Deindustrialization of Kosovo and establishment of the private sector in Kosovo - Obstacles

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Abstract

This paper aims at analysing activities, and some of the causes of deindustrialization of Kosovo's economy, and the stage of initial establishment of the private sector in Kosovo. The purpose of the paper is to present the current situation and development orientations, namely to review some of the obstacles from the perspective of entrepreneurs, with a view of eliminating such obstacles and fostering development. The paper shall provide a comparison of exports and imports, with a special focus on obstacles to Kosovo's SMEs. This paper shall prove an overview on the situation of SME development and its sectors, and it is an effort to mirror the main obstacles preventing competitiveness and development of the sector. The analysis in this paper represent an effort to inform stakeholders with the sector, and help interested parties to take necessary action in improving the situation in the sector, and to assist sectors in benefitting from business opportunities, by creating a business development conducive environment, so that the changes occurring in the sector feed economic development, foster employment and help in attracting foreign investments.

The main goal of the paper is to provide a basis for informing various actors involved in industrial development policy making in Kosovo.

On the other hand, it is also an effort to contribute in consolidating information and statistical records, with a view of providing an accurate overview on Kosovo's industry.

Keywords: *deindustrialization, industry, SME development, obstacles to business, SME growth, exports, imports.*

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1. Introduction

Kosovo is a country of 10.867 km2 and a population of 1.7 million, the youngest population of the region. The main features of economic development are: (i) continuously negative trends of macro-economic indicators (especially the GDP, which is approx. €4.9 Billion, or around 2800 Euros per capita, according to the population census in 2011). On the other hand, the imports are deemed to be covered by exports at a rate of 10 %), (ii) high unemployment, which appears to be over 40%, (iii) lacking foreign direct investments, and (iv) a reforming system of secondary and higher education (Central Bank of Kosovo, 2011). According to the same source, around 15% of Kosovo's population lives in extreme poverty, while around 39% of the population lives close to the poverty line.

Following the installation of the colonial regime in Kosovo, during the period of 1990-1999 by Serbia, Kosovo lived through a ruthless destruction of economy and industry, which was otherwise rather productive before the 1990-ies.

During the war, industrial capacities and processing facilities such as Trepça, Elektro-ekonomia, Agrobiznesi, were almost entirely destroyed. By the end of the war, the remaining capacities of these combines were robbed and carried to Serbia. During the "compulsive measures" imposed, manufacturing and service enterprises expelled all Albanian employees, which were the central column of their development and productivity, carrying all skills and experience acquired in many years, and they were replaced with mono-ethnic and unqualified managers, and also unqualified employees of Serbian nationality.

Table 1: Deindustrialization indicators / industry share to Kosovo's GDP (%?)

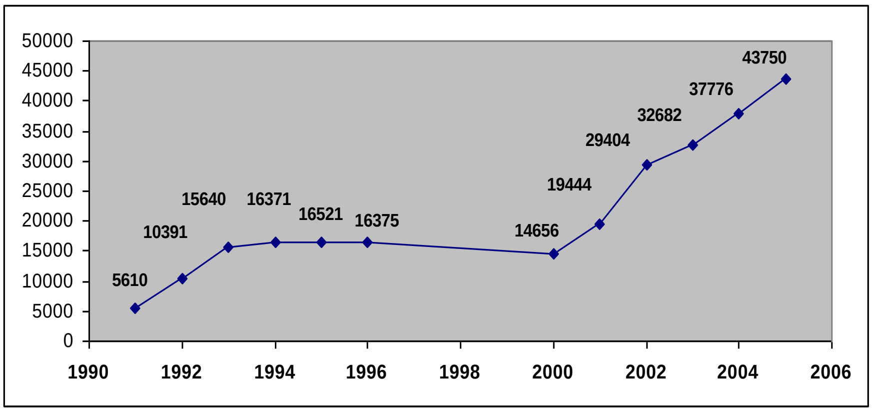
	1971	**1975**	**1980**	**1989**	**1994**	**1996**
Industry	33.3	36.5	36.8	47.4	32.3	33.8
Agriculture	28.2	23.8	18.6	20.4	35.4	28.8
Other	38.5	39.7	45.0	32.2	32.3	37.8

