

# THE IMPACT OF FOREIGN DIRECT INVESTMENT ON THE TOURISM DEVELOPMENT IN KOSOVO

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## Abstract

During their development phase, many countries have been practicing Foreign Direct Investment (FDI) as one of the sustainable socio-economic development possibilities. FDI in Kosovo is considering as an important resource for development of the country and so far they mainly concentrated on the process of privatization, banking and telecommunications sector, while tourism cannot be identified with any such investment. Although tourism in Kosovo is not consider a primary source for country development, it is necessary to identify effects that can produce FDI in tourism development, since Fdi's are not always shown effective and successful in sustainable development. The rapid development of tourism through favoring FDI can bring increased revenue from the "export" of services, creating new jobs, infrastructure development and other positive effects. On the other side, the rapid development reflected such environmental degradation, which is unable to protect themselves from such developments risks the sustainability triangle also in socio-economic aspects.

**Key Words:** tourism development, foreign direct investment, positive and negative effects

## 1. Introduction

Tourism is one of the industries which has marked recent years the fastest growing in the world. Such a rapid development has resulted in the creation of high profits from the export of tourist services, thus affecting the growth of various countries. In this case, the Foreign Direct Investment (FDI) has played a decisive role. The presence of FDI in developed countries has been high, while in developing countries have been more reserved to invest. Foreign direct investment present, in general have played a decisive role in socio-economic development, but, not in every country these investments have been successful. Inefficiency of FDI in these countries has emerged as a result of difficulties in establishing a clear relationship between FDI and sustainable development. On the other hand, experience of various countries have shown that often the impact of FDI can be totally incomprehensible due to deficiencies in the legal procedures for FDI in a country that is developing or in exit from the various crises, whether economic or political.

Despite that FDI may have negative effects, but almost all countries, whether developed or developing, constantly are trying to create a favorable business environment to attract foreign investors and investments. Kosovo is one of the emerging countries which proves to be more attractive to foreign investors, offering various facilities. In particular, countries such as Kosovo are attractive for investors with high purchasing power, especially when the privatization of public property is in the process, when unemployment is high and labor is cheaper, when natural resources have been using, when there are legal gaps or other different reasons.

Although Foreign Direct Investment considered as an engine for development, their presence in tourism activities is more subtle than in other economic activities. Kosovo is a small place and being that is at the center of South-East Europe, has a favorable geographical position which makes the connection point to the different states. Kosovo has various tourism potentials which provide the basis for tourism development. When it comes to tourism development and Kosovo as other developing countries, attracting FDI should be looked at "between hope and fear". Why?

In FDI have hoped that can contribute to economic growth, the impact on creating new jobs, the impact on poverty, in raising the welfare of local residents, or to sustainable socio – economic development of the country. On the other

hand, FDI besides their capital, carry with them the element of decision making on property or company where foreign capital is investing and the element of control over local resources (natural or human). This means, FDI raises fear of their impact on economic and cultural independence of the company where capital is investing, but also promote fear of damaging the environment and the community at which they operate. Based on the above findings, the paper ends with the conclusion that Fdi's are necessary and useful for the development of tourism, as long as foreign investors with their investments do not pollute the environment in which we live, do not abuse employees, do not affect the tradition and culture of local people or do not use them for other investments.

### 1.1. Methodology

Since tourism is one of the most neglected sectors in Kosovo, it is clear that there is a lack of enough evidence, which can prove the level of FDI in tourism development. Therefore, to find the effects of FDI in tourism development in Kosovo, the paper is based on theoretical generalizations through which FDI proved the importance of these investments. To test the effects which may follow from FDI, is the use the methodology of collecting, measuring and reporting the latest data available. It means that paper is based on analysis of primary and secondary sources. Besides literature, as primary sources related to the level of FDI in Kosovo are using data obtained from various official reports of ESK<sup>1</sup>, UNCTAD<sup>2</sup> and World Bank. While secondary sources are use as ratios of local and international equivalent of more reliable information and data from previous research and scientific experiences.

