Kosovo: Economy

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INTRODUCTION

The economy of Kosovo is deeply influenced by historical legacies. A province of the Ottoman Empire until 1913, Kosovo was subsequently annexed by the newly created Kingdom of Yugoslavia and did not embark on a path of economic modernization until the beginning of socialist rule in 1945. From then on, industrialization gathered pace quickly, especially in the western city of Gjakova/Djakovica. As in the rest of socialist Yugoslavia, the economic system was hybrid, combining central planning with workers' self-management. The penetration of Yugoslav industry, however, remained shallow, with public investments concentrated in the energy and mining sectors. Growth in gross domestic product (GDP) per head averaged 2.9% annually during 1952–89, well below the Yugoslav average of 4.4%. The Socialist Autonomous Province of Kosovo remained a net recipient of federal development funds. Yet, its relative income per head continued to decline over time, from 44% of the national average in 1951 to 26% in 1989. Social indicators, however, improved dramatically. The adult illiteracy rate, for instance, fell from 62% in 1953 to 18% in 1988.

Following a year of industrial unrest, Kosovo's autonomous status was violently abolished in 1990. Serbian firms took over many of Kosovo's socially owned enterprises (SOEs), and 80,000 ethnic Albanian workers lost their jobs. Largely financed by an unprecedented mobilization of diaspora donations, the ethnic Albanian Ushtria Çlirimtare e Kosovës (Kosovo Liberation Army, or UÇK), founded in early 1993, launched a full-scale armed insurgency in late 1997. The ensuing conflict, and the March–June 1999 military intervention by North Atlantic Treaty Organization (NATO)-led forces, took a heavy toll on Kosovo and its economy. More than 10,000 Kosovans died, and around 1.3m. ethnic Albanians were either internally displaced or became refugees in neighbouring countries. An unconfirmed number of ethnic Serbs (perhaps some 200,000) were driven out or fled as Yugoslav forces withdrew from the province. Some 120,000 houses were damaged or destroyed, with the total cost inflicted on the housing stock estimated at €1,100m. Overall, the war was responsible for dramatic losses of human, physical and social capital.

At the end of the war in June 1999, Kosovo entered a phase of rapid economic recovery and growth. During 2000–01 inflows of humanitarian and reconstruction aid reached as much as €1,000m. annually, and GDP per head expanded at a rate of 27% per year. As the economy stabilized, growth in GDP per head levelled off at around 4% during 2002–07, but later slowed down considerably as a result of the global financial and economic crisis of 2007–08. By 201 Kosovo remained the poorest economy in the Western Balkans, and the third poorest economy in Europe after Ukraine and Moldova. Yet, it recently graduated from 'lower-middle' to 'upper-middle income' status, according to the World Bank classification of income levels.

MACROECONOMIC PERFORMANCE

Following the euro debt crisis of 2010–11, the Kosovo economy quickly regained its dynamism, recording an average GDP growth rate of 4.9% per year during 2015–19. Real output dropped by 5.3% in 2020, but rebounded strongly in 2021 with a record growth rate of 10.7%. In that year the country's GDP, measured in current prices, stood at US $,9,412m. The rate of population growth has long been on a declining trend, as a relatively high (albeit diminishing) rate of fertility—of over two births per woman—is counterbalanced by increasing outward migration. During 2015–19 the total population declined at an average annual rate of 0.2%, reaching 1.87 m. people in 2020. Consequently, real GDP growth was slightly higher (5.2% per year) if measured in per-head terms. In 2021, nominal GDP per head was US $5,270 at market exchange rates, or $13,056 if measured on a purchasing-power-parity (PPP) basis, similar to that of Egypt or Peru. At market exchange rates, this level of income was equivalent to around 14% of the European Union (EU) average (or 27% on a PPP basis), and 43% (46% on a PPP basis) of the corresponding level in Bulgaria, the poorest EU economy.

Kosovo’s growth model remains overwhelmingly consumption-driven, and the country continues to struggle to mobilize domestic resources for development. Gross domestic savings (calculated by subtracting the aggregate consumption expenditure of households and government from GDP) amounted to only 1.3% of GDP in 2019. Yet, a slow but notable increase in the savings rate, which was as low as −7.4% in 2008, suggests that Kosovo’s economy is becoming more self-sustaining.