Source: Activities and democratic development of Kosovo, Riinvest, 1997

This economy had already taken a deep plunge, rapidly expanding unemployment rates, and reducing the GDP, and consequently increasing extreme poverty. In such conditions, all people started seeking for a way out, a survival possibility, thereby adding to the migration demand, which was specifically high after the 1990-ies. Records and data from various sources say that during the period between 1990-1999, over 200.000 people left Kosovo to find necessary means of existence (Riinvest, 2009). During 1994-1997, Kosovo's economy marked a decline of 50%, while only the industry, during the same period, had suffered a fall of more than 70%. Elektro-ekonomia - 57.1 %, black metal ore production - 86.5%, black metal production – 86.5%, metal processing – 97.1%, manufacturing of electrical appliances and machinery – 89.5%, and manufacturing of food products - 67.6% (Kosovo Industry Strategy 2009-2013 - Riinvest). This deindustrialization trend shows the fall of industry's share in the total economy, from 41.0% in 1987, to only 21.1 % in 1994 (Riinvest, 2009).

Private enterprises in Kosovo started springing by 1989. Nevertheless, the intensity of registering SMEs had an inclination after 1990, and continued until 1995. At this time, enterprises were mainly organized in the form of family enterprises, handicrafts, small retail, restaurants and agricultural enterprises. The establishment of such enterprises was not an outcome of an attractive business environment, but sprang out of the need to create jobs for people expelled from work in socially owned enterprises. These businesses were created with own resources and Diaspora remittances. The trends of private business development are presented in the following chart (Riinvest, 2003).

Figure 1. Trends of private business registration in Kosovo (SMEs in the period 1990-2006)



Source: Statistical Office of Kosovo (2006)

The reason for falling trends in SME registration between 1994 and 1996 was the large pressure exerted from the then-government against the Kosovo businesses, and the deterioration of the general situation throughout Kosovo in 1998, and until the armed conflict. Open violence and expanding physical insecurity, insecurity of property and limitations of freedom of movement of citizens and businesses in Kosovo pushed the SME registration down.

Table 2. SME registration rates per 1000 population

Country	Total SME 2003	SMEs per 1000 pop.
Kosovo	32,682	16
Albania	56,442	17
Bulgaria	224,211	28
Croatia	59,907	14
Macedonia	27,938	14
Moldavia	18,898	5
Romania	306,073	14
Serbia /Montenegro	68,207	8
Czech Republic	876,990	85
Hungary	275,671	27
Poland	1,762,982	46

Source: Observatory of European SMEs 2003 (SMEs in focus)

With the end of the war (June 1999), the trends in registering private businesses, namely SMEs, doubled. According to Statistical Office of Kosovo registers, the number of SMEs in 2002, compared with 2001, marked an increase of 31%. This trend continued further into 2003, marking an increase of 34% of SME registration, compared with the year before. In 2004, again an increase of 14% was marked (Annual SOK Report, years 2001, 2002, 2003, 2004).

Although Kosovo embarked later in the process of transition, it does not fall much behind other countries in terms of small and medium enterprises per 1000 population (Report: Socio-Economic Profile of Kosovo and development challenges, Riinvest 2005, p. 59-60). In comparison to other countries, which entered transition earlier, Kosovo, with its rate of 16 small and medium enterprises per 1000 inhabitants, stands pretty good (twice more than in Serbia or Montenegro), before Slovakia, Moldova, Macedonia and Croatia, while it is equal with Albania.

After the war, pursuant to the Law on Privatization in Kosovo, Law no. 03/L-067, three processes of property transformation took place for the non-private properties:

- Commercialization process, through which 23 socially owned enterprises were commercialized,
- Privatization process, involving around 500 SOEs,
- Publicly owned enterprise restructuring process, such as in the Kosovo Energy Corporation, Post Telecommunications of Kosovo, Railways, Heating District and other publicly owned enterprises.

The restructuring of these enterprises is now being implemented through corporatization.