## 2. Theoretical Overview on Foreign Direct Investment

### 2.1. What are Foreign Direct Investments

There are different definitions that can be used to describe FDI. However, FDI are essentially external funding sources, which integrate into a country's total investments for the purpose of economic growth and sustainable development of the country.

According to the International Monetary Fund (2001), FDI is when an investor owns 10% or more of the shares or

<sup>1</sup> ESK - the Statistical Office of Kosovo ( <http://esk.rks-gov.net/> )

<sup>2</sup> UNCTAD - United Nations Conference on Trade and Development ( <http://unctad.org/> )

assets of an enterprise in a country where the investor is not resident.

By Reilly and Brown (2002), an investment is the current commitment of dollars for a period for the purpose of issuing future payments that will compensate the investor for (1) time as funds are committed, (2) the expected rate of inflation and (3) uncertainty of future payments. "Investor" may be individuals, governments, pension funds or corporations.

While, according to Sornajah (2007), FDI include the transfer of tangible assets or intangible assets from one to another country for the purpose of their use in the country to generate wealth under full or partial ownership of those assets.

Fdi's describe the stream of investment abroad from a company, which invests in equipment or other property in the target market. FDI allow companies to produce, sell and compete locally in key markets. FDI involves the transfer of resources, including capital, technology and personnel (Clarke and Chen, 2007).

FDI is a key element in the rapid evolution of international economic integration, referring to the globalization. Fdi's provide tools for creating a direct link between long term and stable economies. Under the right environmental policies, they can serve as an important tool for the development of local enterprises and also can contribute to improving the competitive position of the receiving economy (host) and the investment. FDI promote transfer of technology and knowledge between economies in the international market (OECD, 2008).

By *World Investment Report* (2010), FDI is defined as an involving investment a long-term relationship between a nonresident entity (direct foreign investor or an enterprise) in an enterprise resident in an other economy than the foreign direct investor (FDI enterprise or branch of the foreign company). FDI is when the investor exercises a significant degree of influence in the management of the enterprise resident in another economy. In essence, definition of FDI by different authors, reflects the same goal that these investments have.

Since FDI in tourism is dominant in developed countries, it seems that their role in developing countries is treating less than in other sectors.

## 2.2. Types of foreign investment

Determining the method for investments in less developed countries is often dependent on the political condition and property law in a foreign land, buildings or location (Chaney and Gamble, 2008). However, the most popular methods of Fdi's are:

- **Greenfield investments.** These investments based on the establishment of entirely new enterprises in foreign

markets and their importance lies in the fact that everything is investing from the beginning. At the same time, these investments are recognized as the most beneficial and favorable for countries in transition and developing countries.

- **Acquisition investment.** These investments are through acquisition or merger with other companies. In this group are included investments and privatizations of existing facilities, which alters the owner and paves the way for new investments.

- **Brownfield investment.** This model is a combination of acquisition and Greenfield investments. In fact, this investment type means the purchase of enterprises or existing facilities and Greenfield investment participation at the same time. In this case, the investor must make changes in touristic facilities as well as in touristic products.

- **Joint venture.** Means the joint investment of domestic and foreign partners who apply joint control.

## 2.3. Foreign Direct Investment in tourism

Many countries during their development phase, considered tourism as a promising potential factor for socio-economic development. However, despite this perception, traditionally agriculture and production are considered with higher priority compared to tourism, being treated as the most significant sources and suitable for generating jobs and income from the export of products or promoting development in rural areas. Tourism is a collection of activities that provide similar and unique goods and services. Transport, accommodation, food and beverages, entertainment and cultural activities, sports and recreation are the core activities which create value chain in tourism. In this value chain are including many other activities that are part of the success or failure of tourism in a given area (fig. 1).

From figure 1, it can be pointed out that construction, agriculture, telecommunications, financial services, health services and other services such as electricity, water, sewage, security and operation of law are activities which affect the production as well as consumption of tourism.

