

## **The Impact of FDI portfolio in the implementation of Local Economic Development Strategy-The Evidence from Municipality of Prishtina**

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### **Abstract**

*Rapid economic growth in few of the developing countries has had an impact in the changes in the global network of investment. This includes also Foreign Direct Investments, as an integral part of the development of any country. One of the economic problems of undeveloped countries and Kosovo is that they do not have enough national savings to finance their investments. They are in constant need of foreign capital in forms of both direct and indirect investments. Foreign Direct Investments in general bring national economic benefits, while at the same time, through invested capital, it will increase the Gross Domestic Product (GDP), and in particular it will contribute to the lowering of the unemployment in the country. Thus, Foreign Direct Investments (FDI) are assumed to benefit for poor country like Kosovo, not only by supplementing domestic investment, but also in terms of economic development, new employment, transfer of technology, increased competition, networking and other positive externalities. In this manner, key determinant and a prerequisite for FDI attraction in a country, including Kosovo, must have if there is an interest to attract the right mode of foreign capital. Having in mind the current conditions, FDIs should play a key role in the economic development through restructuring and growing the national economic competitiveness. By bringing resources like added capital, technological and managerial “know-how”, and access to local, regional and global markets, FDI will increase productivity and increase the export. The study investigate the investment possibilities with their investment in municipality projects and which steps needed to be undertaken from institutions in order to create attract the right mode of foreign capital. The study found a high degree of importance and prioritization of FDI (prior and after investment decision) in increasing budget capacity for implementation development strategy in Municipality of Pristina. The findings also revealed “corruption”, “small market size” and “political instability” as major barriers to increasing the investments in the country.*

**Keywords:** FDI, investments, capital, development, strategy, country.

### **Introduction**

Sustainable economic development is done through the Development Strategy. Development strategies have some priorities: they encourage other participants, stakeholders and those that impact the investment acting in accordance with the vision. Local economic development is a process where local communities (public, businesses and government organizations and non-governmental) work towards achieving a sustainable economic development, and provides an increased level of employment, welfare and quality of life for all. The strategy in itself provides the opportunity for the community to continuously improve the investment climate, including FDI, and possible improvement of the business environment, making it possible to increase their competitiveness in relation within territory of Kosovo, and other capitals cities in Eastern Europe. In cases where resources are insufficient, the effective and efficient allocation of resources is gaining weight and importance. To achieve this, it is necessary to control the use of limited financial resources.

Municipalities must learn how to compete and how to deploy themselves in order to ensure quality of life, jobs and services, which then influence the attraction of investments. Strategy is often a prerequisite for financing municipal projects through government grants, FDI, banks, public-private partnerships, or EU funds.

During this process, the municipality creates partnerships, both within and outside the municipality. The stronger that these partnerships are, the chances of a municipality to secure future development are greatest. Important prerequisite for the construction of a system of well-municipal budget and its effective management is the provision of funding for projects to manage and possession of skills that transform budget in quality services, etc. Possible sources of budget financing of projects from (a) own resources (b) loans (c) donors (d) concessions (e) FDI (f) other partnerships with the business community, banks, insurance companies, public utilities etc.

### ***Literature Review***

Local government is important, because of the skills, of being a catalyst for representation in public interest so that the projects are to be implemented by finding new forms of financing, such as foreign direct investment. Strategic planning plays an important role in the future success of any organization (Gray and Larson, 2006) "created mission, objectives, goals and strategies of where the organization wants to achieve in the future" (Cleland 1999). The strategic planning process is done by the following four activities: review and define the organization's mission, defining long-term goals and objectives, analyze and formulate strategies for achieving the objectives and implementation of strategy through project (Gray and Larson 2006). In order to fulfil its objectives communities rarely implement these strategies through projects. This deficiency is not only important to communities. Businesses have difficulty in completing the final phase of the strategic planning process as the most difficult step in the process (Gray and Larson 2006). The main goals for municipal organizations are to focus on achieving competitive advantage through projects. The authors have given different definitions for the project. One of them, Lewis (1993) says the project is an activity, which is not repeated, and that also has to define its start and end, with a clear definition of scope, and budget constraints. According to Gray and Larson (2006) three problems occur when certain projects are not a priority system. The first problem is known as the "implementation gap". The second problem has to do with the organization's policies. The third problem has to do with the conflict between diversified resources and tasks. Therefore FDI and chances are a good opportunity to expand the sources of funding of projects in development strategy. This strategy is a process by which citizens and business community, as well as non-governmental sector as partners all work together to create better conditions for real economic growth and employment generation. It focuses on increasing competitiveness, sustainable growth and ensures that growth is inclusive. Important prerequisite for the construction of a good system of municipal budget and its effective management is the provision of funding for projects to manage and possession of skills that transform budget in quality services, etc.

