Gearing up for a More Productive Future

June 2022
Kosovo is the youngest country in Europe and is estimated to have increased its income 10-fold since 1995.

Kosovo has experienced significant growth and poverty reduction since independence. The economy recovered from its first recession in 2020 and income by 2024 is projected to double from its 2009 level (if recent global pressures subside.)
Yet, a large **income gap** between Kosovo and the average European Union member state remains.

Kosovo’s **income per capita** is only 12 percent of the average EU member or 20 percent of aspirational peers (Latvia, Estonia, Lithuania, the Czech Republic, and Slovenia).
....and this gap is closing only at a slow pace.

At Kosovo’s estimated current potential for growth, reaching today’s living standards of aspirational peers would take more than 30 years.

Despite considerable progress in poverty reduction, around 2 in 10 Kosovars still live on less than US$5.5 per day.

Lack of jobs is a major impediment to inclusive growth. About 2 in 5 people of working age people are participating in the labor market. However, formalization is accelerating.

Only 20 percent of women actively participate in the labor market, and women’s participation in the economy as entrepreneurs is limited.

Only 23 percent of pre-school children are on track in terms of literacy and numeracy skills.
Yet, with the right reforms, Kosovo can gear up for a more productive future.

Gearing up for a More Productive Future

GDP per Capita Projections Based on Structural Changes, US$, 2020-60

Note: The light blue line represents the projected growth trajectory for Kosovo based on average real growth of 4 percent. The dark blue line represents an alternative reform trajectory with a modest shock of a 2 percentage point (pp) increase in net FDI inflows, 2 pp increase in employment rate, 2 pp increase in TFP, 2 pp increase in exports as a share of GDP between 2025–35 compared to the baseline.
For Kosovo to get there, reforms are needed in **five key areas:**

**Gearing up for a More Productive Future**
- Business regulations
- Access to finance
- Digitalization

**Increasing Firm Productivity**
- Value chain integration
- Sustainable use of natural resources
- Improved public spending

**Raising Farm Productivity**
- Education
- Skills development
- Labor force participation

**Enhancing Human Capital**
- Trade facilitation
- Competition policy
- Investment promotion eco-system

**Boosting Exports, Competition and Investment**
- Foundational requirements

**Entrenching Macro Stability and Sound Governance**
- Inclusive
- Resilient
- Sustainable growth in Kosovo

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Gearing up for a More Productive Future
INCREASING Firm Productivity
Firms in Kosovo need to increase **scale** and **productivity**

TFPR, Sales, and Value Added per Worker, 2013–17, Percent

Active Firms by Size, Average, 2010–18, Percent of Total

Firm productivity growth is slow...

...and firms are overwhelmingly small scale
Firms also suffer poor **survival rates** with few reaching international markets.

Survival Rates by Firm Age, Percent of Total Firms

Firm survival rates are low...
Firms also suffer poor **survival rates** with few reaching international markets

**Exporters and Importers, Percent**

- **Non-exporter & Non-importer**: 79.4%
- **Importer & Exporter**: 0.5%
- **Only Exporter**: 2.0%
- **Only Importer**: 18.1%

<table>
<thead>
<tr>
<th>Country</th>
<th>% of manufacturing firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td>46.0</td>
</tr>
<tr>
<td>Latvia</td>
<td>27.5</td>
</tr>
<tr>
<td>EU (2020)</td>
<td>21.7</td>
</tr>
<tr>
<td>Lithuania</td>
<td>17.8</td>
</tr>
<tr>
<td>Croatia</td>
<td>14.2</td>
</tr>
<tr>
<td>Slovakia</td>
<td>9.5</td>
</tr>
<tr>
<td>Kosovo</td>
<td>6.4</td>
</tr>
<tr>
<td>Czechia</td>
<td>4.3</td>
</tr>
</tbody>
</table>

...and very few firms (compared to total) export
Gearing up for a more productive future

Increasing Firm Productivity

1. Reduce administrative burden, regulatory uncertainty and continue to improve access to finance
2. Strengthen the national innovation system and foster digitalization
3. Remove barriers to women’s participation in the economy

- Continuously reduce the administrative burden and regulatory uncertainty faced by firms, e.g., through streamlining licenses and permits and improving the inspections regime through better coordination and risk-based inspections.
- Strengthen the national innovation system to foster the diffusion and adoption of technology and investment in research and development (R&D).
- Foster digitalization of businesses by ensuring timely adoption and implementation of regulations on E-ID, data protection, and cybersecurity, and improve the coverage, quality, and affordability of Internet connectivity and related managerial capacities.
- Improve access to finance through non-bank financial institutions, private equity, and venture capital, ensuring uptake of Kosovo Credit Guarantee Fund guarantees and securing property rights.
- Incentivize women’s entrepreneurship and remove barriers to women’s participation in the economy through, e.g., investments in preschool education and child and elder care, and increasing financial inclusion by introducing a basic payment account.
- Improve firm capabilities through targeted programs (e.g., technical assistance to SMEs funded through voucher schemes or grants) to upgrade management and organizational practices.