Such a chain of values "interpreted" into opportunities for investment and employment, makes tourism industry comprised of many sectors, which can have a high contribution to the socio-economic development of developing countries. Investments can be in different areas and can be implemented by various companies, domestic or international. Also, creation of new employment opportunities implies endorsement of semiskilled staff, particularly women. It means the development of tourism in developing countries creates positive effects, which affect economic growth, while reducing unemployment and poverty.



Road passenger transport services	✓
Water passenger transport services	✓
Supporting passenger transport services	✓
Travel agencies and similar	✓
Cultural Services	✓
Other sports and recreational services	✓

Source: UNCTAD

As Foreign Direct Investment in tourism activities are considering investments in other profiles such as transportation, tour operators and booking system, but the dominant complexity of the tourism sector has done that often Fdi's destination are undefined in terms of their spread. With the introduction of the Tourism Satellite Account TSA<sup>1</sup>, most countries now have regulated the difference between companies that are involving in the production and consumption of tourist services, but the TSA as a methodology does not distinguish between domestic enterprises and foreign.

### 3. Foreign Investment in South-East Europe with emphasis on Kosovo

The countries of South - East Europe especially after exceeding the already well-known political crisis and security have created the most favorable business environment for foreign investors. The policies of these countries besides attracting foreign investments were necessary for meeting the standards for integration into the European Union. From Table 2, it is notice a large fluctuation in FDI over the years (2005-2010) in various countries. Based on data from World Investment Report (2011), Croatia and Serbia in recent years have marked the biggest attraction of FDI. While Croatia in 2008 has managed to attract approximately 6.2 billion dollars, in year 2010 has seen a drastic decline in 583 million dollars. However, other countries have shown a positive trend in FDI but steady decline.

**Table 2. Foreign direct investment in South-Eastern**

FDI inflows (millions of dollars)						
Countries	2005	2006	2007	2008	2009	2010
Albania	264	325	656	988	979	1 097
Bosnia and Herzegovina	613	766	2 080	932	246	63
Croatia	1 825	3 473	5035	6 179	2 911	583
Macedonia	96	433	693	586	201	293
Montenegro	501	622	934	960	1 527	760
Serbia	1 577	4 256	3 439	2 955	1 959	1 323
<b>South - East Europe</b>	<b>4 877</b>	<b>9875</b>	<b>12 837</b>	<b>12 601</b>	<b>7824</b>	<b>4 125</b>

Source: World Investment Report 2011 - UNCTAD (Annex table I.1. Page 190)

According to the same source, only Albania from all countries of South-Eastern Europe has had a positive trend with continuous increase of the amount of FDI in 2010 which reached 1.1 bil.dollars.

#### 3.1. Foreign Direct Investment in Kosovo

According to the Economic Initiative for Kosovo - and Investment Promotion Agency ECIKS of Kosovo - IPAK (2009), FDI in Kosovo after the war of 2000 to 2006 have been 634million euro, while from 2006 until the year 2009 have reached approximately to 1 billion euro.

FDI in Kosovo in the period 2000 - 2006 identified 236 million euro through the process of privatization and Greenfield investment by 398 million euro. Also, this period is characterizing for FDI in the banking sector, while the year 2007 when the noted increase of FDI in 440million EUR identified with high investments in the telecommunications sector.