2. Sectorial structure of economy

The establishment of small and medium enterprises serves economic development and improvement of economic structure. This further enables the substitution of many imported goods with locally produced goods, and increased internal competition, which in turn results into lower prices.[1]

Nevertheless, the trends in the last years in Kosovo have not spoken about an evident improvement of economic structure. The reasons may be found in the absence of economic policies of the government, and lack of measures for incentivizing manufacturing, in conditions of Kosovo being fully open to goods from other countries.

Kosovo is now facing serious problems, generated by an unfavorable economic structure. The establishment of enterprises in the post-war Kosovo is characterized by a larger focus on trade, and hesitation to invest in manufacturing. The reasons for such failure to invest in manufacturing may be various, but the most mentioned ones are:

- Poor quality financial resources, which do not correspond to manufacturing (high lending interest rates and short terms);
- Taxation policy, which does not support domestic manufacturing. Instead, the policies incentivize imports of products which would easily be produced locally;
- High competition from other countries, suspicious quality products at very low prices, which cannot be competed with by locally produced items.

Table 3. SME trends divided in branches (%)

Sectors	2001	Share	2002	Share	2003	Share	2004	Share
Manufacturing	5458	30.2 %	7008	23.8 %	8091	24.8 %	5926	16 %
Services	2632	14.6 %	6482	22 %	7591	23.2 %	12419	33 %
Trade	9990	55.2 %	15914	54.2 %	17000	52 %	19571	51 %
Total	18080	100 %	29404	100 %	32682	100 %	37916	100 %

Source: Small and Medium Enterprise Development report in Kosovo (2006) Riinvest, 2006

The data show that SME establishment trends in 2004 are approximately equal with the 2001 trends. Nevertheless, in 2001, the share of manufacturing enterprises in the population was 30.2%. Meanwhile, this share in 2004, instead

[1] In 2005, consumption in Kosovo fully depended on imports. The imports/exports rate was only 5% (meaning the dependency rate was 25:1). Trading exchange in Kosovo 2004, MTI, 2005

of growing, it fell to 16%. The reduced interest in establishing SMEs in the manufacturing sector reflects a rather poor economic environment for the sector.

3. SME development

Since it is rather difficult to construct fully-fledged indicators of performance, due to poor reporting (especially in economies where improper competition and informal economy are key problems, such as in Kosovo), we are compelled to find other approximate indicators to present the trends. In literature, the growth in employee numbers is widely applied in SME research, because it is less sensitive against underreporting issues, which may be a problem in such surveys. The following table provides some data on the enterprises marking an increase, remaining still or declining in employee numbers.

Table 4. SME growth in Kosovo (%)

Performance 2005/04	Frequency	Percentage
Growing	185	30.8
Unchanged	356	59.3
Declining	59	9.8
Total	600	100.0

Source: SME development in Kosovo, Riinvest, 2006

Records show that around 30% of enterprises have increased their staff; around 60% have remained at the same level, while the remaining 10% have reduced their employees. In the SME sector performance analysis, shown in Table 4, it may be derived that the enterprises marking growth pertain mainly to the trading sector, together with the enterprises which have neither increased nor decreased their staffing. On the other hand, the majority of enterprises declining pertain to the manufacturing sector, even despite the small share in the sample, which already suggests instability in the sector, which is also related to the severe competition, especially that coming from abroad.

Table 5. SME performance by sector (%?)

	Manufacturing	Services	Trade
Growth	29.2	28.1	42.7
Unchanged	18.4	32.2	49.4
Decline	35.6	30.5	33.9
Share in the sample	23 %	31 %	46 %