Read the full paper at worldbank.org/en/country/kosovo
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Foster digitalization of businesses by ensuring timely adoption and implementation of regulations on E-ID, data protection, and cybersecurity, and improve the coverage, quality, and affordability of Internet connectivity and related managerial capacities.

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RAISING Farm Productivity
Farm enterprises in Kosovo lack **scale** and **efficiency** to compete.

Agricultural VA, Compared to Structural and Aspirational Peers, 2008–19, Percent

Direct Payments to Farms by Economic Size, Kosovo, 2017, Percent

Raising Farm Productivity
Gearing up for a more productive future

Raising Farm Productivity

Provide incentives to encourage aggregation of farms and other food chain firms so that they modernize and explore scale economies.

Facilitate farm competitiveness by modifying current types of farm support; consider a shift to decoupled farm support.

Reallocate public resources to farm activities that have higher rates of return to improve the sector’s competitiveness and enhance incomes.

Facilitate the modernization of smaller farms through better-targeted support and promote an enabling environment for small and medium-sized farms by providing advisory, training, technical, and information support, infrastructure, R&D, and storage capacities.

Expedite cadastral reconstruction to cover all of Kosovo by prioritizing more economically active agricultural land and cadastral zones; and invest in sustainable management of natural resources, including timely implementation of the irrigation master plan.

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ENHANCING Human Capital
Kosovo has demographic advantages, but **educational quality** needs to be improved.

Children in Kosovo perform below comparators on measures of educational performance...
Kosovo has demographic advantages, but **educational quality** needs to be improved

Students Not Functionally Literate in Reading, PISA 2018, Percent

- Estonia: 11
- Slovenia: 18
- Czech Republic: 21
- Latvia: 22
- Lithuania: 24
- Uruguay: 42
- Moldova: 43
- Montenegro: 44
- Albania: 52
- North Macedonia: 55
- Kosovo: 79

OECD Average: 22.6%

Estimated Impact of COVID-19 on the Socioeconomic Achievement Gap

<table>
<thead>
<tr>
<th>Post - COVID</th>
<th>PISA Scores in Reading</th>
</tr>
</thead>
<tbody>
<tr>
<td>324</td>
<td>1 year of schooling</td>
</tr>
<tr>
<td>53</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Baseline</th>
<th>PISA Scores in Reading</th>
</tr>
</thead>
<tbody>
<tr>
<td>336</td>
<td>1 year of schooling</td>
</tr>
<tr>
<td>45</td>
<td></td>
</tr>
</tbody>
</table>

...and there is a worrying gap between in educational attainment between the top and bottom 20 percent

Poorest 20%: 324
Richest 20%: 336

40 points in PISA scale ≈ 1 year of schooling

Improving Education Quality
Gearing up for a more productive future

Enhancing Human Capital

- Develop a student registry to track academic performance that includes an early warning system of at-risk and poor performers for better targeting of services that keep students in school.
- Continue using and improving a system of learning assessments that guides teacher instruction and motivates improvement over time, especially in lagging municipalities.
- Improve spending efficiency and equity in the sector by completing a school optimization study and implement it in order to re-orient spending in education to reduce infrastructure gaps, improve the quality of education, and revise the school financing formula.
- Develop a comprehensive plan to digitalize education delivery and ensure the equity of digital content and connectivity with sufficient equipment and skilled and supported teachers.
- Improve the targeting and coverage of the social assistance scheme to reduce the liquidity constraints of poor families with more children.
- Take stock of and institutionalize remedial and support programs delivered by NGOs, especially those targeted to low-income families, minority children, and rural students.

Optimize the school network and re-orient spending to reduce infrastructure gaps and improve quality.

Improve learning assessments to guide and motivate teaching quality.

Accelerate plans to digitalize education delivery.
Develop a student registry to track academic performance that includes an early warning system of at-risk and poor performers for better targeting of services that keep students in school.

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Increasing the intensity of market competition would help to **boost economic activity**

**Market-based Competition Score**

- **Aspirational**: 9.4
- **OECD average**: 8.5
- **Albania**: 7.0
- **Serbia**: 7.0
- **Kosovo**: 5.0

**Anti-monopoly Policy Score**

- **Aspirational**: 10.0
- **OECD average**: 8.7
- **Albania**: 8.0
- **Serbia**: 7.0
- **Kosovo**: 6.0

Levels of competition in Kosovo fall behind those seen in key comparators...
Increasing the intensity of market competition would help to **boost economic activity**

**PMR Indicators: Overall Score**

Score (0-6, from best to worst)

- **Total average**: 1.55

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Removing Regulatory Barriers to Competition and Boosting Exports and Foreign Direct Investment
Kosovo’s **export performance** has been **improving**, but from a low base.