**Table 3. Foreign direct investment in Kosovo (2005-2010)**

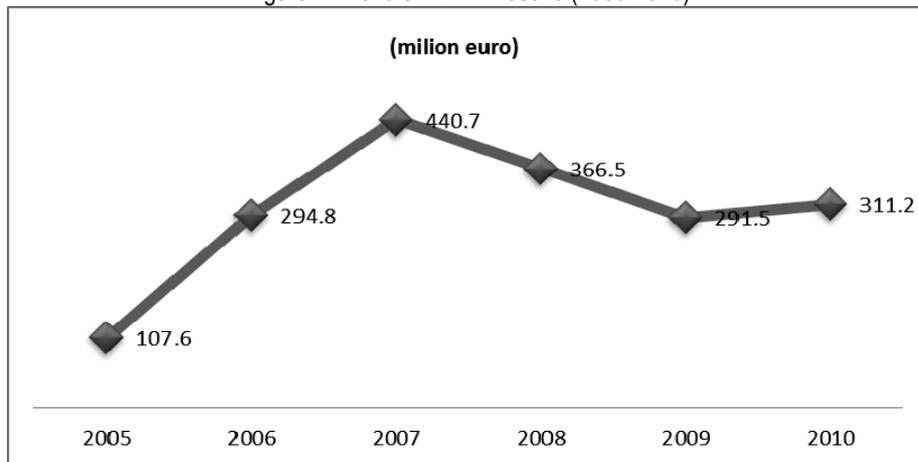
Description (year)	2005	2006	2007	2008	2009	2010
Foreign Direct Investment (mil. euro)	107.6	294.8	440.7	366.5	291.5	311.2

Source: Investment in Kosovo, January 2012

<sup>1</sup> Tourism Satellite Account (TSA) is a Statistical Approach developed by the WTO-OECD-Eurostat Inter-secretariat Working Group and endorsed by the Statistical Commission of the United Nations in 2000. It defines tourism industry as "all establishments whose principal productive activity is a tourism characteristic activity" (WTO 2004, pp. 13-14). The TSA Recommended Methodological Framework identifies 12 Separate accounts National Activities industry as tourism characteristic. All are service industry, and half are related to Transportation.

Although foreign investors are protected by law in Kosovo, according to World Bank report of 182 countries surveyed for the protection of foreign investors Kosovo ranks 172, and this was one of the reasons for the positive trend but significant decline FDI from 2007 (graf.1.)

Figure 1. Trend of FDI in Kosovo (2005-2010)

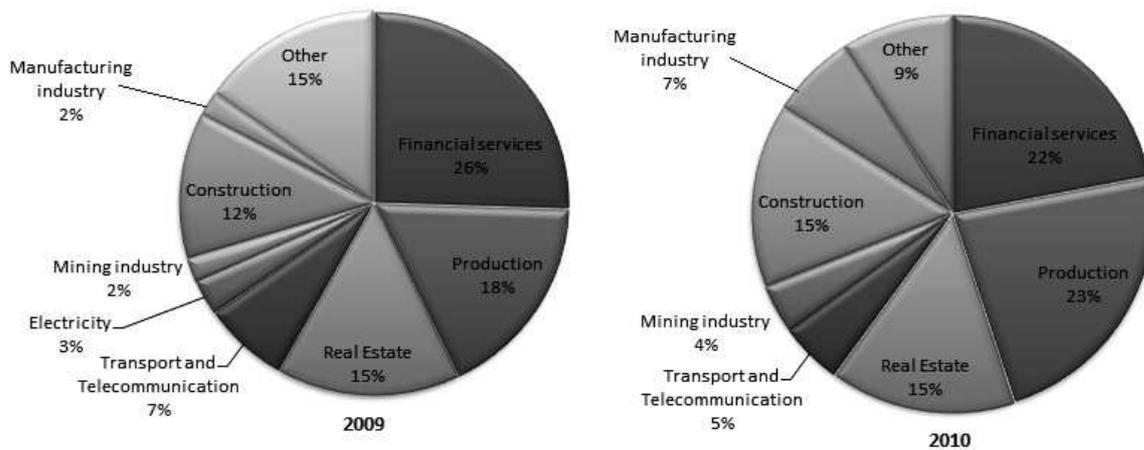


Source: Investment in Kosovo, January 2012 Central Bank of Kosovo (2011)

In such a trend of foreign investments in Kosovo cannot be excluded the negative impact of global financial crisis, poor quality of infrastructure in general and high level corruption.

In 2010, FDI in Kosovo amounted to € 311.2 million or near 9.6% more than in the previous year. Unlike the years 2006-2007, during 2009 and 2010 the structure of FDI in Kosovo has been a change by being enriched with new investments (graf.2.).