Because of the low domestic propensity to save, gross capital formation, which was stable at around 34% of GDP during 2015–19, depends overwhelmingly on foreign savings—that is, foreign direct investment (FDI) and external loans. This rate of investment was higher than the EU average but substantially lower than that of more dynamic emerging economies, such as the People’s Republic of China (43%).

Development aid and migrant remittances together remain important drivers of economic growth. Although Kosovo is becoming progressively less aid-dependent, overseas development assistance (ODA) continues to account for over 4% of national income. In 2019 ODA inflows amounted to US $345m., making Kosovo one of the world’s largest recipients of ODA in per-head terms. In 2017 over one-half of the aid budget was devoted to ‘government and civil society’ programmes, with only a small share of aid allocations targeting infrastructure investments and private sector development. During 2015–19 remittance inflows remained stable, at around 15.3% of GDP. Evidence suggests that migrant remittances have played a significant role in poverty reduction, especially by increasing household consumption in rural areas. Remittances have been much less effective as a means to finance investment in fixed assets, however.

THE EXTERNAL SECTOR

Kosovo’s external sector is characterized by large and persistent imbalances. The trade deficit (including goods and services) has remained stable at around 27% of GDP in recent years (compared with 41% in 2008). Amounting to US $3,079m. in 2022, this deficit is financed primarily by aid and remittances ($1,972 m. in that year) and, much less significantly, by income from Kosovo-owned investments overseas ($101m.). A surplus on the capital and financial accounts of the balance of payments (US $40m. and $711m., respectively) covers the remaining portion of the current account deficit (US $1,007m.).

In recent years some sectors have achieved international competitiveness, reducing Kosovo’s dependence on transfer payments from abroad. After a post-crisis slump, export growth rebounded quickly, expanding at roughly the same rate (4.5%) as the overall economy during 2015–19. In 2019 export revenues amounted to 28% of GDP, and covered 52% of the cost of imports. The export sector is dominated by trade in services, in which Kosovo operates a conspicuous surplus. In particular, travel and tourism, fuelled by a seasonal influx of Kosovan citizens working abroad, are an important source of foreign exchange. Goods exports were equivalent to 18% of GDP in 2019.

Excluding services, Kosovo’s export mix is dominated by low value-added or labour-intensive products, and is poorly diversified. Base metals accounted for nearly 37% of all exported goods in 2020. Other product categories with an increasingly prominent position in Kosovo’s export mix include rubber and plastics, and foodstuffs and beverages (notably wine and fruit juices). The largest market for exports in 2021 was the USA, accounting for 16.4% of export revenue, followed by Albania (14.7%). In the EU, the main export markets are Germany and Italy. Together with India, Italy is one of the main destinations for Kosovo’s largest export category—ferronickel granules. Although Türkiye (formerly known as Turkey) accounts for less than 3% of Kosovo's export revenue, it is an increasingly important market for Kosovo's manufactured products, as two former SOEs producing conveyor belts and synthetic yarns were privatized by Turkish investors.

In the late socialist period, Kosovo had started to develop the capacity to produce and export higher value-added manufactures such as motor car parts. The post-war transition, however, has accelerated a (re-)specialization in primary commodities and base metals. There is evidence that Kosovo's terms of trade with the rest of the world (the ratio of export prices to import prices) may have begun to deteriorate as a result.

The composition of Kosovo's imports confirms the overall consumption-driven character of the economy. With the exception of mineral fuels (there is no oil refinery), the most important import categories consist of consumer goods, rather than intermediate or capital goods. High-technology manufactures, such as motor cars and telephone sets, are typically imported from EU countries. In 2021 the main import partner was Germany, accounting for 13.0% of such trade. Raw materials (petroleum derivatives, steel bars) and lighter manufactures (food and beverages, clothing) are sourced from regional partners (such as Albania, North Macedonia), Türkiye and, increasingly, China.