### ***Problem Statement***

Foreign Direct Investment (FDI), generally bring a benefit the national economy, contributing capital investment through increased Gross Domestic Product (GDP), payments balance, and lower unemployment. The importance of FDI is defined as a matter of important matters like the global context, especially in the transition countries and less developed countries. Foreign direct investment (FDI) by OECD (2007), reflect the intention of providing a stable interest of a resident entity in one economy (direct investor) in an entity resident in another economy (direct investment enterprise). The concept of sustainable investment implies the existence of a long-term relationship between the direct investor and the organization, as well as a significant influence by the investor on the management of the process of decision making in the organization. Index's FDI is important in developing countries and in developed ones. Approval of the Foreign Investment Law, No.2006/33 in Kosovo, where the main purpose of this Law is the promotion and encouragement of foreign investment in our country by offering to foreign investors and guarantees the fundamental rights and the executable that give surely these investors that they and their investments will be protected and will be dealt with the right way, and in full accordance with the principle of the rule of law and the recognized standards and international practices. (Foreign Investment Law No. 2006/33). Usually there are two types of forms in which foreign investment can be realized by one country (investor country) to another (the host). The indirect foreign investment, otherwise known and portfolio investments, are investments made by existing financial channels between investors and the host country. Meanwhile, the second way is that of foreign direct investment. According to the classic definition, FDI is considered a company of a certain country that makes a physical investment by building an industrial under taking or arbitrary firm in another country (Rugman & Hodhett, 1995).

Rapid economic growth that some developing countries have suffered, as well as changes in the global network of investments, has enabled the definition of FDI to expand even more in order to include new notions.

In general, foreign investment, generate and expand businesses, can help employment, salary increase or replacement of critical sectors or falling market. However, not infrequently, the benefits from these investments can only feel from a very small segment of the population, in case of employment, training and relevant training limited to a very small group of well educated elite. Also, investments in new sectors can stimulate the development of infrastructure and new technologies' 'know how', technologies implemented in the country where these, in the identical time we increase the professional capacity of technical management. In recent recommendations for EU candidate countries (as well as for Kosovo) the emphasis was put on improving the environment for business development. For this purpose some specific recommendations were made and they are:

- Implementation of the plan to cut administrative barriers to investment and simplifying administrative procedures.
- Defining clear conditions and procedures for the establishment, registration and operation of domestic and foreign companies, according to EU standards. Ensuring non-discrimination legislation for business.
- Adopting suitable trade legislation. "(EU recommendations.)"

Kosovo cannot be held in the path of European integration, without attracting massive foreign investment and taking more of a role in the region. Kosovo will be a more attractive place for foreign investment in the region and beyond to the objective of improving the investment climate. This could be achieved through fighting corruption, reducing the informal economy, liberalization of market entry procedures, design and implementation of a package of incentives to investors, guaranteeing the rights and conflict resolution associated with ownership, expansion and modernization of the financial sector, etc. (MTI for Investment Promotion Agency.) We think that the existence of a legal framework for stimulating foreign direct investment, increase the level of security to invest, improving physical infrastructure, reduction of administrative barriers, skilled labour and improving the climate show greater opportunities to invest in country. Promoting FDI needs to coordinate institutions and Investment Promotion Agency. It is very necessary cooperation with regional and local authorities. In later stages its possible the opening of representative offices in other countries and promoting opportunities in a foreign country.

Given the level of development of the Kosovo Economy after 1999 where Kosovo has been unstable in order constant in economic and political terms, where GDP growth was mainly a result of donations and remittances from Diasporas, not the result of economic activity. (Study Report "RIINVEST", Pristina). Stand structure was identical on Pristina economy, which has emerged from an extremely low industrial production and high level of unemployment. Taking into consideration the existing conditions FDI should play a crucial role in economic growth, restructure and enhance the ability of competitive local economics. By bringing resources like added capital, technological and managerial "know-how", and access to local, regional and global markets, FDI will increase productivity and increase the export. Moreover, FDI may increase potentially employment in, increase local competition in most of the producers and approach in foreign markets. FDI will remain a proportional important a source of financing of the huge trade deficit (Study Report, "RIINVEST" 2004, Pristina). Taking into account local investors a small potential it is necessary to orient institutional efforts towards policies for attraction FDI's with the aim of greater flexibility on economic development at the central level as well as at the local level.