Source: SME Development Report in Kosovo, 2006

4. Obstacles in doing business

One of the key areas of SME survey is the business climate, and its impact on business development. Similar to past years, respondents have been asked to rank on the Likert scale from 1-5 a list of 17 potential obstacles. According to a Riinvest survey made in 2006, while so far, we have had only 14 obstacles in a list held to research trends, while this year, we have added several questions related to infrastructure and public services, which are to be discussed later. Based on answers obtained, the intensity of every obstacle has been calculated. Absolute intensity is equal to 100, in the case when respondents assign maximal importance to the obstacle, meaning in cases all respondents assign high scores to an obstacle, or vice-versa.2 The following table presents the trends of 7 key obstacles, most of which have been held in the questionnaire since 2000. Records show that since 2002 until 2005, improper competition is considered to be the main obstacle for businesses, which has not lost its intensity, or its ranking in the table. It is obvious that legislation and implementation has fallen visibly since 2000, although it is still considered as one of the key obstacles in the comprehensive list. One of the key obstacles marking a visible increase both in intensity and ranking, passing from sixth place in 2002 to second place. On the other hand, access to lending has marked a continuous growth in ranking, while the other obstacles, such as high taxation and severe competition have almost not changed at all, ranking rather high in the list.

Table 6. Trends of key obstacles to business (2000-2005)(intensity of obstacles?)

Key obstacles to business	2000	2001	2002	2003	2004	2005
Legislation (implementation)	85	76	67	52	55	58
Improper competition	75	75	75	72	79	78
Access to lending	61	76	54	52	51	44
High taxation	51	57	59	68	64	69
Severe competition	49	58	63	65	66	60
Corruption		41	42	49	68	76
Deferred payments				56	54	54

Source: Annual SME Development Report, Riinvest, 2006

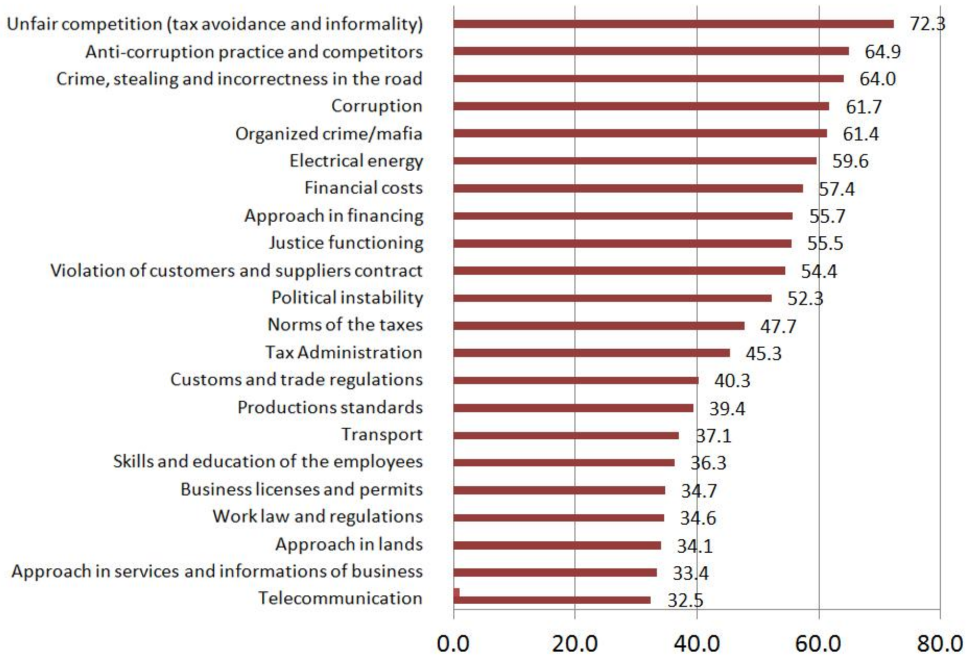
[2] Intensity is calculated by weighed average, making a cross-multiplication of frequencies of obstacles, causing problems of various intensities, with the number of cases such obstacles appear. In the last column of the table called "intensity of obstacle", the weight of the problem caused by obstacles is noted. The basis for calculation and analysis is the maximum possible threshold of 100, which means that the intensity of the problem is so large that it completely disables the activities of such an enterprise.

From the above, one may conclude that improper competition which is largely affected by corruption, and both shape the external business environment, as key obstacles to business growth and development.