During 2014–18 the largest suppliers of investment capital were Switzerland, Germany and Albania. FDI volumes are relatively high compared with other developing countries of a similar size. Yet, the projects financed by foreign investors are predominantly of the 'market-seeking', rather than the 'export-orientated', variety. Up to three-quarters of the FDI stock is in the services (banking and retail) and construction sectors. Manufacturing accounts for as little as one-fifth of existing foreign investments. A significant share of investment inflows is financed by diaspora savings, especially in construction and real estate. A project that was expected to become the single largest foreign-owned investment in Kosovo—a coal-fired power plant projected to cost €1,300m.—was halted in March 2020, following years of controversy over Kosovo's heavy reliance on lignite coal (of which it holds the world's fifth largest reserves) for electricity production.

ECONOMIC STRUCTURE AND INDUSTRY

Owing to the country's mountainous geography, arable land is scarce. In 2022, agriculture contributed only 9.2% of GDP, despite approximately 60% of the country's population living in rural areas. In that year mining, manufacturing and electricity generation accounted for some 2.4%, 16.1% and 5.0% of aggregate output, respectively, with construction accounting for another 10.6%. As in other post-socialist economies, Kosovo's transition from plan to market was accompanied by rapid de-industrialization, although the overall share of industry (mining, manufacturing, construction and energy) in GDP (35.1% in 2022) remains significant. The economy is highly tertiarized, with 55.8% of GDP produced by the services sector in 2022. Foreign-owned banks and chain stores are flanked by a vast 'kiosk economy' of low-productivity micro-firms, epitomized by the ubiquitous coffee shop. A promising new sector with the potential to further increase its international competitiveness is information and communications technology (ICT), with a number of new domestically owned small firms offering outsourcing solutions to advanced country clients.

Official statistics do not take into account the extensive 'informal economy', which consists predominantly of rural and semi-urban construction activities and street-vending. There is also evidence of a sizeable 'criminal economy'—partly a legacy of the smuggling and trafficking activities that contributed to financing the UÇK-led insurgency.

During 2015–19 manufacturing value added grew steadily at a similar rate to the overall economy (4.2%). Although historically important, mining has entered a period of stagnation caused by delays and disputes in the privatization process. There is evidence that output growth in industry is driven primarily (though not entirely) by factor mobilization, as Kosovo's industrial firms continue to struggle to achieve substantial growth in productivity. The manufacturing sector is highly concentrated and, with a few notable exceptions, fairly inward-looking. Most capital- and energy-intensive operations are confined to a few 'enclaves' of export-orientated industrial production. These are typically owned and operated by foreign companies, and tend to be former SOEs.

By far the most important 'enclave' is NewCo Ferronikeli, a nickel smelter in Drenas/Glogovac. Ferronikeli was acquired in 2018 by Balfin Group, a holding company owned by Albania's wealthiest businessman. Ferronikeli is the largest private employer in industry and a leading source of Kosovo's export revenues. The firm's contribution to value addition, however, is modest, as the plant continues to rely heavily on nickel ores imported from Albania and Guatemala (despite its proximity to, and ownership of, two nickel mines). Moreover, the company's revenues remain vulnerable to nickel price fluctuations. In mid-2019 the European Bank for Reconstruction and Development (EBRD) announced a €25m. loan to improve the technical and environmental efficiency of the plant.

Beyond the 'enclaves', Kosovo's industrial economy is mostly import-substituting rather than export-orientated, with small- and micro-enterprises operating labour-intensive, single-unit plants equipped with low-energy machinery. The food and beverages industry alone accounts for around one-half of total industrial value added. An important enterprise in this sector is the Pejë/Peć-based Devolli Corporation, which owns a coffee-roasting company, a mattress manufacturer, and a flour factory in Xërxë/Zrze, among other ventures. A nominally separate concern, Devolli Group, controls several popular dairy and soft drinks brands, and holds a controlling stake in Kosovo's largest brewery, former SOE Birra Peja. Another notable and fast-growing sector is plastics and rubber. Here, a representative firm uses copper wires and plastic granulate imported from Bosnia and Herzegovina and Hungary to manufacture plastic-coated electrical cables for the domestic market. A noteworthy company is Kaçanik-based Kivo, a Dutch-Kosovo joint venture producing customized food-packaging products for the export market. Overall, there are only a few private firms in industry employing more than 50 full-time workers.