**Table 1: Increase of FDI during period 2008 -2013 (in million EUR)**

Year	2008	2009	2010	2011	2012	2013	Total
FDI	366.5	287.4	365.8	393.9	229.1	258.90	1,901.60

**Source:** Central Bank of Kosova (2014)

FDI's in Kosovo during the last year were higher for 13.10 percent than in 2012. As a result of the global financial crisis, FDI to GDP dropped by constant rate since 2008, while 2013 recorded a growth from 4.7 percent to 5 percent of GDP. FDI in the first half of 2014 are in the amount of 37.5 million euro's, which represents a significant decrease compared with the value of 141.0 million euro's in the same period of the previous year.

This decline can be attributed to FDI mainly selling shares of some foreign companies operating in Kosovo, as well as super dividend distribution of some foreign companies<sup>1</sup> operating in Kosovo.

<sup>1</sup> With super dividend understood dividend which is higher than the profits of the company in the relevant period. Distribution the super dividends affects the reduction of the share capital which represents a decrease of FDI

Up until now the most attractive sector for investment has been one of the banks, mainly capital from Austria, Germany, Netherlands (Raiffeisen Bank, Pro Credit Bank), Italy, Switzerland, Liechtenstein, and EBRD (BpB)<sup>2</sup>, the capital of Slovenia (NLB- Pristina) created by the merger of BRK and Kasabank<sup>3</sup>, recently the Turkish capital (BKT, & TEB)<sup>4</sup>, is Bankasi<sup>5</sup>, as well as some international financial institutions. Whereas, insurance sector has withdraw investment from Albania, Croatia and Kosovo Diaspora. As assessment of the study of World Bank appears that legislation for market economy was created in Kosovo, the main problem is staying on his consensus operational level where the pronounced lag in its applicability. At the time of the implementation of Pristina Development Strategy (2008-2012), on the basis of statistical statements FDI in Kosovo capture majority of € 1,642.70 million records on MTI. According Agency for Registration of Businesses in the identical period of time society there are 1815 registered business of foreign trade. As the official statistical recordings are missing in survey and research estimates made by "RIINVEST" it appears that 65% of the overall number of these enterprises are operating in the municipality of Pristina.

**Table 2: FDI in 2008 -2013 by Country (in mil. EUR)**

State	2008	2009	2010	2011	2012	2013	Total
<b>Germany</b>	44	75.2	91.5	66.6	49.5	21.7	348.56
<b>United Kingdom</b>	36.6	6.2	38.9	80.1	14.3	17.08	193.12
<b>Slovenia</b>	44.3	50.8	34.0	16.2	9.3		154.56
<b>Switzerland</b>	32.1	22.7	35.1	30.9	43.8	41.7	206.34
<b>Turkey</b>	23.8	14.5	4.9	34.7	65.6	86.8	230.26
<b>Austria</b>	51.3	15.5	21.1	19.6	0.4		107.86
<b>Albania</b>	21.9	23.3	20.3	11.2	4.7	20.5	101.89
<b>Netherlands</b>	22.5	15.1	14.5	14.2	-26.0		40.33
<b>USA</b>	4.8	11.8	12.6	14.3	10.8		54.34
<b>Others</b>	70.7	29.9	71.5	88.0	35.2		295.2
<b>Total</b>	366.5	287.4	365.8	393.9	229.1	258.90	1,901.6

**Source:** Report from Central Bank of Kosovo (2014)

Capital investments are the main category of FDI in Kosovo. Capital investments comprise 70.5 percent of total FDI. Real economic development policies, which entered into force in 2009, have increased FDI in Kosovo. The resumption of the privatization process, and the reduction of corporate tax, may be singled out as more positive developments. Also, membership in international institutions in 2009 as: The International Monetary Fund (IMF) and World Bank (WB) are a positive incentive for potential investors. FDI growth has contributed to the increased investment in road infrastructure. Membership of the Republic of Kosovo in the EBRD (December 2012) will help in economic development, the implementation of European standards reforms and infrastructure development by supporting private sector development, mobilizing foreign capital and improve the environment for investment. Origin of foreign investors in Kosovo is mainly from EU countries. Germany continues to be the place from which come most FDI. After that is sorted Slovenia, Austria, etc. Recently regarding the origin of FDI's, Turkey holds the first place (33.6 percent) followed by Switzerland (16.10 percent), Germany (8.4 percent), Albania (7.9 percent). While investments from Turkey have increased by 32.3 percent during 2013, investment from Germany and Switzerland declined 56.2 percent. Also, it is worth mentioned that investments from Albania have tripled in 2013 compared with 2012.

