



**“THE ROLE OF HUMAN RESOURCES IN FOREIGN DIRECT INVESTMENTS –  
EVIDENCE FROM KOSOVO”**

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I dedicate this work to my beloved wife and my children for their patience, assistance, support and faith in me.

Thank you to my father and mother for their encouragement and continued support over the years and their enthusiasm as I approached my goal.

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## STATEMENT

Under full moral and material responsibility I hereby declare that text in my doctoral dissertation, titled ‘The Role of Human Resources in Foreign Direct Investments – Evidence from Kosovo’” is my genuine and independent work based on my findings during the research, as well as on the theoretical knowledge and the practical experience in the relevant field and that it represents solely my work, except for the parts marked with footnotes. For any unauthorized use of someone else’s text or paper or plagiarism, I agree to bear the appropriate disciplinary, civil and criminal consequences.

## **Abbreviations**

**ASTD** - American Society for Training and Development

**ATP** - Autonomous Trade Preference Regime

**CBK**-Central Bank of Kosovo

**EU** - European Union

**FDI** – Foreign Direct Investments

**GDP** - Gross Domestic Product

**GoK** - Government of Kosovo

**IPA** - Investments Promotion Agency

**KA** - Kosovo Assembly

**KEC**- Kosovo Education Center

**KIESA** - Kosovo Investment and Enterprise Support Agency

**KIPA** - Kosovo Investments Promotion Agency

**LFS** - Labor Force Survey

**PPP** - Public Private Partnership

**SME** –Small and Medium Enterprise(s)

**SOE** - Social Own Enterprise(s)

**SOK** - Statistical Office of Kosovo

**CCQE** - EU Candidate and Potential Candidate Countries' Quarterly Economy

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## **Chapter 1: Overview**

### **1.1. Introduction**

Since 1999, different factors have contributed to the growth of Kosovo trade deficit such as war, liberalization of trade, insufficient investment in the real sector of the economy, and long-term isolation of the national economy from the impact of the international market. Country's economy lags behind the regional developments in applied production technology, which results in reduced capacity and competitiveness in foreign markets. Insufficient investment impedes structural changes of domestic production and export as preconditions for sustainable long-term growth, and it is necessary to attract foreign direct investments (FDI). However, the motivation for investing in Kosovo has to be intensified by the creation of an attractive and stimulating environment. Kosovo belongs to the weakest ranked countries in transition regarding FDI (World Bank Group in Kosovo, 2015). At the same time, in the most prosperous countries FDI has a prominent role in providing the necessary capital for accelerated growth. The question is why unlike the other regional economies in transition, Kosovo missed a greater inflow of foreign investment? Is it because of political instability or inadequate human capital? What can Kosovo do to advance the overall environment for more significant, continuous, and steady inflow of foreign direct investments? The discussion on FDIs in the academic world and in the general public associates FDIs with the benefits for the host country. FDIs for economies in transition are considered as an important factor in economic growth, in addition to the domestic investments as a reliable source of financing the current account deficit. The importance of FDI does not rely only on its direct effects, but it also can indirectly generate a positive impact on the national economy. To be mentioned, among others are human capital formation, technological pullovers, or access to foreign markets are only some factors that can be generated by the FDI. The confusing results acquired from the literature to a rather unenthusiastic conclusion do not justify funds mobilized to attract foreign investors. Hence, the objective of the study is to analyze foreign direct investment from human resources perspective and to try to identify the conditions favoring a positive effect. Even though this area of research is highly explored from different angles, this study will make use of an extensive research of the most relevant literature available in the field. In addition, through a combination of specificities of Republic of Kosovo about foreign direct investments will serve as a good base for future researchers to conduct research in this field.

The author considers that research paper will contribute to the extension of academic knowledge regarding the phenomenon of FDI and human impact on effective classification and serious analysis of research objectives, theoretical frameworks of commonly applied references, procedural issues, and the most significant findings and conclusions found by the majority relevant academic literature existing in the area. The author is also willing to contribute in the development of the international field of entrepreneurship as a scientific discipline in Kosovo.

## **1.2. Research Problem**

Despite the increase of total foreign direct investments (FDI) in developing countries, the distribution of these investments among countries is disproportional. The inflows have been directed only to a limited number of developing countries. The most significant effect of FDI on the country's economy is the injection of needed capital and employment to overcome the gap between the savings of a developing economy, which does not invest much in new business, hindering so the employment increase. Also, FDI brings to the host-country know-how and efficient technology, and stimulates economic growth (Bernstein, 1998, Javorcik, B. S 2014), while and from the other side, the high growth rate attracts FDIs (Barrel and Pain, 1996, Alfaro L. & Charlton, A 2013). Therefore, FDI and economic growth are commonly interconnected. Although in the academic world, the impact of FDI on economic growth is a widely debated topic. Some scholars claim the positive effect of FDI on the development of host country (Asheghiana, 2004, Baliounte-Lutz, 2004, Amighini, A., Rabellotti, R., & Sanfilippo, M. 2013), whereas others insist that its influence is not proved, or it is negative (Mona Haddad, 1993, Kolstad, I, & Wiig, A.2012).

The transition process from planned to open market economy brought profound changes to economic agents. Core economic indicators such as investments, employment, output, wages, and prices quickly stopped being fixed centrally by the government and became determined by market forces (Gerard Roland, 1993). Human capital is the field where the transitional process has had significant and lasting implications. A redistribution of labor across industrial sectors and its reallocation from state to the private sector were the two most important structural changes in the labor market (Blanchard, 1997, Bruno, 2006, Giddens, A. 2013). Developing countries during transitional phase experienced a shortage of domestic capital. National investments were far from fulfilling the demand for investments. To bridge this situation apart from domestic investments, developing countries urgently needed to attract foreign capital. Differently from neighboring countries, Kosovo was not able to do so. The

Investment Promotion Agency is the major institution that focuses on efforts to attract foreign direct investments (FDI). IPA is creating efforts to attract FDI by further liberalizing the FDI inflow policies and promoting small and medium enterprise (SME) competitiveness. To date, around 2,000 companies of foreign or mixed ownership have invested in Kosovo (Financial Stability Report 2015). Last year's inward FDI in Kosovo was insignificant and highly trembling. The current amount of inward FDI is still small compared to countries in the region (UNCTAD, 2015) hence, more effort is needed to take the advantage of FDI. In this aspect, FDI attraction along with human capital development remains a considerable challenge in the upcoming years for the government of Kosovo and other responsible entities. Attracting FDI has various prerequisites. One of them is the supply of trained and educated human capital. In the case of Kosovo, the economic development should be based on its young population, and it is vital to make education system correlated with economic development. According to the latest research conducted by Kosovo Education Centre (KEC), education lags behind to some excellence standards (KEC, 2011).