THE LABOUR MARKET AND SOCIAL INDICATORS

The recent economic growth has left large segments of the working-age population out of employment. During 2015–19 the number of working-age adults in employment grew at an average annual rate of 2.6%, lower than the rate of GDP growth over the same period. As a result, less than 30% of the working-age population (14% of women) were employed in 2019. The unemployment rate was 25.9% in 2021, according to official estimates, one of the highest in the Western Balkan region. Youth unemployment is particularly severe, with over 50% of economically active young adults lacking formal-sector jobs.

This pattern of jobless growth is partly a consequence of Kosovo's economic model, as the economy's heavy reliance on 'unearned income' (aid and remittances) increases the workers' reservation wage. More than one-half of Kosovo's registered private firms are sole proprietorships, many of which are engaged in retail trade, a sector with limited potential for employment creation. Lack of investment in labour-intensive industries is another reason for the sluggish growth in labour demand. The dynamism of the food-processing sector offers hope for the future, however, as does the recent emergence of a ready-made garment cluster. In 2020, however, only 11.8% of the employed labour force worked in manufacturing (less than the corresponding share of manufacturing in GDP).

Poor job prospects and the availability of non-wage income keep many adults out of the labour force altogether. At the same time, traditional gender norms and the burden of unpaid care work in a country with the youngest population in Europe cause the labour supply of women to be substantially lower than that of men. At 59.1% in 2018, the share of the working-age population that does not participate in the labour force is very high. For working-age women, the inactivity rate is as high as 81.6%. Women are typically over-represented in low-ranking jobs and in the public sector. Occupational segregation based on gender is partly related to educational choices, as young women are heavily under-represented in science, technology, engineering and mathematics (STEM) degrees. Since 1999 employment (and social and economic life more generally) has been tightly segregated along ethnic lines, with the near-totality of Kosovo Serbs living and working in separate communities.

Union membership in the private sector is close to zero. Yet, the availability of non-wage income, and the relatively high salaries paid by aid agencies to local staff, have continued to fuel wage growth, potentially damaging the competitiveness of Kosovo's manufacturing exports. During 2015–19 the average monthly gross wage grew at a rate of 3.4% per year, reaching €484 in 2021. In addition, the smooth functioning of the labour market is undermined by skill mismatches and a continuing reliance on informal networks (family and friends) to convey labour-market information and facilitate recruitment. Compared with their private-sector counterparts, public-sector workers earn a large wage premium, which stood at 51% during 2015–19.

Although school enrolment rates have improved in recent years, the quality of the education system remains low. In the 2018 Programme for International Student Assessment (PISA) by the Organisation for Economic Co-operation and Development (OECD), which measured the performance of young people aged 15 in reading, mathematics and science, Kosovo was ranked the third worst of all the countries for which data are available. In terms of other social indicators, however, Kosovo performs decidedly better. With a Gini coefficient (a standard indicator of national income distribution) of 29 in 2017, Kosovo has the most egalitarian income distribution of all the Western Balkan countries, at a similar level to Sweden and Norway. Not only has income inequality not increased in recent years, but absolute poverty (as measured by the poverty headcount ratio of US $1.90 a day) has also declined, from 3% in 2005 to 0.2% in 2017.

FISCAL POLICY, MONEY AND BANKING

The macroeconomic environment is generally stable. Despite the state's relatively low fiscal capacity, successive governments have shown moderate fiscal discipline. While tax revenue as a share of GDP averaged 26.6% during 2010–15, total government expenditure did not exceed 28% of GDP. Reflecting the economy's high propensity to consume, indirect taxes (value-added tax and import duties) typically contribute the largest share of total tax revenue (70%), while taxes on income and profits account for as little as 11%. Since the 2008 declaration of independence, the share of wages and salaries has increased dramatically as a proportion of total government spending, at the expense of subsidies and capital expenditure, raising serious questions about job patronage and wage inflation in the public administration.

Although the budget deficit is low, the stock of public debt has experienced an upward trend, increasing from 10.7% of GDP in 2014 to 17.5% in 2019. This rise is partly due to a single public infrastructure project—the motorway to the Albanian border, built by a US-Turkish joint-venture (Bechtel-ENKA) during 2010–13, at a cost of almost €900m. (equivalent to around 20% of Kosovo's GDP in 2010). A new motorway connecting the capital city of Prishtina (Prishtinë—Priština) with North Macedonia was also inaugurated in 2019. Despite these public investment projects, the stock of public debt remains very low by advanced country standards. Owing to the limited international recognition of Kosovo's statehood, the Government struggles to access private capital markets. In 2018 Kosovo's largest foreign creditors were the World Bank and the International Monetary Fund (which Kosovo joined in 2009), followed by the German development bank KfW.