Figure 2. The structure of FDI in Kosovo



Source: Investment in Kosovo, January 2012

By IPAK and ECIKS, there are ten fundamental reasons to invest in Kosovo:

1. Youngest population in Europe
2. The power of high skilled workforce and cost effective
3. Use of the euro as official currency
4. Free access to EU markets, U.S. and CEFTA
5. Low taxes (personal income 0-10%, VAT 16%, 10% business income, the contribution required for employee 5%)
6. Stable political environment
7. Compatible with EU legislation
8. Strategic location and infrastructure development
9. Sound banking system, and
10. Great opportunities for investment

Although Kosovo is believe to create a favorable environment for foreign investment and there are different reasons to invest, even from the above chart is a note that these investments are totally missing in the tourist sector.

#### 4. Foreign Direct Investment on tourism development in Kosovo

In Kosovo, 65% of the population belongs to the working age. Although this age represents the available workforce, only 26% are employed (World Bank 2010). Of the working age, approximately 70% of the unemployed belong to the new age. Despite the positive trend, of economic growth in recent years, the employment rate in Kosovo is estimate to be lowest in Europe. Unemployment is one of the key factors that reflected the poverty of the population in Kosovo. According to SOK in 2009, 34% of Kosovo's population lived below the absolute poverty line of € 1.55 for an equivalent adult per day and 12% live below the extreme poverty line of € 1.02. These data show that Kosovo still continues to be ranked among the poorest countries of South-East Europe.

The positive trend of economic growth did not shows the economic development. Although Kosovo is in the stage of overcoming the political and security crisis, economic and social crisis are still extremely strong. To create a long-term stability in this aspect is indispensable reform of economic and social system, which means the enrichment of the current economic structure with new activities. For this reason, in Kosovo is constantly trie attraction of Fdi's. How and where will invest equity a foreign investor in Kosovo depends on many factors.

Tourism in Kosovo is one of economic activities that have attracted less attention of foreign investors. When discussed tourism development, all attributes can be dedicated to private initiatives as well as local businesses. What is the impact of Foreign Direct Investment in tourism development in Kosovo?

The answer to this question is essential for society in general and the unemployed in particular, the business community - especially one dealing with the development of tourist activities as well as policy makers for Foreign Direct Investment in developing countries.

Relationship, which may arise between FDI and tourism in developing countries is analyzing from numerous authors, who have given various opinions for and against FDI in tourism development. Some have argued FDI in tourism with economic growth, increased productivity and social welfare of local residents, but also to sustainable economic development. The most common problem seemed by others

is considering the fact that investments depend on foreign capital, which can be managed foreign staff, and the profits will go to foreign investors. However, this may not always be correct since it is likely that foreign capital to stay under the umbrella of foreign investments, but to be managed by a local staff and the income earned from tourism can be reinvested back into the country. Some others argue the negative impacts of FDI, claiming to increase the level of ownership of local resources by foreign investors as well as altering the local culture and customs. For this reason, developing countries develop policies that restrict FDI.

Attracting FDI to developing tourism in Kosovo, means "supply" of the country's tourist facilities and activities, but not with foreign tourists. Tourists are those who define a tourist destination to visit. Despite investment in a developing country or destination, foreign tourists are not obliged to visit the place because the FDI is present here.

Attracting tourists from FDI can only be done if those investments affect various aspects of increasing the attractiveness of tourism:

- **Through marketing activities** - In particular the promotion of Kosovo's tourism product or service offered by that business in the country of origin of the investor. This can be a sustainable strategy while foreign investor to have knowledge of the market in which previously operated, including a request for accommodation, food, transportation and other activities. However, despite such efforts by a foreign investor, it seems unlikely that the use of such strategies in other countries can be fully effective for attracting foreign tourists.
- **By changing the existing tourism product** (in Kosovo there is not yet defined a tourist product) by identifying in advance the demand. Important role in changing and improving the quality of the tourist product have also operators who can operate both within and also outside. If the foreign investor (who may be the owner of a hotel chain, owned a construction company, owns a transportation company, etc.) has the skill to change Kosovo's tourism product, then the responsibility for attracting a larger number of tourists is on tour operators. The difference between the investor and operator lies in the fact that the investor (owner) is the founder and financial supporter of the development of a business, while the operator "tailoring" being responsible for attracting greater numbers of tourists, should identify the needs and requirements tourists and give them the final product quality that they require.
- **By applying the most affordable price** tourist services in comparison with the same level destinations.