When in the beginning of transition, Druska (2001) argues that transition countries have a high level of human capital, and it does not pose a problem for those states (Druska, 2001). In this stance, Spagat (2002) shows that based on the educational levels it might suppose that transition economies are doing very well. However, later it was realized that existing skills, knowledge, and education might not be relevant for foreign investors from industrialized countries. Moreover, Druska (2001) confirmed the existence of a significant mismatch between the types of skills and competencies that workers possess, and the kind of expertise and skills are required from new economy demands. Referring to the above arguments, the mismatch between the stock of human capital (the supply) and the skills required (the demand) from foreign companies is thought to be a barrier to attracting FDI, especially the ones who need specialized and trained human capital for their operations in the host country. More specifically, according to Ioan Talpos and Cosmin Enache (2010), FDI inflows in Central and Eastern Europe (CEE) have distinct patterns of human capital, different from the rest of the developing countries. Having this said, it can be concluded that human capital matters in attracting FDI inflows and can speed up the transfer of know-how from foreign investors to host country. Human capital in Kosovo has some distinctive features to be analyzed and compared to other countries, such as very young population (the youngest in Europe one-third of the population is under the age of 16) and large-scale emigration (which consists of around 15% of total population of 1.8 million). Moreover, Kosovo is the latest

country to declare its independence (17 February 2008) from Serbia, meaning that Kosovo is the last state to embark on the road of transition from a communist to a market economy. Such events had a profound impact on current economic development, FDI attraction, and human capital development in Kosovo. According to the study conducted by the International Labor Organization (2012), over 145,000 Kosovors workers were laid off in early 1990-s. During the period 1990-1995, output fell by 50% to less than US\$400 per capita. Unemployment, being at 27% in 1989, reached the level of approximately 68% just before the war in 1999. Although the situation in Kosovo changed drastically after the war in 1999, the history impacted the current economic development, human capital development, FDI attraction, and investment opportunities. The reconstruction process just after the war in 1999 absorbed a considerable workforce. Moreover, unemployment was still high, although it has been decreasing from approximately 70% right after the war in 1999 to 48% in 2002 and 39% in 2010 (KIESA, 2012). The unemployment rate is high, especially among young people aged 16-25 and females, while around 70% of the unemployed are long-term unemployed (Kosovo Human Development Report 2014). The need for investments (domestic and international) is significant. Domestic investment capabilities are highly limited in Kosovo therefore, FDI is seen as a proper solution to decrease high unemployment. However, the limited knowledge, skills, and the advanced educational system might act as a major barrier to attracting FDI.

In Kosovo's point of view, having the youngest population in Europe might be a competitive advantage, regarding the labor supply and availability of human capital, but in the policymakers' perspective, it might cause challenges in directing this kind of human capital. One of the biggest concerns is that the skills and competencies possessed by workers are not the ones that are demanded by firms, suggesting the need for further changes in the educational and training systems. The business community and academia should work more closely with the compatibility of skills and knowledge acquired from formal education and the business need (relation: theory vs. practice). It is considered that the increase of FDI will contribute to decreasing high unemployment, economic growth, technology transfer, and human capital advancement. In this perspective, the endeavor of the government remains low and unnoticed. Moreover, it is worth noting that during the period 1999-2007, Kosovo attracted all kinds of FDI, and there were almost no criteria or priorities set by the government. From the development perspective, this will have long-term implications, and it considered a great mistake. After the war in 1999, the FDI flow was high, and most of the

investors were short term investors. Kosovo is interested in enduring investors who can and want improve the image of Kosovo internationally. Due to the high unemployment rate in Kosovo, FDI, which absorbs high labor stock, might be one of the policy priorities. The facts mentioned above are hindering the development of human capital in Kosovo, and as a consequence, the attraction of FDI is fading. In this aspect, it is crucial to note down that fiscal and monetary incentives alone are not the only means to attract FDI. Parallel to this, government and other institutional bodies should also focus on developing human capital that will be able to challenge the demands of international companies.

### **1.3. Research Objective**

While the theoretical literature on Foreign Direct Investments (FDI) focuses largely on movements in the capital, firm's location and firm-specific technology (Dunning, 1977; Theo S. Eicher and Pantelis Kalaitzidakis, 1997), some of the current empirical studies (Oulton, 1998; Urmas Varblane & Priit Vahter, 2005, Stanistic, N. 2015) are focused on human dimension necessary to attract FDI. In this line, this research intends to examine the role of human capital in determining and attraction level of FDI. Human capital is the most important form of wealth in the contemporary economy. It is considered to be three to four times the value of the capital market, and it is becoming a critical currency of our knowledge-focused economy (Beck Thorsten, George Clarke, Alberto Groff, Philip Keefer, and Patrick Walsh, 2001). Considering the facts above, if the government of Kosovo and other responsible institutions pay more attention to human capital, Kosovo will be able to attract the right FDI, and it can bring adequate benefits to the utilization of the workforce. This research will help the interested stakeholders to conduct and take necessary actions/steps to make use of young human capital as a competitive advantage in attracting FDI. This research intends to contribute to the existing theory of FDI and human resources. In general this research will:

- Emphasize the role and impact of FDI in human capital development;
- Explore the role of human capital from the perspective of foreign investors as employers.

Another objective is to give recommendations to the current educational system and how it can be improved and harmonized with demands of foreign investors, and treating human capital as a prerequisite to increasing the inflow of FDI. Due to limited national capabilities of domestic investments, higher FDI inflow can speed up the process of transition in Kosovo in general and transfer of some best practices from developed countries. Moreover, by

investigating the impact of human capital on FDI attraction, it is aimed to contribute to some useful recommendations that can help policy makers to formulate new policies/priorities for FDI attraction in Kosovo. Finally, to the best knowledge, this is the first research in Kosovo that will try to explore the relationship between FDI and existing human capital. Considering the importance of the study, Kosovo Chamber of Economy is very interested in the research findings.

#### **1.4. Research Design**

The inconsistency and absence of the official data in Kosovo are only some of the barriers to reliable studies.

- **For study purpose, of Kosovo business climate:** The data's information used in this research was conducted in Kosovo. Kosovo Chamber of Commerce within the "Foreign Investment Club" has conducted research based on foreign direct investment in Kosovo. Namely, the aim of this study was that through surveying companies, which are the major investors in the country, to understand the actual state of the Kosovo business environment in and to recognize all the segments and dimensions in which GoK and all people of Kosovo have to do more to attract foreign direct investment. For study purposes, they have surveyed 28 investing companies in the country. Companies were selected from lists provided by the Investment Promotion Agency (IPAK) and other lists were provided by Chambers of Commerce in Kosovo. Data were collected in late June and early July 2013 in the whole territory of Kosovo. This survey collected information from owners and managers of companies investing in Kosovo regarding their assessments of the environment of doing business in Kosovo, barriers, evaluating the capacity of our local workforce, and their preference to invest again in Kosovo.
- **In the process of testing the hypothesis that Human Resources are important factor to attract FDI in the Republic of Kosovo:** From the variety of different components that have an influence on foreign direct investment inflows in a country, the author has decided to narrow empirical research only to human capital related factors. In the process of testing the hypothesis: Are the Human Resources an important factor to attract FDI in the Republic of Kosovo, the author chose a sample that consists of new European Union Members (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia). The chosen countries share common characteristics and historical background. As a dependent

variable, the author uses FDI inflows as a percentage of GDP, and as independent variables the author uses few elements of human capital like life expectancy, people with lower secondary education (as % of total population aged 15 to 64), people with higher education (as % of total population aged 15 to 64), and people with tertiary education (as % of total population aged 15 to 64). The author chose only the independent variables, because the intention is not to build an inclusive model, but to focus some possible determinants which are the quality elements of the workforce.