In 1999 the United Nations Interim Administration Mission in Kosovo (UNMIK) took the decision to adopt the German Deutsche Mark as legal tender, which was then succeeded by the euro in 2002. The Serbian dinar remains in circulation in Serb-inhabited areas. Because of euroization, the central bank cannot use many conventional instruments of monetary policy to steer the economy and attenuate the transmission of financial and other shocks. A financial market developed rapidly in the post-war years, as foreign lenders (notably, ProCredit Bank and Raiffeisen Bank) entered the banking sector, which is fully foreign-owned. By 2019 the broad money supply had expanded to 48% of GDP, from 38% in 2009. Credit constraints in the private sector persist, however. At 39%, the share of private-sector credit in GDP was the second lowest in the Western Balkans region after that of Albania. Loans for household consumption—for cars, weddings and holidays—remain a fixture of Kosovo's credit market. In 2018, however, the share of non-performing loans (NPLs) in total credit (2.8%) was the lowest in the region, reflecting the risk aversion of Kosovo's lenders. The increased availability of foreign credit has also driven up the stock of private external debt. Averaging 1.0% annually during 2015–19, the rate of inflation remained quite low until very recently. Although it rose to 2.7% in 2019, inflation fell back to 0.2% in 2020.

TRADE AND INDUSTRIAL POLICY

After taking over the country’s administration in 1999, UNMIK quickly launched an ambitious programme of economic liberalization. Before long, the capital account was fully open and interest rates were set by the market. UNMIK also adopted a liberal trade policy, with a dual tariff rate of either 10% or zero. About 80% of product categories are subject to the 10% rate. In 2015 the average trade-weighted rate was only about 7%, with a low rate dispersion intended to minimize price distortions. There are limited export promotion incentives—for instance, a rebate scheme allows exporting firms to import capital goods (and, in some cases, raw materials) tariff- and VAT-free.

Since January 2007 Kosovo has been a member of the Central European Free Trade Agreement (CEFTA), a regional free trade zone. CEFTA mandates the full elimination of tariff barriers and other restrictions (for instance, import licences and quotas), as well as the progressive reduction of non-tariff barriers to trade. It also requires member states—including those that are not World Trade Organization (WTO) members, such as Kosovo—to comply with WTO rules. A Stabilization and Association Agreement (SAA) was signed between the EU and Kosovo in late 2015, providing for the full liberalization of trade with EU countries. Although EU barriers on Kosovo’s exports were lifted immediately, Kosovo benefited from a transitional period during which it could reduce its tariffs on EU imports progressively. In 2013 Kosovo also signed a free trade agreement with Türkiye, which only entered into force in September 2019.

Two CEFTA countries, Serbia and Bosnia and Herzegovina, do not recognize Kosovo as an independent and sovereign state. Partly for this reason several trade disputes have erupted between Kosovo and its Western Balkan neighbours in recent years. In 2011 the takeover by Prishtina of two border crossings in the predominantly Serb-inhabited provinces of northern Kosovo led to Serbia’s imposition of a ban on Kosovo’s imports, prompting immediate retaliation. The crisis was defused seven months later when Serbia and Kosovo reached an agreement on customs procedures. An EU-mediated dialogue process between Serbia and Kosovo, covering technical issues such as ID cards and license plates, has been ongoing since at least 2012, with only limited results. A dispute in September 2013 led to a mutual trade embargo between Kosovo and North Macedonia, following the latter’s imposition of protectionist measures on wheat and flour imports from Kosovo. In November 2018 Kosovo imposed a 10% import tariff, subsequently raised to as much as 100%, on imports from Serbia and Bosnia and Herzegovina. This measure was introduced in retaliation for Serbia’s successful attempt to thwart Kosovo’s bid to join Interpol, the international police agency. As a result, imports from Serbia fell from €389m. in 2018 to less than €6m. in 2019. The tariff was eventually lifted in April 2020 under strong pressure from the USA. Generally, non-tariff barriers remain a significant obstruction to the ability of Kosovo’s exports to penetrate regional markets, especially Serbia.