**Firms Exporting Services and Export Value, US$ Millions, Total Firms, 2013–18**

![Graph showing firms and export value from 2013 to 2018](image)

**Products Exported and Destinations Served, 2013–19**

![Graph showing products and destinations from 2013 to 2019](image)

More firms are exporting... …and entering new markets

**Removing Regulatory Barriers to Competition and Boosting Exports and Foreign Direct Investment**

_World Bank Group_
Kosovo’s FDI inflows are concentrated in non-tradable service sectors

Kosovo: FDI Inflows by Sector, 2007–19

- Other services and activities
- Real estate activities
- Financial and insurance activities
- ICT
- Accommodation and food service activities
- Transportation and storage
- Wholesale and retail trade
- Construction
- Electricity, gas, water
- Manufacturing
- Mining and quarrying
- Agriculture, forestry and fishing

Greenfield FDI announcements are low...
Kosovo’s FDI inflows are concentrated in non-tradable service sectors

Shares of number of greenfield FDI project announcements in Kosovo, by motivation and subsector, Percent

### Shares of FDI by Motivation and Subsector

- **Financial services**
  - 35
  - Consumer electronics: 9
  - Business services: 7
  - Transportation: 3
  - Building materials: 3
  - Telecom: 3
  - Real estate: 2
  - Textiles: 3
  - Food & Beverages: 5
  - Renewable energy: 2
  - IT services: 3
  - Automotive components & OEM: 2
  - Chemicals: 1
  - Pharmaceuticals: 1
  - Coal, oil & gas, and minerals: 3

### Categories

- **Market seeking**
- **Efficiency seeking**
- **Resource seeking investments**

...and focused on market seeking sectors
Gearing up for a more productive future

Continuous address business environment constraints to provide an enabling environment for firms to enhance productivity.

Improve regional integration and promote it as a springboard for better integration with EU and global markets.

Continue dialogue with partners on deepening trade integration through trade agreements with international partners.

Reduce trade facilitation and logistics gaps.

Continue to improve the business environment to attract higher FDI to link with GVCs.

Leverage strong diaspora ties to increase penetration of firms into export markets in the region and beyond.

Prepare an action plan for e-commerce to improve the regulatory framework and promote digital trade, facilitate e-payments, and improve digital connectivity.
Gearing up for a more productive future

- Improve POE governance and eliminate POE-related barriers to competition to ensure equal treatment of private and public operators in markets where they compete.
- Enhance the quality and control of the regulatory process and facilitate business registration to boost market entry.
- Reform entry and conduct regulations for professional services, eliminating exclusive rights and regulatory restrictions.
- Strengthen the regulatory framework for competition policy and improve the efficiency of regulatory functions to reduce restrictions on competition in network sectors like electricity, transport, and telecommunications.

Read the full paper at worldbank.org/en/country/kosovo
Gearing up for a more productive future

- Modernize the investment ecosystem to make it more efficient and to attract higher-quality investments.
- Sharpen the focus of FDI attraction and retention efforts and devise an action plan to accelerate investment attraction and COVID-19 recovery.
- Empower KIESA as the national lead agency for attracting investment by sharpening its focus on delivering core investor services, improving its governance, and scaling up its provision of services to investors.
- Establish an effective investor grievance mechanism to enhance investor confidence and reduce regulatory risk.

Read the full paper at worldbank.org/en/country/kosovo
ENTRENCHING

Macroeconomic Stability & Sound Governance
Kosovo has seen strong rates of economic growth, but needs to close the **governance gap** with comparators.

GDP growth has been impressive, but there is still some way to go to close the gap with key comparators.

...and the comparator gap is especially large when it comes to governance.
Higher levels of foreign investment are needed in productive sectors to support job creation.

Foreign investment has been strong, but focused primarily in the real estate sector.
Gearing up for a more productive future

Entrenching Macro Stability and Sound Governance

- Improve the efficiency of public spending through better targeting
- Increase revenue mobilization by reducing exemptions and leakages
- Strengthen rule of law and judicial system

- Improve the timeliness and accuracy of national statistics to inform evidenced-based policy making, in particular the national accounts, for effective implementation of the rules-based fiscal framework.
- Improve the efficiency of public spending, by better targeting social protection benefits to the poor, allocating resources to maintaining public assets, and investing in human capital.
- Mobilize more revenue by rationalizing fiscal exemptions, reducing leakages, and giving local authorities incentives to collect more own-source revenue.
- Ensure effective implementation of laws through better coordination of state institutions and a well-functioning judicial system.
- Continue to closely monitor financial sector health to manage exit from borrower relief measures adopted in 2020, taking into account increased uncertainty about the economic recovery and asset-quality challenges generated by the COVID-19 shock; and strengthen the financial safety net through the bank recovery and resolution framework to be introduced by the new banking law.
Proximity to major markets in Europe and a youthful population provide an opportunity for growth. Kosovo is one of the youngest countries in an aging Europe. Trade facilitation and logistics connectivity are getting better. Proximity to a large and affluent market, and strong ties with its diaspora will help support growth.

Yet, with the right reforms, Kosovo can gear up for a more productive future. A package of reforms to (1) entrench macroeconomic stability and sound governance; (2) increase firm productivity; (3) raise farm productivity; (4) enhance human capital; and (5) boost exports, competition and private investment, especially foreign direct investment (FDI), could see Kosovo closing the gap with its aspirational peers much sooner.

Read the full paper at
» worldbank.org/en/country/kosovo