integrate with the broader Kosovan marketplace and at worst struggle to find work, get loans, receive an adequate education and benefit from even basic social services.
- A pro-people economic strategy could assist in realigning domestic and international growth investments. Kosovo needs a balanced economic portfolio that broadens its active economic base, rather than one that merely increases revenues and GDP. A future growth model that alleviates poverty where it hits deepest (in rural areas and among ethnic minorities), builds human capabilities and provides decent work for the broadest range of men and women would likely spring from a renewed and formalized primary sector, a tradable and sustainable secondary sector and high value-added tertiary sector.

- Sector-specific barriers need to be addressed as part of a holistic, cross-government strategy for growth. There are three key criteria for identifying inclusive growth-ready sectors: 1). tradability (opening the door to international cross-fertilization of investment, skills and innovation); 2). labour-intensity (the highest proportion of decent work created for men and women); and 3). value-addition (the extent to which skills are fostered in the workforce, enlarging capabilities and incentivizing knowledge acquisition). All sectoral considerations should be passed through the filter of sustainability.

**(iv) Cycles of dependency must be broken for a future where wealth grows alongside human dignity and freedoms.**

- Kosovo needs to foster a culture of learning. Far too many Kosovans are unskilled (nearly two thirds of adults). With many schools ill equipped for a modern, competitive market, less than a third of young people think that education is preparing them for life. A culture of nepotism is sapping the will to learn, and after opportunities are missed there are few chances to catch up.
- Revenue redistribution could work much more effectively to break cycles of dependency and link vulnerable people to the job market. The current social welfare system effectively ejects families once their children reach school age. Opportunities are being missed to link the unemployed and poor to skill development programmes, or to direct Kosovo's vast remittance inflow to job-creating investments.
- Businesses do not understand the conceptual linkages between private sector growth and environmental sustainability. Without data it is impossible to measure trends in either compliance with environmental law or in investment for environmentally-friendly growth. However, it is safe to say that both are at a low ebb. Linkages little understood and connections with national advances not made at the municipal and street level. Promoting compliance and investment means more education and outreach, with the potential to bring people together across social divides in the common interest.

## Recommendations

All Kosovans – young and old, men and women and every ethnicity – seeks a life of dignity in which family needs can be met and ambitions pursued. Such a future is worth striving for - one in which people benefit from a flourishing private sector, bringing jobs and opportunity on an equal basis. This analysis suggests three key steps towards making this a reality:

### 1. Build a vision for inclusive & labour intensive growth

**1.1. Establish a cross-government inclusive growth strategy**, linked to the MTEF cycle and with the Europe 2020 targets in mind. This strategy should a). identify growth-ready economic sectors; b). analyze sector-specific barriers; and c). introduce equity-based reforms into linked public services such as education and social assistance. Such a strategy would acknowledge that healthy private enterprise must be created across a balanced portfolio of sectors, and is rooted in Kosovo's social context. Some growth incentivization strategies may be sector-specific (such as VAT scaling for agriculture to spur formalization of businesses and tax payments and labor-force protections). Others, such as tackling corruption and supporting women in the workforce, span all sectors and types of businesses. The quality of leadership would be critical, as would participation of key Ministries including Finance, Labour and Social Welfare, Trade and Industry, Environment, Health and Education. Leaders would set benchmarks for growth and job creation, and also for behavioural changes within the enterprise culture – offering more dignity and opportunity to a broader base of workforce participants.

**1.2. Start a government-led participatory dialogue for growth** engaging both those within and currently excluded from the marketplace. This dialogue would seek to minimize the distance between businesses and regulators, and support the willing adoption of major policy advances (in environment and labour laws) tying growth into public wellbeing. Kosovo's private sector need targeted information from public officials, as well as transparency backed by action. These are central to ending some of Kosovo's biggest business bugbears – informal industry, evasion, unfair business practices, lack of compliance and workforce discrimination.

### 2. Create the right climate for fair and sustainable enterprise

**2.1. Set a target for the development of small to medium enterprises** as a long-term goal for job creation. This would set enterprise growth as well as enterprise creation at the heart of economic strategies, focusing on supporting the leap from small to medium. Ultimately, gains in decent work and poverty reduction will be made fastest through larger, well regulated and value-added businesses in addition to micro family firms. Concurrent efforts will need to be made to inculcate a culture of fair hiring practices as firms grow, particularly to

ensure that job creation also offers more opportunities to women. This is best done through equipping women with relevant skills and bringing female job-seekers and employers together, rather than enforcing quotas.