This research has used a mixed methodology dominated by quantitative methodology, and it is based on secondary data.

### **1.5. Research Partners**

To meet the objectives of this research project, the author has undertaken a review of the extensive literature that focuses on explaining FDI and its key features. Meanwhile, secondary data collected helped to recognize and understand the critical issues the key elements interconnected with FDI. Secondary data sources include previous studies and case studies in this field, journal articles, reports, conferences and working materials, statistical tables, and online databases. The research seeks to elaborate the link between indicators such as FDI, GDP, and GDP per capita, the number of residents, trade liberalization, and foreign policy. Data on flows and stocks of FDI have been taken from various editions of the OECD's Statistical Yearbook of Investment and IMF's Payments Statistics. Data on GDP, GDP per capita, population, and economic development are taken from the statistical data of UNCTAD. Kosovo related data derive from the Kosovo institutions such as Kosovo Chamber of Economy, Kosovo Economic Development Agency, Central Bank of Kosovo, the Ministry of Economy, and Institute of Statistics.

### **1.6. Restrictions and alternative ways to search**

Even though the author has worked to find the most current information possible until the defending thesis of this research (2016), the available data are from period 2013-2014. Also, the coverage of the data varies from country to country, because many of the central banks of the countries analyzed are not yet in the correct position to produce data that include all types of foreign direct investments. We have this situation when making assessments or regional comparisons between countries.

### **1.7. Analyses data**

Secondary data - extensive studies are taken regarding FDI in transition countries by institutional lines (EBRD, IMF, World Bank, National Banks), as well as individual work by different authors. Therefore, this will help to analyze the role of human resources in attracting FDI. Secondary data will be used to draw some recommendations for best practices in this field.

Main research partners:

- Central Bank of Kosovo (CBK) –agreed to provide a ranking of prime FDI in Kosovo. A formal request has been already sent to the department of statistics within CBK to have the official list which contains prime foreign investors operating in Kosovo.
- Kosovo Chamber of Economy

### **1.8. Chapter conclusion**

This chapter provided general overview of the study, aiming to inform and explain the main rationale of chose topic, problem statement, limitations, and significance. The main theoretical models affecting FDI and human capital, literature review, types and, concepts will be discussed in details in Chapter 2.

## **Chapter 2: Overview -Foreign Direct Investments**

### **2.1. Theoretical Framework**

Because of the transition from planned to a market economy, domestic capital in most of the transition countries is insufficient to meet all investment needs. Foreign Direct Investments can speed up the transition process by creating a foundation for more effective corporate governance and by encouraging the enterprise reformation, which is vital to the transition process (Murrell 2002 ; Ramasamy, Bala, Matthew Yeung, and Sylvie Laforet 2012). Therefore, the role and impact of FDI are more important in the developing economies compared to the developed countries. Human capital is among the most valuable resources in any economy. The literature on FDI considers the human capital as one of the important factors for inward FDI's (Dunning, 1988; Kevin Zhang - James Marcuse, 1997, Jaumotte, F., Lall, S., & Papageorgiou, C. 2013), but there are few types of research which consider a different country comparison to identify the major factors of inward FDI in developing countries. According to Koji Miyamoto (2003), the leading reason for this absence of studies comes from the difficulty in constructing qualitative explanatory variables, particularly for the indicator of human capital (Miyamoto, 2003). In the recent years, the importance of FDI is increasing, specifically in developing countries; therefore, it is considered as the leading source of capital flows to their economy. FDI attraction is followed by numerous fiscal and monetary incentives. However, it should be noted that FDI attraction should (apart from monetary and fiscal incentives) be accompanied by development and increase in the level of human capital, as a prerequisite in the attraction of the right FDI and not every kind of foreign investment (which scenario happened in Kosovo between 1999 and 2008). The type of foreign investments that a country attracts is critical regarding development and orientation of human capital. Human capital development and foreign direct investments (FDI) are among the major factors of growth in developing and developed countries. They reinforce each other through complementary effects. Based on indicators of educational attainment in transition economies, it was claimed that the average level of education which is needed for labor force in transition countries is moderately high (Duczynski, 2001; Druska, 2002, Spagat, 2006, Verhaest, D., & Van der Velden, R. 2013). On the other side, some studies suggest that firms in these economies lag behind those in advanced industrialized countries regarding the quality of their workforce ( EBRD, 2000-2007). These studies served as a barrier in the attraction of higher and more qualitative FDI. The impacts of FDI are on many levels, but the real impact on the economy and human capital depend on the ways and

channels the host country chooses. Studies show that the benefits of FDI are confirmed in transition countries and developing countries (Moran, T. H. (1998, Damijan, J. P., Knell, M., Majcen, B., & Rojec, M. 2003, Javorcik, B. S. 2004). Kosovo, a relatively new country, needs to attract FDI as much as possible, to fulfill the gap between the needs of investments and missing domestic funds. In this research, it is common sense to assume that availability of human capital is essential to the FDI inflow. Theoretical and empirical evidence indicate that human capital is imperative for drawing FDI in the developing countries, and the host country needs, at least, a minimum of elementary schooling for the whole population to show that their country has a sound investment climate (Miyamoto, 2003). Despite this, it should be noted that countries looking for high value-added and high technology, manufacturing and services need to develop more than a basic education such is tertiary education and professional education. In the contemporary dynamic business environment, the accordance with the theory of schooling and practice at business is crucial. The kind of human capital essential to attract FDI clearly depends on the type of FDI host countries seek. In order to be drawn a high quality of international enterprises, it is necessary to develop the tertiary education sector in close collaboration with the industry, formulate demand-driven programmers (Kuemmerle, W. 1999, Noorbakhsh, F., Paloni, A., & Youssef, A. 2001 ,Koji Miyamoto, 2003).