Nominally, Kosovo has adopted a ‘horizontal’ industrial policy with no ambition to ‘pick winners’ and promote or protect strategic sectors. The main elements of this policy are ‘special economic zones’, which are intended to facilitate agglomeration effects and provide enhanced access to essential infrastructure (such as electricity supply, which remains unpredictable) to selected companies. The available evidence suggests that firms operating in the special zones have enjoyed higher productivity growth than other firms. Donor agencies, notably Germany’s Deutsche Gesellschaft für Internationale Zusammenarbeit (German Corporation for International Co-operation), but also the US Agency for International Development (USAID), have offered small grants and technology consulting services to selected firms, especially in the metal-processing and wine industries. Agriculture (including viticulture) is subsidized by the state.

PRIVATIZATION

The privatization process, which began with a 10-year delay compared with other post-socialist countries, has been a central element of Kosovo’s post-war development strategy. Yet, at least four legacy issues have hampered the successful implementation of the privatization programme. First, under Yugoslavia’s economic system, ownership in the means of production was nominally vested in society as a whole, rather than the state. Unlike other socialist countries, Yugoslavia also gave workers’ councils a prominent role in enterprise management. Second, several SOEs were transformed into joint-stock companies and privatized in the 1990s, often to well-connected insiders and associates of Serbian leader Slobodan Milošević. Third, the end of the war paved the way for a spate of 'spontaneous' privatizations, with UÇK-appointed mayors informally taking over the local SOEs from fleeing Serbian managers. Finally, many SOEs were heavily indebted, mostly owing to unpaid salaries and utility bills.

To address these issues, while ensuring a quick transfer of Kosovo's industrial assets to the private sector, UNMIK developed and implemented a system of 'spin-off privatization', to be presided over by a newly created Kosovo Trust Agency, or KTA (which was renamed as Privatization Agency of Kosovo, or PAK, in 2008). The assets of SOEs were to be separated from their liabilities and transferred to subsidiary corporations (known as NewCOs), which were then sold through sealed-bid auctions. 20% of the auction proceeds were to be distributed to the SOEs' former employees, as compensation for their loss of self-management rights. The remaining 80% was to be used to settle outstanding claims by creditors and former owners, with any remaining balance held in a Trust Fund to be transferred eventually to the Kosovo budget. By 2018 over 500 SOEs had been designated for privatization; some 750 NewCOs and 950 individual assets had been 'spun off' the former SOEs and sold to private investors, generating revenues totalling €660m. By then, creditors and former employees had received €120m. and €110m., respectively.

Around 26 enterprises, deemed critical for Kosovo's economy, were privatized through a 'special spin-off' process, which imposed a limited number of investment and employment commitments on the buyer, typically for a period of four years. It is questionable whether this process had the intended effect of protecting and promoting Kosovo's most important industrial assets. Several special spin-off sales, such as that of Zastava Ramiz Sadiku (a former supplier of automotive parts for the Yugo and FIAT car brands) and Llamkos (a galvanization plant), eventually closed down. Others, such as NewCO Industria Metalike e Kosovës (IMK), a manufacturer of large-diameter pipes for utility networks, laid off a large number of workers as soon as the four-year special spin-off period came to an end. Generally, many privatized SOEs—especially those that had suffered substantial war damage or vandalism in the post-war years—survived either by renting out their premises to commercial establishments (petrol stations, nightclubs) or by engaging in asset-stripping. Nevertheless, most of Kosovo's leading export firms (including Ferronikeli, IMK, and NewCO Balkan) are all former SOEs.

A limited number of enterprises were privatized by means of another parallel mechanism that allowed creditors to submit their claims and approve a reorganization plan prior to the SOEs being auctioned. The most important SOE that fell in this category is the Trepça mining and metallurgical complex in Mitrovicë/Mitrovica—formerly one of Yugoslavia's largest industrial conglomerates. At mid-2023 the company's restructuring had yet to take place and Trepça's assets continued to be managed by two separate units (divided along ethnic lines), under the PAK's nominal authority. An attempt in April 2015 to bring Trepça under the direct control of the Government, in order to expedite restructuring and privatization, met strenuous resistance from the Kosovo Serb community.