**2.2. Tackle a climate of unfair business practices** through three strategies: a). increase incentives for tax and regulatory compliance, for example, by reducing the tax compliance paperwork burden, lifting barriers to fiscalization (this programme has been hampered by the high and non-reimbursable cost of equipment, as well as the laboriousness of tax compliance requirements) and providing a clear and proportional quid pro quo to businesses in terms of services rendered to them in return; b). step up a participatory fight against corruption - for example, by enforcing rigorous competition into contracts for governmental service provision, acting quickly in response to tip offs and encouraging and protecting whistleblowers. c). introduce a voluntary, incentivized formalization scheme, which encourages specific sectors (starting with agriculture) to register businesses by providing useful information and other forms of support to registrees through municipal offices. This scheme could be incorporated into municipal development plans.

**2.3. Reform burdensome or anti-competitive regulatory mechanisms** that restrict investment in, and the development of, Kosovo's markets. Over-complex, multi-transaction point rules for business registration and tax compliance stifle entrepreneurship and encourage many businesses to operate in the informal economy. Intervention is a priority in the following two areas a). Kosovo's VAT collection system needs to be simplified and collection increased inside the borders, to avoid pricing Kosovo's domestically-produced goods out of the market, particularly hurting the rural poor; and b) continue with the simplification of business licensing processes, reducing the multiplicity of transaction points to decrease start-up and expansion costs, and reduce over-reliance on the discretion of public officials. This would have the dual effect of reducing opportunities for corruption and increasing incentives for formalization.

**2.4. Focus on access to and cost of finance as a key engine of business expansion.** Banks and micro finance institutions should be facilitators of businesses seeking to innovate, expand or introduce relatively excluded groups into the marketplace. Critically, the level of information asymmetry between the bank and the customer needs to be lowered. Business owners and potential start-ups could benefit from outreach and other programmes to improve understanding of financing process and requirements. Women, young people and ethnic minorities in particular require encouragement, to move these excluded groups beyond reliance on charity and internationally-supported micro-credit schemes. Collateral challenges faced by many men and women could also be removed through reform of the cadastral system to be more effective and less costly in registering property. In addition, judicial capacity needs strengthening to manage default and other cases outstanding in the courts. High interest rates in Kosovo are directly proportionate to the degree of risk that banks face in a climate

of weak or long delayed law enforcement. Reduced interest rates and targeted information schemes will provide a lifeline to those unable to fund ventures from their own resources, working to narrow Kosovo's poverty and opportunity gap.

**2.5. Increase capacities for accountable implementation and enforcement of laws.** Timely and consistent enforcement is essential to a pro-growth and formalized business environment and also to essential protections for the well-being of employers and employees. Courts in particular need to be faster, to process the volume of contract-related cases sitting with them. Establishment of regional economic courts would significantly reduce the current workload. In addition, separation of economic and business cases from other general court cases is a necessity for improvement of the poor relationship between businesses and courts. With regards to tax evasion, successful deterrence mechanisms require at least doubling the capacities of the tax administration and customs officials, which are currently the lowest per thousand inhabitants in Europe, as well as enhancing their operational and technical capacities. This would in turn reduce imbalances in tax compliance that derive from over-focusing on already compliant businesses.

**2.6. Provide education and outreach on labour laws** to build a culture of acceptance now absent. Currently laws on the books, designed to protect the poor and women, are being interpreted in a discriminating way. It would be a travesty if these laws denied poor work, or contributed to further shutting women out of reliable, contractually stable jobs. Any reform or review of Labour Laws should be approached after a period of dialogue with and between employers and employees. Maternity leave, for example, does not have to be seen as a burden that business carry by themselves. It can also serve as an opportunity to promote temporarily within companies, with government perhaps contributing to a degree of added cost, enabling greater knowledge acquisition within the workforce.