## **2.2. The definition and measurement of foreign direct investment**

The foreign direct investment means any form of investment of enterprises of one country in the company of another country. There are two categories of foreign investments:

- FDI (foreign direct investments) and
- Portfolio investment

What is the difference between portfolio and direct investment? From the degree of influence of capital owner viewpoint, it is considered to be foreign direct investments if an investor owns more than 10% of the voting rights of the company in which directly invests. In practice the terms "enterprise" and "company" are widely used, because they cover private and public companies, organizations, and corporations. On the other side, if the foreign investor invests funds in the purchase of shares exercised less than 10% of the voting rights of the company, investments are considered portfolio investments. Under portfolio investment are also found deposits in banks as well as financial investments in securities issued by the state or the private sector. The phenomenon of FDI can be considered from two related but fundamentally different aspects: the aspect of international funding or

macroeconomic point of view, and from the point of industrial organization and microeconomic aspect. From a macroeconomic perspective, FDI is a particular form of movement of capital across the borders of the national economy towards the host country. The significance of the movement of capital across borders is reflected in the increase of the capital stock in the host country. The microeconomic aspect of phenomena aims to explain the motivation for undertaking direct investment abroad from the perspective of investors. This aspect also studies the consequences of the undertaking of multinational corporation activities or affiliates, arising from these investments, both by investors and the country of investor and the host country. Motives and consequences are intrinsically interlinked with the control affiliates of foreign investors and the ability of multinational corporations to coordinate activities of the parent companies and subsidiaries abroad. The way of defining the notion of FDI differs depending on whether the definition is established for the purpose of compiling the balance of payments or for research purposes. The term FDI has a different definition in the various countries, and the definition itself changes over time. Definition of FDI which is in use today from the International Monetary Fund (1993) and approved by the OECD (1996) ignores the idea of control for something unspecific concept. Direct investments are a category of international investment that reflect the emergence of when a resident located in one country (foreign direct investor or parent company) achieve lasting benefits over the enterprise which is a resident of another country (Lipsey, R. E., Blomstrom, M., & Goldberg, L. S., 2001). The long-term cooperation between the direct investor and the company's affiliate ensure the realization of the long run interests which indicate the existence of the influence of investors in the management of the company that is a resident of the other country. Such investments include both the initial transaction between the two entities, and all other operations between them and affiliations established for which exist applicable corporate governance, but also for those who are not under the control of a particular parent company. The definition of FDI is not precisely defined as a concept, but its concrete application is more specific. The United Nations Conference on Trade and Development (UNCTAD 2008) defines FDI as a long-term relationship between companies in the home country (the investor) and one more company in the host country (country of investment). According to this definition, the company of origin (the foreign investor) is defined as the company that owns assets in another company or production unit that belongs to a country other than its native country. To adhere to this definition of foreign investment, the investing company has to hold not less than 10% of the ordinary shares or the voting power of the board of the registered companies or their equivalent of other companies. The

local companies are labeled as subsidiary units or affiliates. The established conditions for owning of at least 10% of share companies in which it invests entitles the direct investor to influence or participate in the management of the company, but does not mean one absolute control over the direct investors” ( Lipsey E. R. 2001). In difference to the definition given by the International Monetary Fund the definition which comes for compiling the balance of payments, there is a different concept and a different official definition of FDI under the USA system, which retains the idea of control and reflects the micro attitude in defining the phenomenon. In the context of this system, which registers the production, consumption, and investment, rather than a description of the entry of capital flows, there is no definition for enterprises that are under foreign control. Companies under the international supervision of subsidiary units are the companies which hold more than 50% of shares by the parent or the holding company. Associated companies in which the foreign state investments in shares 10% -15%, may be included or excluded from individual countries to a qualitative assessment of the participation of foreign control (Lipsey E. R. 2001). As a result, regarding the host country, as well as for the analysis of production, employment, and trade, control remains a priority in the definition of FDI. In recent years, U.S. Department of Commerce has accepted the definition of FDI approved by the IMF and the criteria of 10% as a threshold for the control of assets. Unlike regulations from 1950, the last review states that direct investments are related to ownership of one person, and not the property of all citizens in the country (Lipsey E. R. 2001). However, the term person is broadly defined and includes various types of organizations or even affiliated groups. The last category consists of "two or more people who use their voting privileges in a consistent way, the realization of activity according to the agreement or arrangement, with the aim of exercising influence over the management of the companies. Abandoning the idea of control is not only due to differences in the criteria by which they determine direct investment compared to the theoretical models of the phenomenon. Investments companies may constitute as an integral part of several multinational companies from several countries. Duplication of data on investment flows and the overall investment condition is avoided allocating financial aggregates an affiliate of the different owners according to the degree of their property. Headquarters operators, not the end holder, determine their nationality. Therefore, a company that operates in the United States and which has one or more affiliates in property across national borders is classified and as the parent company in the United States, although it is under the control of foreign firms. For this reason, a business in America can be designated as the US parent company and as an affiliate of foreign start-ups in America. In most cases, an investor and assets that

are managed abroad represent business enterprise. In this kind of cases, the investor is typically referred to as a parent (or parent company), and assets abroad as an affiliate or subsidiary company. According to Kindleberger (1966), direct investments are a form of international movement of capital. However, economists are trying to interpret as a direct investment movement of capital which is characterized by a few special features. First, direct investments often are not accompanied by the transfer of capital, since foreign investors can borrow the capital from the local market of the host country. Alternatively, investments are undertaken in some degree, through the exchange of rights ownership of patents, technology or facilities in return for shareholder rights without transfer of cash funds. Therefore, FDI is one of the forms of capital movements, although they are more than just a movement of capital (Lipsey E. R. 2001). A similar definition regarding this phenomenon is given by Dunning (1970), which states that something other than financial capital is included in international direct investment. FDI is carried out and the transfer of managerial or technical skills in management on one side, and the distribution of knowledge and entrepreneurship in the form research and development, manufacturing, marketing knowledge, managerial skills on the other. There are three major foreign direct investments (UNCTAD, World Investment Report 2003). Investments in shares of 10% or more which have the common voting rights in the joint-stock company are usually considered as a limit to control the assets. In this category are included mergers and acquisitions and the establishment of new facilities, so-called greenfield investments. The mergers and acquisitions are a major source of foreign direct investment in developed countries. Another form of investments is inter-company loans or intra-company debt transactions, which refer to the category of loans and short-term and long-term borrowings, franchising, licensing, and participating in the production.

### **2.3. The Determinants of FDI: Empirical Evidence**

The literature examines numerous factors that explain FDI. Some of these factors are integrated into the formal hypotheses or in other theories of FDI, while others are recommended because they make sense instinctively. Most of the factors used in empirical studies appear in UNCTAD (2013), the descent of the determinants of FDI. There are many factors often quoted in the econometric studies. In the following titles, some of the influencing factors and their acknowledgment will be outlined in previous FDI studies

#### **Market Size**

According to Chakrabarti (1998), market size has the biggest and the most important place in FDI determinants. In using a thoroughly bound analysis, Chakrabarti examines the likelihood

of a host of variables concluding that most are highly subject to conditional variations. According to this research, the market size grows to a certain critical value then FDI will increase with further expansion. Nicolini (2008) noted that the market size as quantified by GDP or GDP per capita seems to be the most robust determinant of FDI in econometric studies. Jordaan (2004) mentioned that foreign direct investments in countries with expanding markets have more predominant shopping potential, in which companies may receive a higher return on their capital peregrinate, and implicative insinuation gets more profit from their investments.