Finally, a number of public-service and infrastructure firms, collectively referred to as publicly owned enterprises (POEs), were transformed into joint-stock companies by the Kosovo Trust Agency (KTA) in the early 2000s, and are controlled directly by either the central or local governments. These firms include the Kosovo Energy Corporation (KEK), which operates two (dilapidated) coal-fired power plants near Prishtina, and Kosovo Telecom (formerly Post and Telecommunications of Kosovo). POEs are prone to mismanagement and are highly dependent on government subsidies.

SECTOR CASE STUDIES: WINE AND METALS

Two sectors—wine and metals—illustrate some of the challenges of industrial transformation in post-conflict Kosovo. Grapes have been cultivated on a subsistence basis in the Rahovec/Orahovac region since antiquity. Production was later modernized and mechanized under socialism, resulting in the establishment of the NBI Rahoveci combine. Following a period of decline, NBI Rahoveci was privatized in 2006; two years later production resumed. The combine's assets were sold in two separate lots, leading to the establishment of two NewCOs—Stone Castle and Haxhijaha. Stone Castle is by far the larger concern, covering around two-thirds of Kosovo's domestic demand.

Total turnover in the wine sector grew rapidly following privatization, reaching €15m. in 2013, of which about one-quarter was generated by exports, mostly to Germany and Switzerland. Foreign sales have since stagnated at around €3.5m. a year (equivalent to 12% of total export revenue in the foodstuffs and beverages product category). Owing to political pressures from local farmers, Stone Castle continues to source grapes from independent smallholders. This business strategy has prevented the firm from implementing tighter quality controls, stalling attempts to raise the sector's international profile. Quality improvements are likely to be an essential priority if Stone Castle is to reduce its reliance on bulk wine exports, which during 2008–14 still accounted for around 60% of total foreign sales. Furthermore, all firms in this sector rely almost entirely on imported technology and spare parts, despite the presence of a former SOE in Rahovec/Orahovac specializing in the production of machine tools for the beverages industry.

The metal products sector has also developed rapidly since 2008. After the war, a significant minority of former metal-processing SOEs succeeded in re-establishing their pre-war commercial links, both nationally and internationally. For instance, NewCO IMK, owned by Kosovo's wealthiest businessman (and former interim President) Behgjet Pacolli, suffered only minimal war damage and quickly resumed exports after privatization. NewCO JugoTerm (now Enrad), a radiator manufacturer in the Eastern city of Gjilan/Gnijlane, grew its export sales at an average annual rate of 24% after production restarted in 2012. The company benefited from a lucrative procurement contract from the Ministry of Education, and around three-quarters of the domestic market is now supplied by Enrad radiators.

In contrast to these larger companies, the vast majority of metal-processing firms, some of them former SOEs, opted to reorganize their production capabilities and take advantage of fast-growing domestic demand for metal products from the construction industry. NewCO Elsam, for instance, had since 1983 produced heat exchangers for industrial applications. Following privatization, the new management converted the plant into a manufacturer of tanks and reservoirs, relying heavily on imported inputs (galvanized metal sheets from North Macedonia and rolled coils from Serbia and Türkiye). Although the metal-processing sector has witnessed substantial growth in labour productivity, there is evidence to suggest that the productivity of regional competitors has increased faster, preventing the emergence of a new comparative advantage and limiting the sector's potential for export growth.

THE COVID-19 PANDEMIC AND ITS AFTERMATH

The coronavirus (COVID-19) pandemic has had a severe impact on the Kosovo economy. Owing to the country's relative geographic isolation, poor transport connections, and ongoing visa restrictions on its citizens, Kosovo was initially spared from the worst damage of the pandemic. During March–May 2020, however, the Government imposed one of the most stringent lockdown regimes in Europe, causing real GDP to contract by 5.3% in that year—Kosovo's worst recession since the 1999 war. A reported 8% of employed workers lost their jobs as a result of the pandemic, with a particularly large number of lay-offs in the hospitality and construction industries. Political instability—including the collapse of two governments in 2020, and early elections in February 2021—put further downward pressure on the economy.