**2.7. Implement laws on energy efficiency and environment in a participatory, education-led way.** Kosovo has excellent environment and energy laws on the books. Once again however, the challenge is implementation efficiency and broad-based outreach. Companies as yet do not understand why already narrow profit margins should be further squeezed so they can carry a burden of environmental protection when no-one else – including the government – seems to care much about it. Outreach at the community level, efficiency in bringing services and infrastructure to poor and contaminated areas, and clear demonstrations of the benefits of – for example – energy efficient approaches to industry and agriculture – are the critical first steps towards a change of heart. A monitoring hub also needs to be established to monitor environmental compliance, for greater transparency in this area, and fines need to be proportionate and swiftly levied.

### 3. Connect more men and women with an fair marketplace

#### 3.1. Set graduated targets for labour force participation rates among men and women.

Currently, Kosovo's labour force participation rates, particularly for women, are woefully low. There are many reasons – cultural, practical and economic – why women are not generally active in the labour force in Kosovo. Even where lack of participation appears to be a choice, it often springs from inability to face challenges associated with getting a job in the context of heavy family obligations. This “choice” is really a form of constriction, and more choices could become open to women if the playing field was levelled. Similar considerations hold for the uneducated rural poor, and excluded minorities. In this regard, gender-equitable enterprise outreach programmes should be incorporated into all municipal development plans.

#### 3.2. Partner with businesses to support youth enterprise and innovation.

Kosovo's young people have enormous capabilities, but there are currently few outlets for them. Youth innovation and enterprise programmes supported by universities and businesses could assist in pooling young talent. Young people linked to these programmes could benefit from and offer their energies to local businesses – gaining skills while also helping companies think through and implement expansion ideas. Entry into such schemes could be run on a merit basis, providing “scholarships” for bright and capable young men and women of all ethnicities to collaborate with each other and with enterprise, building Kosovo's individual and workforce skills.

**3.3. Establish a lifelong-learning culture** through two strategies: a). introduce work-readiness skills into school curricula - including basic essentials such as CV preparation, interview techniques, business management, equity in the workplace, environmental linkages and finance processes; b). develop a comprehensive adult education strategy integrating targeted initiatives for basic (catch-up), mid-level and sophisticated skill acquisition. Key services such as vocational training and catch-up learning need to be better targeted to excluded groups such as rural women and the long-term unemployed. This is the only way to make any meaningful headway in reducing Kosovo's ingrained centres of poverty and lack of opportunity. Training workshops to increase workforce and non-workforce skills could be run and sponsored by businesses themselves and shaped to target audiences. For example, food processing basic training could be sponsored by local producers for women living in rural areas. Such initiatives would require cross-sectoral cooperation at the municipal level.

#### 3.4. Place the Law on the Social Assistance Scheme on annual rotation for Parliamentary reform.

Kosovo needs to align its revenue redistribution and growth strategies. Much needed and long-anticipated reforms to the Kosovo's social welfare law cannot be meaningfully introduced without additional budget for their implementation. The current law, even after 2012 reforms, works against growth by failing to protect the poorest and reinforcing cycles of poverty, capability-loss and dependency. Keeping the Social Welfare Law budget-neutral

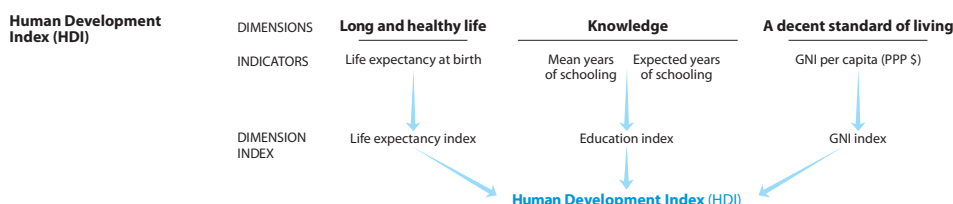
is costing Kosovo in the long-term. This law should be reviewed annually to match GDP growth with social protection and every opportunity taken to align benefits to dependency breaking strategies. Two options are a). removing the age-linked categorization of a child dependent, allowing families with school-age children to receive benefits but linking such benefits to school attendance; and b). working actively to connect long-term unemployed beneficiaries with job-seeking schemes, catch-up learning and vocational training. Implementing these changes will depend on boosting the capacity and number of social workers administering the law, to help them manage already high caseloads.