The impact of FDI in the country's overall development is reflecting in:

- Increasing the overall level of investment,
- Penetration of various economic activities in the local market,
- Creating new jobs and change the structure of employees.

#### 5. Conclusions and recommendations

Prior to identification of the benefits and costs of tourism development, there is a need to identify some of the

fundamental reasons that may encourage a foreign investor to invest in tourism development in Kosovo.

- Each foreign investor whether individual or juridical, determine to invest in Kosovo if it satisfies that it is possible to achieve its goals.
- If an investor finds his perspective in Kosovo as a country currently in development.
- If the investor owns the high purchasing power and tourism coincides with the interests, skills and competencies.
- If taxes in Kosovo are more affordable than in the country in which the investor operates currently.
- If lack the will and experience of local investors to take the risk of such an investment.
- If there are deficiencies in the law on FDI and tries to profit from it weakness.

On the other side, the country benefits from FDI and the possible increase in the number of tourists have also its cost.

#### **1. Changing the structure of economic**

Enrichment of the country's economic structure with new activities such as tourism or businesses that directly or indirectly related to tourism will have an impact both in economic growth as well as in raising the welfare of local residents.

#### **2. Loss of capital**

FDI in the tourism industry can lead to loss of capital. If the flow of FDI would be oriented (in any method of investment) in the hospitality and other tourist activities, then we are dealing with the loss of ownership and control of those businesses.

#### **3. Impact on environment**

Kosovo's natural resources which possesses, are too much limited to develop different tourism types. Tourism development can bring the degradation of environmentally sensitive areas from different overloading.

#### **4. Effects of congestion**

Effects of congestion from tourism represent a whole process of the implications. In areas where natural resources are available for tourism development, is require to develop infrastructure and accommodation capacities. Than the increased demand, for tourist a service also imposes an overload of tourist attractions and businesses

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that aim to meet the needs and demands of tourists (shopping centers, sports, recreation, etc.). Such overloading "strong" and if overcrowding of these areas and in certain periods of time during a year, significantly affect the degradation of the environment.

#### **5. Additional costs to the economy**

If have an interest from foreign investors for investment in areas where claims develop tourism and lacks basic infrastructure, the economy is face with additional costs for the development of tourism.

#### **6. Effects of FDI on job creation**

Tourism development in Kosovo promotes the development of other activities such as agriculture, construction, manufacturing and food industry, thus affecting the structure and profile of employees. Greatly creates advantages for female employment.

#### **7. Effects of overloading with foreign tourists**

If foreign investors have the ability to attract a large influx of foreign tourists, the effects may be of a different nature: (1). Comes to expression not elasticity tourist supply, which means limiting tourist resources that can be used, (2). In the absence of supply meeting demand from local businesses, foreign owners are a force to import products from other countries, and this may gradually lead to the decline of jobs, (3). Increase the despair of local tourists by favoring foreign tourists.

#### **8. Technology**

Use of technology in tourism produces positive effects, but oppositely other industries those effects are minimal.

#### **9. Real estate prices**

Overhead purchasing power of foreign investors has consequently raising prices for real estate (land and buildings) that negatively affect local buyers and investors with low purchasing power.

#### **10. Tourist market in Kosovo**

Kosovo has a small market to attract large numbers of FDI in tourism. Despite the possibility, that the greatest benefits from attracting FDI may be more "foreign" rather than "domestic" Kosovo needs foreign investment, which enrich the country's economic structure. Support for FDI should be according to rules and laws that protect not only foreign investors but also to restrict it to its actions