5. Obstacles to business in 2011

The following table provides a clearer overview of the list of obstacles in 2011. The data shows clearly the negative perceptions of entrepreneurs on the external business environment. Improper competition, together with corruption and informal economy, lead the ranking list of obstacles in 2005. On the other hand, there is large discontent of entrepreneurs related to public utilities (electricity and power supply).

Figure 2: Obstacles to business of enterprises in the survey (600) in 2005



Source: Riinvest Survey with 600 SMEs, 2011

It is interesting to make a comparison between obstacles related to the external business environment and those related to the entrepreneur and the enterprise themselves, which are considered to be internal factors. Perceptions of entrepreneurs clearly show that the external environment is visibly a larger obstacle, compared to internal environment. Almost half of the obstacles leading the ranking list are related to the external environment, while other factors such as enterprise capacities and human resources (of the entrepreneur or the employees) are considered as smaller obstacles to business.

Nevertheless, when talking about external obstacles to business, it is often uncertain whether the reasons for firms not growing are endogenous, and whether assessments of all firms on the business climate may paint an unrealistic overview of the business environment.[3]

6. Corruption

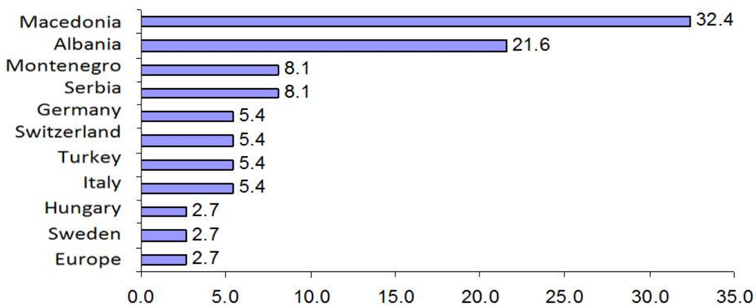
Kosovo entrepreneurs have been asked various questions related to corruption, its spread, causes and consequences. Despite the fact that the phenomenon is rather delicate, interviewed entrepreneurs have not hesitated to respond to questions of the Riinvest Institute questionnaires.

Perceptions of entrepreneurs surveyed on the presence of corruption remain concerning. There is even deterioration recorded in their perception trends. While in 2011, around 72 % of respondents thought that corruption is very present, or present, this percentage has only increased or kept the same level for several years on row (Riinvest Survey with 600 SMEs, 2011). In general, Kosovar entrepreneurs think that corruption is widespread in Kosovo. Furthermore, they believe that this phenomenon is not being combated properly. Hence, 72 % of the respondents state that the corruption is not being combated at all, or that very little is being done in the combat against corruption.

7. Exports and imports

The intensity of imports is much higher than exports. The countries to which Kosovo market exports mostly are:

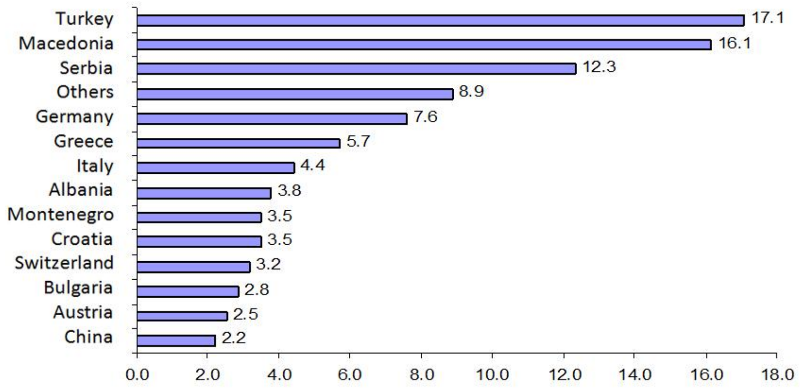
Figure 3. Countries of exports for the Kosovo economy (%)



Source: Survey with 600 SMEs, Riinvest, 2011

[3] E.g. estimates of a one-man company, or a self-employed person, on access to lending may be disorienting.