**3.5. Integrate remittances into investment strategies within municipal development plans.** Municipalities can be more active during planning cycles to stimulate decent, equitable enterprise in their localities. If municipalities are seen to be delivering on services and promises, they are in a better position to engage with potential entrepreneurs and job providers in a transparent way. Services that municipalities can provide include linking businesses with each other to stimulate local trade, encouraging cooperation for economies of scale and pointing the way to viable investment outlets for resources that might otherwise be directed elsewhere. Although Kosovo's government cannot tell people what to do with money received from abroad, such an open engagement strategy might be useful to direct at least a proportion of remittance inflow towards sustainable, growth-oriented and poverty reducing investments.

**3.6. Establish a funding pool for rural-urban green job creation enterprises.** Within the context of an overall enterprise development strategy, a special niche funding pool, initially topped up by international donors, could be established to promote green enterprise. Particular emphasis should be placed on businesses that connect urban and rural populations through technology in solving common environmental problems. For example, projects are badly need to fill the many environmental data gaps around biodiversity, pollution rates and trends in violation of environmental laws. These businesses are likely to be small scale in the short term, government contracted and limited in their profitability. Kosovo is also full of badly administered pools of reserved funding. However, a well-implemented, pragmatic and far-sighted scheme could be a powerful incentive for greater environmental awareness, activity and cooperation that benefits Kosovo far into the future.

# Statistical Annex

Calculating the human development index – graphical presentation



The Human Development Index (HDI) is a summary measure of human development. It measures the average achievements in a country in three basic dimensions of human development: a long and healthy life, access to knowledge and a decent standard of living. The HDI is the geometric mean of normalized indices measuring achievements in each dimension. For a full elaboration of the method and its rationale, see Klugman, Rodriguez and Choi (2011). This technical note describes the steps to create the HDI, data sources and the methodology used to express income.

## Steps to estimate the Human Development Index

There are two steps to calculating the HDI.

### Step 1. Creating the dimension indices

Minimum and maximum values (goalposts) are set in order to transform the indicators into indices between 0 and 1. The maximums are the highest observed values in the time series (1980–2011). The minimum values can be appropriately conceived of as subsistence values. The minimum values are set at 20 years for life expectancy, at 0 years for both education variables and at \$100 for per capita gross national income (GNI). The low value for income can be justified by the considerable amount of unmeasured subsistence and nonmarket production in economies close to the minimum, not captured in the official data.

### Goalposts for the Human Development Index in this Report

Dimension	Observed maximum	Minimum
Life expectancy	83.4 (Japan, 2011)	20.0
Mean years of schooling	13.1 (Czech Republic, 2005)	0
Expected years of schooling	18.0 (capped at)	0
Combined education index	0.978 (New Zealand, 2010)	0
Per capita income (PPP \$)	107,721 (Qatar, 2011)	100

Having defined the minimum and maximum values, the sub-indices are calculated as follows:

$$\text{Dimension index} = \frac{\text{actual value} - \text{minimum value}}{\text{maximum value} - \text{minimum value}} \quad (1)$$

For education, equation 1 is applied to each of the two subcomponents, then a geometric mean of the resulting indices is created and finally, equation 1 is reapplied to the geometric mean of the indices using 0 as the minimum and the highest geometric mean of the resulting indices for the time period under consideration as

the maximum. This is equivalent to applying equation 1 directly to the geometric mean of the two subcomponents.

Because each dimension index is a proxy for capabilities in the corresponding dimension, the transformation function from income to capabilities is likely to be concave (Anand and Sen 2000). Thus, for income the natural logarithm of the actual minimum and maximum values is used.

### Step 2. Aggregating the subindices to produce the Human Development Index

The HDI is the geometric mean of the three dimension indices:

$$(I_{Life}^{1/3} \cdot I_{Education}^{1/3} \cdot I_{Income}^{1/3}) \quad (2)$$

### Kosovo

Indicator	Value
Life expectancy at birth (years)	70
Mean years of schooling (years)	11.2
Expected years of schooling (years)	11.3
GNI per capita (PPP \$)	7,410

Note: Values are rounded.

$$\text{Life expectancy index} = \frac{70 - 20}{83.4 - 20} = 0.788$$

$$\text{Mean years of schooling index} = \frac{11.2 - 0}{13.1 - 0} = 0.855$$

$$\text{Expected years of schooling index} = \frac{11.3 - 0}{18 - 0} = 0.627$$

$$\text{Education index} = \frac{\sqrt{0.855 \cdot 0.627} - 0}{0.978 - 0} = 0.748$$

$$\text{Income index} = \frac{\ln(7,410) - \ln(100)}{\ln(107,721) - \ln(100)} = 0.616$$

$$\text{Human Development Index} = \sqrt[3]{0.788 \cdot 0.748 \cdot 0.616} = 0.714$$