### **Country's openness**

According to Liu, X., Buck, T., & Shu, C. (2005), inward flows of FDI are positively correlated to economic growth and the level of openness of the economy. Charkrabarti (2001) found evidence of a correlation between the FDI and country's openness. The hypothesis which remains valid states: For the investment projects in the tradable sector, a country's level of openness to international trade should be an important factor in the decision making process. Jordaan (2004) argues that the impact of country openness on FDI hinge on the different type of investment. When the type of investments is market-seeking, country trade restrictions (restricted openness) might have a positive influence on FDI. The reason for this comes from the hypothesis of "tariff jumping" and which claims that foreign firms seek to adapt to local markets can decide to create divisions in the host country if their main products are imported into the country. At the contrary, multinational firms engaged in export-oriented investments might prefer to invest in the high scale open economy since incremented limitations that accompany trade bulwark implicatively imply greater transaction costs which are associated with exporting. Wheeler and Mody (1992) observed a strong positive support for the hypothesis in the industrial sector, with a weak link in the electronics industry. According to ODI (1997), it is verbally expressed that while access to specific markets, judged by their volume, size, and magnification is paramount, and local market factors are certainly much less in export-oriented foreign firms. A range of research reviews suggest that the economies that are considered as open encourage more foreign investments.

### **Labor costs and productivity**

In the Bevan, A. A., & Estrin, S. (2004) researches we find that unit labor costs are negatively associated with FDI which supports the hypothesis that foreign investors are cost sensitive.

Chakrabarti (2001) argues that wages, as a labor cost indicator, were the most controversial of all possible determinants of FDI. In theory, the result of careful work in multinational environment attraction is accessed by the dependency hypothesis as well as the assumption of modernization, but with very different suggestions implicated. There is, however, no unanimity even among the fairly minor number of studies that have explored the role of wages affecting FDI: labor costs are an important component of total production cost and productivity of firms. In the empirical analyses, we often encounter wage variables since it applies in particular to labor-intensive production activities that higher wage might determine FDI. There is no agreement in the literature concerning the role of wages in FDI attraction. Blomstorm, Magnus, Steven Globerman, and Ari Kokko (2002) in their researches have shown that higher wages are not attractive for FDI. According to the Overseas Development Institute (1997), it is expressed verbally that empirical research has found that additional costs of labor are statistically paramount, especially for investment in labor foreign industries and subsidiaries focused on export. Nevertheless, when the labor cost is relatively unimportant, the know-how of the workforce is possible to have an influence in the decisions regarding FDI location

### **Political risks**

The ranking political risk among the determinants of FDI remains relatively obscure. According to ODI (1997), when a country which hosts the investments is rich in natural resources, no other incentives may be necessary as it is visually perceived in politically unstable countries, where high yields in the cumbersome heavy industries seem to balance the instability in the political scene. In general, as the foreign company is confident enough to operate with expected profitability without taking additional risk of personnel and capital, it will perpetuate to invest. For example, numerous major mining companies resolve some of the political risks by investing in their security forces and infrastructure maintenance. In integration, these companies are not inhibited by the strength of local markets or by the foreign exchange risk because they incline exclusively for sale on the international market prices in hard currency. Correlation between FDI and political instability is never proved with the empirical evidence, and it is still unclear. Political instability (the probability of a regime change) was considered paramount, while political violence (i.e. the frequency of political assassinations, politically motivated strikes, and riots) was found to be ineffective.

## **Infrastructure**

Infrastructure contains several segments, starting from land roads, sea ports, railways and telecommunication systems that are key for institutional development. According to ODI (2013), the infrastructure in general can be perceived visually both as an obstruction and as an opportunity for the foreign direct investments. According to Ancharaz (2003), the number of phones lines per 1000 inhabitants is a standard quantification in the literature for the development and improvement of infrastructure. However, according to Elizabeth Asiedu and Anne P.Villamil, (2002) this quantification is not valid because it does not capture the availability of the infrastructure. Also, it includes only the online infrastructure refined and non-cellular (mobile) telephones.

## **Magnification**

The role of intensification in attracting FDI has been the subject of many types of research and controversy. According to Charkrabarti (2001), the magnification hypothesis developed by Lim (1983) states that a fast growing economy offers relatively better opportunities for creating profits than the ones growing gradually or not increasing at all. Frey and Schneider (1985) find a considerably positive effect of magnification on FDI. The majority of the research on FDI in developing countries has concentrated on quantitative nature (Tsai, 1994) of the different factors and is relatively easy to be measured. Progressively, researchers are coming to the assumption that FDI is influenced by more qualitative (nature) determinants, and hence, they are not always possible to directly measure.

## **Fiscal policies**

Whether taxes play a decisive role in FDI remains unclear, and the literature remains mainly indecisive. Many studies on the effects of taxes on FDI disregard strategies on tax planning which are used by investors to decrease their level of taxation. However, activities on the importance of tax planning are growing significantly. OECD (2008) research encourages the researchers to factorize the effects of activities on tax planning when studying the impact of taxation on FDI. The competition of taxes in attracting the FDI is very intense in today's global environment. Investors regularly match the burden of taxes in different places.

A widely accepted view is that taxes are likely to be more considered in choosing location of an investment if non-tax barriers are removed and as national economies converge (OECD, 2008).The above mentioned theories bring us to the conclusion that taxes plays both positively and negatively role on FDI. For example, trade barriers, workforce's costs,

exchange rates, and taxes in different studies have been found to be positive and adverse effects of FDI. In the empirical studies, various consolidations of these determinants as explanatory factors have been utilized. Simões, António Jacinto, José Ventura, and Luís AG Coelho (2015) states that because there is no consensus on a theoretical background, there is no-common ground for explanatory factors that can be considered as determinants of FDI.

#### **2.4. Types of FDI in the Global Economy**

There are many theories which attempt to define the determinants of FDI. Development of these theories is in the critical stages of the direction of development of a regular agenda for the development of FDI. Thus, the capacity of each of the theory to accommodate as a general theory, which could expound all types of FDI, has been inquired in the works of different authors. Dunning J. H is most referenced by various authors working on the subject of FDI. Dunning J.H (1993) explains three major types of FDI which are based on the motive of the investment from the standpoint of the investing firm. This first type of FDI is called market-seeking FDI, and the aim is to accommodate for the local and regional market. A firm may place production close to the consumers and make replication of its production for country abroad to save on costs of transportation. This type of investment is known as horizontal FDI, and it is related to trading in different goods to parties outside of the firm. Tariff-jumping or export-superseding FDI is an irregular type of FDI. Since the motive for horizontal FDI provides better settling to a local market to local production, the size of the market and its development for the economy of the host country play important roles. Difficulties in entering in local markets, such as customs tariffs and transport costs encourage this type of FDI. The second type of FDI is called resource-seeking. This type of FDI occurs when firms invest in a foreign country to attain resources which are difficult or not available in the countries of origin, such as natural resources or labor at lower costs. Particularly in the industrial sector, when foreign direct investments to be able to export, the cost factor becomes essential. In difference from the horizontal FDI, the vertical (export-oriented FDI) involves relocating components of the production to the host country. The availability of low-cost labor is a major driver for export-oriented FDI. Logically, FDI in the major resource sector, such as gas and oil, and it is appealing to countries to a lot of natural endowments. The third type of FDI called efficiency-seeking, takes place when the firm can gain from the effective governance of geographically dispersed activities in the presence of economies of scale and scope.