In order to mitigate the economic consequences of the pandemic, the central bank of Kosovo suspended loan repayment requirements for individuals and businesses. The banking system, being foreign-owned, also benefited indirectly from the European Central Bank's emergency asset-purchase programme (PEPP). In April 2020 the Government adopted an emergency support package worth €170m., or about 3% of GDP, subsequently augmented with an agricultural support scheme to provide €53m. in transfer payments to farmers. As a result of these measures, public debt growth accelerated considerably, raising the total stock of public debt to US $1,900m., or 23.3% of GDP, in 2021. In early 2021 the Government launched a COVID-19 vaccination programme, with vaccine doses provided by COVID-19 Vaccines Global Access (COVAX, the global vaccine alliance serving low- to middle-income countries) and the European Commission, among others. By June 2022 almost 44% of the resident population had been vaccinated.

In 2021 the Kosovo economy experienced a dramatic post-pandemic recovery, with GDP growing at a record rate of 10.5%, in real terms (according to the central bank), well in excess of earlier forecasts.

The rebound came in the wake of strong growth in credit and exports, an increase in diaspora tourism, and the Government's fiscal stimulus. In an extraordinary expression of solidarity, diaspora workers sent home an additional 20% in remittances in 2021 compared with 2020, raising total remittance receipts to almost €1,000m. and stimulating household consumption. Supported by a strong rebound in tax revenues, the Government achieved an almost balanced budget in 2021, after recording a budget deficit of almost 8% of GDP in 2020. In 2022, however, the current account deficit (US $1,007m.) had doubled compared to pre-pandemic levels (US $447m. in 2019).

The Kosovar economy began to show signs of overheating in mid-2021, with inflation accelerating in the wake of rising energy costs. In 2021, consumer prices closed the year 3.4% above the price level recorded in 2020. In the 2021-22, winter, the country faced severe energy scarcity and regular blackouts. In 2022, the global energy and food crisis triggered by Russia's invasion of Ukraine put additional upward pressure on prices, with inflation reaching a record annual rate of 11.6%. The capital city of Prishtina continued to see an impressive construction boom, with high-quality new residential blocks being built in semi-central and sub-urban areas. Housing prices have also increased significantly in recent years, although less so than in neighbouring Albania and Serbia. Real GDP growth eased to 3.5% in 2022, driven by consumption (which remained elevated despite inflationary pressures) and export revenues.

CONCLUSION

Owing to substantial inflows of aid and remittances, and a stable macroeconomic environment, Kosovo has experienced almost uninterrupted economic growth since 1999. Yet, in a depressingly typical case of 'growth without development', the young state's macro-economic dynamism has yet to result in significant work and livelihood opportunities for many of its citizens. The productive economy has experienced limited structural change. The consequent failure to discover and nurture new comparative advantages in higher value-added sectors is likely to mean that Kosovo will remain dependent on primary commodity and low value-added exports for the foreseeable future, harming its terms of trade and undermining sustainable growth and development. Kosovo's reliance on remittance inflows and income from diaspora tourism is also likely to prove a critical vulnerability, as the social bond between permanent migrants abroad and source communities—currently very strong—begins to weaken.

Moving forward, Kosovo should build on its many strengths—relatively low public debt, macroeconomic stability, high levels of social trust and cohesion—to discover and implement new and bold development ideas. A notable policy innovation was the approval in early 2022 of a plan to establish a Sovereign Wealth Fund with a mandate to administer and depoliticize the state's shareholding interest in POEs. The Fund, which was explicitly inspired by the East Asian model of the 'developmental state', was hailed by Prime Minister Albin Kurti as a break from the economic policy strategy of the post-independence years. In addition to acting as a share-holding company for Kosovo's POEs, the Fund is expected to take over the management of Trepça and other strategic assets from the PAK. It will also help POEs to issue corporate bonds, attract foreign portfolio investment (including from the diaspora) and stimulate financial development more generally.

Even so, Kosovo will probably continue to face daunting economic challenges, not least due to its ongoing dispute with Serbia and partial formal recognition as a sovereign state by many countries and international organizations. Unless growth and structural change can be accelerated, and income per head raised substantially, it is unlikely that the youngest country in Europe will ever secure candidate status for EU membership, let alone realize the 'European aspirations' of its citizens.

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