### Data sources

- Life expectancy at birth: UNDESA (2011)
- Mean years of schooling: HDRO updates (<http://hdr.undp.org/en/statistics/>) based on UNESCO data on education attainment (<http://stats.uis.unesco.org/unesco>) using the methodology outlined in Barro and Lee (2010a)
- Expected years of schooling: UNESCO Institute for Statistics (2011)
- GNI per capita: World Bank (2011a), IMF (2011), UNSD (2011) and UNDESA (2011)



### Methodology used to express income

GNI is traditionally expressed in current terms. To make GNI comparable across time, GNI is converted from current to constant terms by taking the value of nominal GNI per capita in purchasing power parity (PPP) terms for the base year (2005) and building a time series using the growth rate of real GNI per capita, as implied by the ratio of current GNI per capita in local currency terms to the GDP deflator.

Official PPPs are produced by the International Comparison Program (ICP), which periodically collects thousands of prices of matched goods and services in many countries. The last round of this exercise refers to 2005 and covers 146 countries. The World Bank produces estimates for years other than the ICP benchmark based on inflation relative to the United States. Because other international organizations—such as the World Bank and the International Monetary Fund (IMF)—quote the base year in terms of the ICP benchmark, the HDRO does the same.

To obtain the income value for 2011, IMF-projected GDP growth rates (based on constant terms) are applied to the most

recent GNI values. The IMF-projected growth rates are calculated in local currency terms and constant prices rather than in PPP terms. This avoids mixing the effects of the PPP conversion with those of real growth of the economy.

### Estimating missing values

For a small number of countries that were missing one out of four indicators, the HDRO filled the gap by estimating the missing value using cross-country regression models. The details of the models used are available at <http://hdr.undp.org/en/statistics/understanding/issues/>.

In this Report, the PPP conversion rates were estimated for three countries (Cuba, Occupied Palestinian Territory and Palau), expected years of schooling were estimated for five countries (Barbados, Haiti, Montenegro, Singapore and Turkmenistan) and mean years of schooling were estimated for eight countries (Antigua and Barbuda, Eritrea, Grenada, Kiribati, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Vanuatu). This brought the total number of countries in the HDI in 2011 up to 187, from 169 in 2010.

# Notes

## Introduction

- 1 For further Information please check Annex 1: Technical Note: Calculating the human development Index of Kosovo as per the Global Human Development Report 2011 (p.167-217).
- 2 Poverty data from the World Bank Poverty Assessment, 2007 (higher estimate range) and Demographic and Health Survey 2009, Statistical Office of Kosovo (lower estimate range). World Bank estimates are based on a figure of 1.42 EUR per adult per day for absolute poverty and 0.92 EUR for extreme poverty in 2002 prices. KAS estimates are based on an inflation adjusted figures of 1.55 EUR per day and 1.02 EUR per day respectively.
- 3 Kosovo MDG Factsheets 2010, Statistical Office of Kosovo, the United Nations Agencies, the World Bank, the International Monetary Fund. Data indicates a 50 percent increase in rural poverty 2000-2004.
- 4 Statistical Office of Kosovo, Labour Force Survey 2009.
- 5 Kosovo Mosaic Survey, UNDP 2009. This survey was conducted with 6,400 households from 33 municipalities, collecting primary data through face to face interviews. Each of Kosovo's thirty-three municipalities was assigned a proportional number of respondents based on population figures and the sample was split equally between urban and rural areas.
- 6 Kosovo Remittance Study, UNDP 2010.
- 7 Kosovo Country Report, European Training Programme 2007; and Mainstreaming with Europe: An Adult Learning Strategy for Kosovo, Employment and Skills Observatory of Kosovo 2004.
- 8 The Position of Roma, Ashkali and Egyptian Communities in Kosovo, Baseline Survey conducted upon the request and with funding from the Kosovo Foundation for Open Society: COMPASS Research & Consulting Company. Pristina: KFOS – SOROS, 2009, and Kosovo Human Development Report, UNDP 2010.
- 9 Kosovo Mosaic Survey, UNDP 2009.
- 10 Justice Denied: The State of Education of Children With Special Needs in Post-Conflict Kosovo, UNICEF 2008.
- 11 Survey of the position of women in Kosovo in 2009, UNIFEM internal paper, p. 3.
- 12 Early Childhood & Women's Literacy Programme Mid-Term Evaluation, UNICEF 2004.
- 13 Informal ventures, constituting the informal sector of the economy is a concept which is used many times throughout this report. The informal sector is defined by economic activity that is neither taxed nor monitored by government and is not regulated and protected by formal institutions.
- 14 Promoting Pro-Poor Growth: Private Sector Development, Organisation for Economic Cooperation and Development (OECD) Policy paper. France 2006.
- 15 Evaluation of Active Labour Market Programme for Youth in Kosovo June 2008.
- 16 Unleashing Entrepreneurship—Making Business Work for the Poor, Commission on the Private Sector and Development 2004
- 17 Soft Hearts and Hard Heads: The Private Sector's Centrality to Poverty Reduction. Asian Development Bank (C.H. Wallich) 2004.
- 18 The Private Sector and Poverty Reduction, Oxfam International (Raworth K., S. Dhanarajan and L.W. Lewis), 2008.
- 19 The Private Sector's Share in Peace: Education to provide social stability in conflict-affected societies, J.A. French 2005