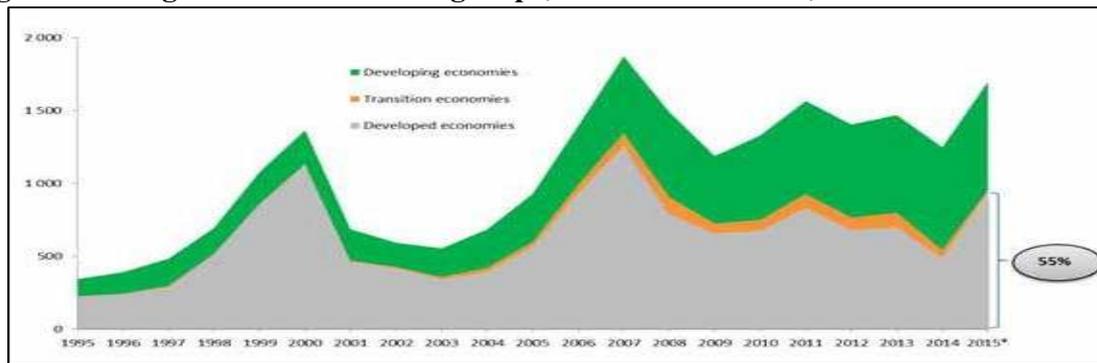
## **2.5. An overview of general trends in FDI**

The last economic crisis led to a significant drop in foreign direct investment (FDI) globally. The fall in FDI was recorded in transition economies and emerging economies. The trend regarding the post-crisis and recession affects the economic and social development, and growth of these economies. The recession and the "fear" on one hand, and the "evaporation" of internal sources of funding or the availability of external sources due to the credit crisis and the rising cost of debt on the other hand, are the fundamental reasons for this trend in FDI flows. The economic crisis and the drop in FDI led to a decline in economic activity, and thus a reduction in employment due to which expected to increase the risk of social and political instability. For this reason, a stronger presence in the country in overcoming the effects of the crisis, including through the intelligent management of investments in the real sector (Hufbauer 2011). The presence of the state is growing in the energy sector, automotive industry, agriculture, pharmaceuticals, and telecommunications. This trend affected the strategists of private companies and banks to become aware of the growing role of the public sector, but also new players in the global financial market (National Investment Funds - NIF) in defining the new management strategy and development.

## **2.6. Economic growth and instability in the period after crisis**

Foreign direct investment (FDI) is considered the most stable form of capital movements in turbulent times. It is also known that FDI brings various benefits to the host country, which is reflected in the introduction of new technologies and know-how, but also through increased employment. These phenomena inevitably affect the growth in productivity and economic growth of the host country. However, during the global economic crisis, FDI have proved to be not as elastic as initially had been thought. The crisis has affected to a significant decline in FDI globally. For seven years after the outbreak of the crisis, FDI is not recovered even closer to a record level before the crisis in 2007. However, they are still around 28% below the level at which they were in 2007 (World Investment Report 2008). There are basically two reasons for this phenomenon. First, internal sources of funding are through retained earnings and lower dividends vanished due to increased demand, while external sources became unavailable due to the credit crisis and the rising cost of debt. Another reason is the severe recession that has hit some countries, especially developed countries, as well as the prevailing "fear of fear". Slower growth of FDI in 2013 met the expectations, so it is assumed that if there are no macroeconomic shocks, FDI in the coming period will have a moderate but stable growth (\$ 1.75 trillion in 2014 and \$ 1.85 billion in 2015).

**Figure 1. FDI global and economic groups, from 1995 to 2015, in billions of \$**

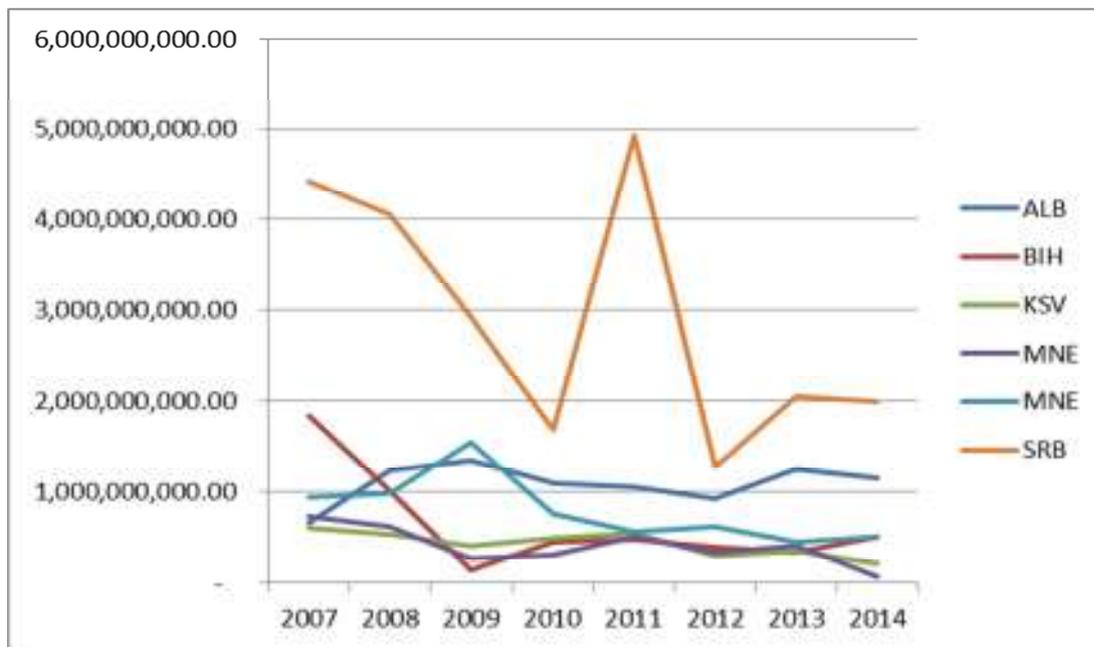


Source: ©UNCTAD.