The structure of FDI economic activity are dominated initially by investments in the financial sector (34.9 percent), transport and telecommunications sector (13.8 percent), manufacturing industry (eight percent), energy sector, water and gas and investment in industry mines by 5 percent. Relatively high percentage of FDI in the also had investments in real estate 16.8 percent of total FDI.

<sup>2</sup> EBRD as shareholders entered in BpB since 2011 with 10% of the total capital of the Bank.

<sup>3</sup> NLB & NLB and BRK & Kasabank from 01.01.2008 are integrated into a bank "NLB Prishtina" (adopted by CBAK on 18.12.2007).

<sup>4</sup> TEB Bank (Türk Ekonomi Bankasi) joint venture with BNP Paribas, have full working license CBAK (now CBK) on 18.12.2007.

<sup>5</sup> IŞ Bankasi is Turkey's biggest bank, which has entered Kosovo market under license from CBK on November 2012.

**Table 3 - Foreign Direct Investment 2008 - 2013 According to the Main Economic Sectors (as % of total FDI)**

Description / Year	2008	2009	2010	2011	2012	2013
<b>Financial services</b>	34.9%	25.5%	19.5%	8.9%	10.4%	11.0%
<b>Manufacturing</b>	6.0%	17.1%	19.8%	12.8%	12.1%	3%
<b>Real estate</b>	16.8%	14.9%	13.4%	16.3%	31.7%	35.4%
<b>Transport &amp; Telecommunication</b>	13.8%	7.4%	4.0%	6.2%	7.9%	14.2%
<b>Electricity</b>	4.5%	2.9%	0.1%	0.0%	1.3%	7.6%
<b>Mines</b>	4.7%	2.4%	2.7%	0.8%	4.6%	3%
<b>Construction</b>	3.7%	12.0%	24.9%	34.3%	20.8%	15.1%
<b>Processing industry</b>	8.5%	2.4%	6.9%	0.5%	0.4%	0.6%
<b>Agriculture</b>	2.3%	4.4%	0.6%	0.1%	0.1%	0.1%
<b>Commercial services, cleaning, collection</b>	2.7%	5.5%	3.3%	2.1%	3.6%	3.8%
<b>Advisory and research activities</b>	0.6%	0.9%	2.3%	2.0%	1.6%	1.7%
<b>Sanitation</b>	0.6%	0.8%	0.7%	0.0%	0.3%	0.3%
<b>Others</b>	0.9%	3.8%	1.9%	16.0%	5.1%	4.2%
<b>Total</b>	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

**Source:** Report from Central Bank of Kosovo (2014)

FDI's in real estate have increased dominance in the structure of the total FDI's during 2013. The growth is also characterized in the transport sector and telecommunications, financial services, energy and trade, while FDI in the manufacturing sector and building activity fell.

### Conclusion

Municipality of Pristina approved Regulation for the creation of the facilitations for external investors. This regulation, adopted by the Municipal Assembly, is the basis for the creation of an environment adequate for infrastructure, and on the basis of the Strategic Development Plan that established businesses based on direct foreign investments will be exempt from paying municipal taxes on a period of given time (2-5 years). This regulation is welcome from the business community where the main objective is to encourage FDI to invest in the area of municipality. Regulatory Plan for new Industrial Works Site (Commercial) from 600 ha. area will create an adequate and affordable space for the FDI, and the investment for local investors. In this space foreign investiture should invest in the business centres. Historically, since the Middle Ages Pristina has been the center of organizing fairs in this part of Eastern Europe. According to that, as Pristina Municipality has the large number of projects in FDI, should be a source of funding to their importance, of which directly will all affect the implementation of Development Strategy. In order to achieve this, constant attempts are needed to be made in the overall improving climate affordable for these types of investments. At the same time we should emphasise the role and impact of FDI in human capital development. Some steps were taken regarding how the current education and skills can be improved in order to be harmonised with the demand of foreign investors, hence treating human capital in institutions as prerequisite to increase the inflow of FDI. Some actions and recommendations should be taken on both levels of governance: Central Government and municipalities, in order to improve business environment through avoiding barriers doing businesses in Kosovo.

The main barriers currently are:

- a) The informal barriers (corruption<sup>6</sup>)
- b) Fiscal barriers
- c) Legal barriers and
- d) Infrastructure barriers.

Therefore, it should be organized more powerful promotions to these institutions for potential investors, always based on the portfolio of projects that are part of development strategies in these institutions by involving the business community through the Kosovo Chamber of Commerce, American Economic Chamber, British, French, Turkish and German Chamber of Commerce.

<sup>6</sup> According to perception of corruption (CPI) Kosova has 33 points (0- more corruption:100- less corrupted; on the same time Kosovo from 177 country is listed in 110 position by Transparency International

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