## Chapter 1

- 20 "Socially-owned Enterprise" means an Enterprise that was created as socially-owned under the Law on Enterprises, the Law on Associated Labour of the Federal Republic of Yugoslavia or any other applicable law, provided that any changes subsequent to the creation of such Enterprise shall be governed by sections 5.3 and 5.4. (REGULATION NO. 2002/12 UNMIK/REG/2002/12, 13 June 2002).
- 21 During the same period the other countries in South Eastern Europe (SEE) grew faster, so the income gap has widened (World Bank2010).
- 22 Kosovo Progress Report, European Commission 2011.
- 23 Exports fell sharply, but because of the small share of the country's GDP which exports constitute, the impact was limited.
- 24 International Monetary Fund, 2011.
- 25 World Bank governance indicators include; voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption.
- 26 Registered unemployment may be overestimated or underestimated depending on the way in which official statistics are collected. Unemployment could be overestimated (commonly referred to as hidden unemployment-

- ment) due to a portion of the informally employed, or those that are unavailable to work or not looking for work, being registered as unemployed in order to benefit from social assistance. Conversely, unemployment could be underestimated due to not taking account of any members of the labour force who are not registered as unemployed because they are discouraged and have completely given up looking for work. These limitations are acknowledged in the report itself (MLSW 2010, p. 39).
- 27 KAS (2009) Results of the Labour Force Survey 2009 Report.
- 28 KAS LFS 2009 uses the standard definition of unemployment: an unemployed person is one who has no job and is actively looking for a job.
- 29 Kosovo Human Development Report on Social Inclusion, UNDP 2010. The report uses KAS LFS data from 2008.
- 30 The ILO (International Labour Organisation) defines decent work as being productive jobs for men and women in conditions of freedom, equity, security and human dignity.
- 31 Young people's transition to decent work: evidence from Kosovo, Corbanese and Rosas 2007.
- 32 Evaluation of Active Labour Market Programme for Youth in Kosovo, June 2008.
- 33 Eurostat 2010.
- 34 Primary sector covers divisions 01 to 05, or branches A (Agriculture, hunting and forestry) and B (Fishing). Secondary sector covers divisions 10 to 45, or branches C to F (Mining and quarrying, Manufacturing, Electricity, gas and water supply, Construction). Tertiary sector includes the rest.
- 35 Findings in this section are a composite of Kosovo Tax Administration and KAS data.
- 36 KAS (based on Kosovo Tax Administration data)
- 37 KAS (based on Kosovo Tax Administration data)
- 38 Enterprise death is calculated from the count of the number of deaths of enterprises recorded in the business register, corrected for errors, compared to the population size. Enterprise death is defined as the dissolution of a combination of production factors with the restriction that no other enterprises are involved in the event. Deaths do not include exits from the population due to mergers, takeovers, break-ups and restructuring of a set of enterprises. The figure does not include exits from a sub-population as a result of only a change of activity. Furthermore, the reported statistics do not consider an enterprise as having died if it undergoes a change of legal form, or if it is reactivated within two calendar years.