Global FDI flows jumped 36% in 2015 to an estimated US\$1.7 trillion, which is the highest level since the global economic and financial crisis of 2008-2009 (figure 1). The economic crisis or the drop in FDI led to a decline in economic activity around the world and thus has reduced employment. The fall in employment on one hand and the introduction of appropriate state measures on the other leads to social turbulence, namely the appearance of social and political instability. These are the basic reasons for the removal of "hidden hand" of the market and a stronger presence of the "visible hand" of the state in overcoming the effects of the crisis, including the intelligent management of investments in the real sector. The presence of the state is growing in the energy sector, automotive industry, agriculture, pharmaceuticals, and telecommunications. This trend affected the strategists of private companies and banks are becoming aware of the growing role of the public sector, but also new players in the global financial markets (National Investment Funds) in the definition of new management strategies and development. Slight recovery and growth of FDI in the coming period also indicates the legitimate need for intelligent management of investments by the state as well as a meaningful strategy of eventual privatization of strategic sectors, especially in transition countries such as South Eastern European countries. Particular emphasis must be placed on creating an environment for attracting FDI, which includes fundamental and radical institutional reforms. The author here is primarily referring to the transition processes in Bosnia and Herzegovina, Macedonia, Kosovo, Montenegro, Serbia, and Albania (SSE6). According to World Bank report (shkruje vitin e raportit), these countries have a slight increase in FDI for 2015 compared to 2014. Foreign Direct Investment in Albania increased by EUR 168.93 Million in the fourth quarter of 2015 followed by Serbia which increased by EUR 124 Million in March of 2016, Macedonia increased by EUR

36.43 Million in February of 2016, Kosovo increased by EUR 26.30 Million in February of 2016, and Montenegro increased by 757,435.19 EUR in 2015 (Trading Economics 2016). The auto industry (Serbia) and financial sector (Macedonia) were the most successful sectors.

**Figure 2 .FDI in countries SSE6, 2007-2014, in \$**



Source: The World Bank

## 2.7. The issue of unemployment in transition countries

Unemployment in transition economies is a growing phenomenon. World Economic Situation and Prospects (2013) concludes that “reducing unemployment should be one of the top priorities for the economic policy” in transition economies. International Labor Organization paper discussing unemployment notes that this “challenge requires coherence and coordination across several ministries and labor market institutions” (World Economic Situation and Prospects 2013). Under communism, state-owned industries employed a large number of workers, but when these countries switched to free markets, people lost their jobs because of privatization. After the fall of communism, the state bureaucracy decreased in size, so many government employees lost their jobs. The transition process has created new jobs, but in place of old ones enabled by the communist government, consequently these new jobs only transferred those already employed and did not create new jobs (Hensman, 2001). Transition economies are making their way toward market economies, and those that have joined the EU have made considerable efforts to do so. The conducted studies before transition countries entered the EU (first, ex-Communist countries acceded to the EU in

2004) are still prevalent because they provide the background and framework for the situation of the transition economies. Many of the CEEC are still dealing with the problems discussed before accession. EU accession has caused changes in some countries, but transition countries inherently have a more difficult time attracting new firms to decrease unemployment quickly because of their past economic and governmental policies. There are two prominent issues in current literature regarding unemployment in transition economies. Although scholars note other factors, the majority of their discussions concern: 1) low job creation, and 2) a large tax wedge (Jan Rutkowski & Stefano Scarpetta, 2005). A significant cause of low job creation in transition economies is the limited growth of firms, both domestic and foreign, (Rutkowski 2003), as well as poorly organized labor markets and inefficient job centers and job searches (William Carrington & Tara Vishwanath, 1994). Increased demand for more efficient job assistance centers can attract private firms to aid in the job search. The ILO 2013 Country Assessment Report on Croatia provides analyses of macroeconomic development during the global crisis. The job creation is a critical process in decreasing the unemployment, and even though it seems obvious, yet it is not since other factors involved make the process complicated. Reforming job search assistance creates a demand for more job assistance firms while also help to decrease the unemployment rate (OECD 2014). Therefore, people can be employed in the new job assistance firms while helping others to find employment. The ILO comes to this same conclusion almost ten years later. Unemployment has been a problem for all CEE countries for many years, and it is still an issue today.

## **2.8. Chapter Conclusion**

The first part of this chapter has provided an overview about FDI, definitions, and theoretical framework for the relationship of FDI with the human capital. This chapter has delivered a critical review of different theories which have been developed to clarify FDI and relationship with human capital. The review has acknowledged a substantial number of potential determinants of inward FDI and human capital was only one of them. From the studies provided, as a determinant of FDI the human capital did not provide reliable arguments on why it may attract FDI.

Having found no clear and specific basis for an association human capital and inward FDI in FDI theory, the chapter searches an analysis of the role of human resources in country economic growth. Consequently, the instruments through which human capital might affect inward FDI are productivity improvement, acceleration of innovation, and acceleration of

technology adoption. Relevant transition-specific factors that may influence the relationship between human capital and FDI will be discussed later in this research.

### **Chapter 3: Regional Experiences - Key features of FDI in Western Balkan Countries**

#### **3.1. The importance of FDI for transition economies**

After the economic changeover from centralized and planned systems to market-oriented systems, an increased interest in Foreign Direct Investment (FDI) in transitional countries has occurred. By this, many of these countries accomplished the transition by paying subsidies to attract FDI, with the justification that social returns to FDI exceed private returns due to productivity spillover from FDI to domestic firms (Hanson, 2000). These appeared as positive externalities in the form of raising a country's technological level, creating new employment, and promoting economic growth (Blomstrom and Kokko, 2003). Because of the significance of positive external variables that recipient countries experience from inward FDI, the determinants of FDI have been drastically examined. Host nations have benefited from knowledge and technology transfers to home companies and the labor force. They also gained from increased competition and improved access to foreign export markets, notably in the source country. Thus, FDI is considered a vital catalyst for economic transformation in the transitional economies. This critical factor is seen as provider of sufficient financial resources for the acquisition of new plants and equipment. Also, it is considered in the transfer of organizational formats of relatively more technologically advanced economies (Kokko and Blomstrom 2003). When the inflow of foreign resources results in a rise in domestic saving rates in the receiving countries, a positive spill-over occurs. These arise through linkages with local suppliers, competition, imitation, and training. Kokko and Blomstrom (2003) state that despite the fact that spill-over studies seldom reveal whether multinationals (International Organizations) can extract all the benefits that the new technologies or information generate among their supplier firms, it is still reasonable to assume that spill-overs are positively related to the extent of linkages. Thus, it is assumed that spill-over benefits are sufficiently large to justify investment incentives. The significance of FDI exists in its ability to enhance competitiveness in local markets of the host country. The results of this are demonstrated by correction of domestic market failures which reflect the spill-over advantages. The entry of foreign firms into host country markets increases the demand for locally produced products in the host country. This results in the entry of other new companies and product varieties into the less competitive sector and reduction in