Figure 4. Countries from which Kosovo SMEs import from (%)



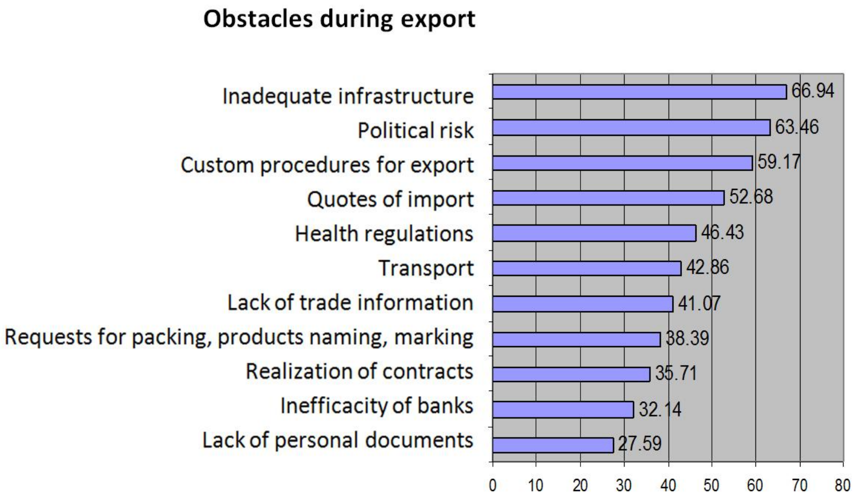
Source: Survey with 600 SMEs, Riinvest, 2011

8. Obstacles to export and import

Apart from the special chapter on the obstacles to business, this survey has gone further on specific obstacles faced by Kosovo enterprises in their imports/exports.

The following figure reflects the obstacles ranked by intensity, led by inadequate infrastructure, political risk and customs procedures for exports. It is worth mentioning that in time, we may record a changing perception of entrepreneurs on exporting activities. For a long time, Kosovar entrepreneurs have had complaints against the lack of personal documentation, and specifically on certificates of origin. Results of this research prove a decrease in intensity of such obstacles. Nevertheless, several obstacles remain constant. Political risk, and more specifically obstacles related to legislation, remains barriers which have permanently concerned Kosovo enterprises.

Figure 5. Obstacles to export (intensity of obstacle)



Source: Survey with 600 SMEs, Riinvest, 2006

9. Conclusions

The establishment of enterprises in the post-war Kosovo is characterized by a larger focus on trade and refraining from investment in manufacturing. The reasons for not investing in manufacturing are of various natures, but most often the following appear: poor quality financial sources, which do not suit manufacturing (high interest rate and short term loans); taxation policy, which does not support local production. Instead, the policy favors more the imports of products, which would easily be produced in country; high competition from other countries, suspicious quality products at very low prices, which cannot be competed with by local products.

The largest number of enterprises is established by a single person (81%). Partnerships, with two, three or more founding members, make 11.6%, 7.4% with three founding members. The majority of SMEs undertake their activities in a single location in Kosovo (77.7%). Meanwhile, manufacturing (with 26.3%) is the sector which is rather different from others, with a higher share of exercising activities in two or more locations. The average employee number per enterprise in 2005 was over 10-14 employees. If the employees retained is taken as a criterion, it may be found that around 60% of SMEs have remained at the same level (neither increased nor decreased), while the remaining part of 10% have reduced their employee numbers. Data show that around 30% of the firms have had increases in employee numbers. Entrepreneur perceptions clearly show that there is no environment which allows SMEs to develop. Entrepreneurs have stated that the external environment is much more an obstacle than the internal environment. Almost half of the obstacles ranked at the top (see Obstacles) are related to external climate, while other factors, such as capacities of an enterprise and human resources (entrepreneurs or employees) are considered to be smaller obstacles to doing business. Another obstacle which has increased the concern of Kosovar entrepreneurs is corruption. While in 2004, around 72 % of the entrepreneurs declare corruption, and such an event remains in 2011 as well (72 %).

The 1999 survey presents the post-war situation. This survey shows that SMEs in Kosovo had an average of 6 employees. Meanwhile, the research on SME development trends in further years, 2005/2006/2011, shows that the employees retained have more than doubled in enterprises, to a rate of 10-14 employees.

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