## Chapter 2

- 39 BEEPS is a joint initiative of the European Bank for Reconstruction and Development (EBRD) and the World Bank.
- 40 Calculation of intensity of obstacles: The questionnaire ranked from 1 to 5 the severity of obstacles (1, no obstacle; 2, minor obstacle; 3, moderate obstacle; 4, major obstacle; 5, very severe obstacle). A weighting process was then used to calculate the intensity of different obstacles and rank them from 20 to 100 (100 being the most severe obstacle).
- 41 Defined as having bank accounts, handing over the money at the bank at the end of the day and installing Point of Sale payment (POS) machines in their stores.
- 42 Kosovo A (approximate installed capacity of 450MW) and Kosovo B (approximate installed capacity of 580MW), both located in Obilić immediately to the North West of Pristina.
- 43 Enterprise Barriers Survey, Riinvest 2002.
- 44 The Friedrich-Ebert-Stiftung Foundation is a non-profit German political foundation, active in Kosovo and over 100 other countries, with a mission to promote democracy, social justice and economic-reform through capacity building, policy development and promotion of dialogue.
- 45 Transparency International is a non-governmental organisation with a mission to create change towards a world free of corruption. The organisation monitors and publicises corporate and political corruption in international development and publishes an annual Corruption Perceptions Index, focussed on corruption levels worldwide.
- 46 Riinvest Enterprise Barriers Survey 2011
- 47 A 'collective action problem' describes a situation in which multiple individuals would all benefit from a certain action, however, this action has an associated cost making it implausible that any one individual can or will undertake and solve it alone. The rational choice is then to undertake this as a collective action the cost of which is shared.
- 48 Kosovo Common Development Plan, 2010-2015, United Nations Kosovo Team

## Chapter 3

- 49 Around 90 percent of start-ups belong to the tertiary sector, 9.2 percent to the secondary sector and only 0.8 percent to the primary sector.
- 50 The Spirit Level: Why Greater Equality Makes Societies Stronger, Wilkinson, R. and Pickett, K. 2010
- 51 Financial data on women in Kosovo taken from the Kosovo Human Development Report UNDP 2010, the Statistical Office of Kosovo, 2008 and Procredit Bank Survey, 2008
- 52 Early Childhood & Women's Literacy Programme, Mid-Term Evaluation, UNICEF 2004
- 53 She\_ERA, Grate Afariste ne Kosove, Analize e

- 54 Getting to Lisbon – Assessing vocational training needs and job creation opportunities for rural women, UNICEF 2008
- 55 The EU trade preferences system offers a preferential trade regime to some developing countries where they pay lower duties on some or all of what they export to the EU. The system is designed to give vital access to the EU market and to contribute to the growth of the economies of the countries in question, supporting economic integration with the EU and hence fostering political stability and economic progress.
- 56 The traded or tradable sector is normally defined to include those industries in which firms sell their goods or services into markets for which national or international competition exists.
- 57 The labour to capital ratio of an industry or sector is calculated based on the ratio of the cost of labour as a proportion of the total capital cost of producing the good or service in question. The labour to capital ratio indicates the labour intensity of the sector being considered: the higher the ratio, the higher the labour intensity.

## Chapter 4

- 58 Kosovo Human Development Report on Social Inclusion, UNDP 2010.
- 59 Definition of different skill levels of workers:  
 An unskilled worker's operations involve the performance of simple duties with little or no independent judgment or previous experience except familiarity with the occupational environment.  
 A semi-skilled worker's operations are generally of defined routine nature where the major requirement is not so much of judgment and skill, but of the performance of assigned duties.  
 A skilled employee is capable of working efficiently, exercising considerable independent judgement, and taking responsibility for their duties and must possess a comprehensive knowledge of their trade, craft or industry.  
 A highly skilled worker is one who is capable of efficiently supervising the work of skilled employees.
- 60 Kosovo Labour Market Information, MLSW 2007.
- 61 Kosovo, Unlocking Growth Potential: Strategies, Policies, Actions, World Bank 2010.
- 62 Unleashing Change, Kosovo Voices of Youth, UNICEF and Kosovo Stability Initiative 2010.
- 63 Getting to Lisbon: Assessing Vocational Training Needs and Job Creation Opportunities for Rural Women, UNICEF 2008.
- 64 MLSW 2003.
- 65 Law on Labour (Law No.03/L –212) - Enacted in 2010. Available at: <http://www.assembly-kosova.org/common/docs/ligjet/2010-212-eng.pdf>
- 66 Kosovo's Social Economic Council is a committee, focussed on social dialogue and labour relations, which is chaired by the Ministry of Labour and Social Welfare and comprised of employers' representatives, trade unions, and representatives of relevant ministries.
- 67 Law on Vocational Ability, Rehabilitation and Employment of People with Disabilities (Law No. 03/L-019) – Enacted in 2008. Available at: [http://www.assembly-kosova.org/common/docs/ligjet/2008\\_03-L-019\\_en.pdf](http://www.assembly-kosova.org/common/docs/ligjet/2008_03-L-019_en.pdf)
- 68 Kosovo Remittance Study, UNDP 2010.
- 69 Kosovo Remittances Survey, UNDP 2011.
- 70 An Overview of the Social Security System in Kosovo, ILO 2010.
- 71 Kosovo Poverty Assessment, World Bank 2008.
- 72 Income equality is defined as a measure of the degree to which there is an equal distribution of income across the various participants in an economy. Income equality is lower, the larger the proportion of a country's income which is controlled by the rich relative to their population (for example, if 70% of a country's income is controlled by 20% of that country's residents).
- 73 Policies for Redistribution: The Use of Taxes and Social Transfers, International Labour Organization 2008 (N. Prasad).
- 74 Kosovo State of the Environment, United Nations Assistance Mission in Kosovo 2003 (Ministry of Environment and Spatial Planning)
- 75 Kosovo Energy Efficiency Plan 2010-2018, Ministry of Energy.
- 76 Analysis and identification of programming opportunities on promoting energy efficiency and renewable energy use in Kosovo, UNDP 2012.



The Global Human Development Report is an independent report, and an annual milestone publication commissioned by the United Nations Development Programme (UNDP). It is produced by a team of leading scholars, development practitioners and members of the Human Development Report Office at the global headquarters of UNDP. Its primary goal is to measure how well nations and societies are progressing towards the goal of human development, draw lessons for progress from different country experiences and move the global dialogue forward on the wellbeing of humanity.

National Human Development Reports (NHDR) seek to replicate this model from the perspective of specific nations. Each NHDR is prepared and owned by national teams, who thereby introduce the concept of human development into national policy dialogue. This means far more than analysis of human development indicators and production of policy recommendations. It springs from the entire country-led and country-owned process of consultation, research and report writing that comprises as NHDR. NHDRs traditionally spur lively public debates and mobilize support for action and change.

The first Kosovo HDR, in 2002, measured Kosovo's progress against the Human Development Index, the Gender Development Index and the Human Poverty Index. The second KHDR, in 2004, featured municipal-level human development data and the first Participation Index, which depicted the levels of civic and political participation across ethnic groups by municipality in both urban and rural settings. The third report, KHDR 2006, focused on the young people of Kosovo and their challenges after the end of conflict in 1999. The fourth KHDR, in 2007, analyzed the critical relationship between energy and human development and provided policy recommendations for Kosovo's nascent energy sector.

KHDR 2008 was dedicated to the undervalued role of civil society and institutions. It provided the basis for programmes supporting civil society organizations to harness knowledge, develop more constructive mechanisms for interfacing with the government and responding to the real needs of communities they represent.

The KHDR 2010 examined traditional socio-economic indicators, from poverty and unemployment to health and education, from the perspective of social inclusion. It explored how discrimination – deliberate or otherwise – affects Kosovo's socio-economic balance, its political process and its EU-orientated policy goals. It also identified social groups feeling the bite of exclusion more deeply than others. These groups risk becoming Kosovo's invisible population unless they are moved quickly up the policy prioritization ladder and made the primary focus of Kosovo's development agenda: the long-term unemployed, disadvantaged children and youth, rural women, Kosovo-Roma, Ashkali and Egyptian (RAE) communities, people with special needs. Finally, it offered recommendations on how the move towards a more inclusive society might be managed, as a fundamental precursor to other economic and political progress.

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