production costs. Therefore, an increase in competitiveness attracts additional foreign investors into the country which raises national income and welfare. This compels the host country to subsidize FDI, creating so competition with other host countries that see the same potential gains. However, FDI can result in negative spill-over as well if it forces domestic enterprises to shut down due to their inability to obtain the necessary resources for financing their activities, or for upgrading their technology (Jansen and Stockman, 2004). Harrison (1993) and Blomstrom (1986) found that foreign presence lowers the average distribution of a sector's productivity, but they also observed that the effect is more significant in sectors with simpler technology which means that the presence of foreign companies force local companies to become more productive in areas where the best practice and technology depend on their capability. Western Balkans during 2014 was characterized by weaker economic growth compared to the previous year. Performance weakening of economic activity in the Western Balkan countries in 2014 has led to economic growth estimate to be only 1.8 percent (CBK, Macroeconomic development report, 2015). The low rate of inflation at the global level as a result of falling prices in international markets and lower demand in the region has resulted in lower rates of inflation in the Western Balkans countries. The common characteristic of the Western Balkans remains the current account deficit in 2014 increased further. The fiscal sector in the Western Balkan countries is characterized by improved budget balance, while the public debt has continued to remain high. The banking sector in the Western Balkan countries in 2014 was marked by various developments, which in some countries lending increased in others decreased. Regarding deposits, their growth trend has accelerated in most countries of the region. The economic recovery that characterized the Western Balkans during 2013 appears to have been fragile since the economic activity performance in the first half of 2014 in these countries seems to be worse. Economic growth in the Western Balkan countries in 2014 is estimated to be 1.8 percent, which represents an increase lower than the initial forecast. Review of economic growth for the Western Balkan states has been attributed mainly to a weak economic recovery in the European Union in 2014 and unfavorable developments in some countries of the Western Balkans. Within the countries of the region, the economy of Macedonia was an exception, being characterized by strengthening the economic growth rate in the first half of this year. Consequently, the IMF has forecast real growth of the Macedonian economy by 3.4 percent in 2014 (Table 1). Economic activity weakened during 2014, especially in Serbia and Bosnia and Herzegovina characterized by the economic decline of 0.5 percent compared to the growth of 0.7 percent in 2014. Economic activity in the six countries of the Western Balkans

is generally marked by the poor performance of industrial production and the slowdown in the construction sector.

**Table 1. Western Balkans Real Economic growth**

Countries	2008	2009	2010	2011	2012	2013	2014
Kosova	7.2	3.6	3.3	4.4	2.8	3.4	3
Macedonia	5	-0.9	2.9	2.8	-0.4	2.9	3.4
Serbia	3.8	-3.5	1	1.6	-1.5	2.5	-0.5
Albania	7.5	3.4	3.5	2.3	1.1	0.4	2.1
Montenegro	6.9	-5.7	2.5	3.2	-2.5	3.5	2.3
Bosnia & Herzegovina.	5.6	-2.7	0.8	1	-1.2	2.1	0.7

**Table 1. Source: IMF (WEO 2014)**

Demand generally was poor in the region, followed by the low level of inflation on the global scale as a result of falling prices in international markets (especially food), has contributed to the economic environment in the countries of the Western Balkans to be characterized by low rates of inflation. In 2014, Montenegro had deflation of 0.6 percent. With a low level of inflation deal, similarly other countries in the region, Serbia experienced the highest inflation rate in the region (2.3 Percent in 2014) (Figure 6). Labor markets in the Western Balkan countries still share some common characteristic such as high rate of unemployment, especially among youth and women, as well as long-term unemployment. According to the IMF, in 2014, the average unemployment rate in the Western Balkan countries was expected to be around 24 percent. Kosovo continues to be characterized by the highest unemployment rate of 30 percent, while Albania is expected to have the lowest unemployment rate of 14 percent in 2014. Particular challenges for the Western Balkan countries also include the high level of current account deficit that continues to characterize the external sector of those states. Almost all countries are expected to deepen the current account deficit except Serbia, which is expected to slightly improve. This deepening on the current account deficit is largely the result of slower growth in exports and imports accelerated growth. Exports of services and goods experienced grow an average of five percent (from eight percent in the last year) while imports of goods are expected to reach 7.0 percent. During the first half of 2014, primarily reflecting the weakening of economic activity, the regional countries as Serbia, Montenegro and Albania reported a decline in lending (CBK 2015). In the same period, easing credit standards by the banking sector are translated into growing loan portfolio in

Kosovo, Macedonia, and Bosnia and Herzegovina. The best overall measure of the importance of FDI for transition countries is the trend in levels of inward of FDI as the share of GDP. The significance of FDI in transitional economies of Western Balkan countries can be seen through the inward FDI relative indicator as a percentage of GDP in the relevant country (Table2). Thus, this indicator enables to uncover the potential effect of accumulated FDI on the overall national economic productivity.

**Table 2. FDI inward stock as a percentage of GDP**

(Percent)							
Region/economy	2008	2009	2010	2011	2012	2013	2014
Transition economies	17.2	33.9	34.7	28.6	30.4	31.7	27.8
South-East Europe	35.5	43.5	49.8	48.3	56.1	58.6	56.1
Albania	22.2	26.9	27.3	34.1	34.9	30.5	33.7
Bosnia and Herzegovina	35.1	32.7	40.4	39.6	38.6	42.7	----
Montenegro	-	-	103	93.5	116	116	112
Serbia	39.3	49	57.1	53.1	63.8	69.2	67.4
Macedonia	41.5	48	46.1	43.9	49.9	50.9	45.3

**Source: UNCTAD**

As viewed in Table 2, the SEEC became much more desirable to investors during the years after 2007. In 2014, the highest FDI stock as a percentage of GDP was recorded in Montenegro (111.7 percent), Serbia (67.4 percent), and Macedonia (45.3 percent). The poorest countries regarding inward FDI stock in 2005 was Albania (33.5 per cent). In contrast to developed countries in Europe where both inward stock and outward stock are present, there is no such case in the transitional economies of the SEE countries. The outward stock of FDI, in comparison to the inward stock of FDI, is low in these countries (Table 3). The explanation for this might be the shortage of capital in the region, and it may indicate the outward stock of FDI. As shown in Table 7, on average, during the observed period (2000-2013), the peak outward FDI as a percent of GDP in Estonia with 19.5%, Slovenia 12.2%), and Hungary 12.1 %. The lowest countries regarding FDI outward, during the observed period, were Albania 0.7% and Macedonia (0.9 percent).

**Table 3. FDI outward stock as a percentage of gross domestic products, 2010-2014**

(Per cent)					
Region/economy	2010	2011	2012	2013	2014
<b>World</b>	31.4	29.3	30.8	34.6	33.7
<b>Developed economies</b>	40.7	38.5	40.8	47.2	45.2
<b>Europe</b>	56.5	54.0	57.5	64.9	59.8
<b>South-East Europe</b>	3.3	3.1	3.7	4.2	4.1
Albania	1.3	1.3	1.6	1.9	1.8
Bosnia and Herzegovina	1.2	1.1	1.4	1.3	1.2
Montenegro	9.1	8.4	10.2	10.2	9.5
Serbia	5.0	4.5	5.4	6.2	6.4
Macedonia	1.1	1.1	1.0	1.4	1.0
Kosova	0.6	0.1	0.3	0.3	0.3
<b>Transition economies</b>	19.7	16.1	17.1	19.0	19.5
<b>European Union</b>	52.6	50.3	53.0	61.0	56.4
Austria	46.5	45.0	51.4	55.0	51.1
Belgium	180.0	178.3	88.1	91.1	84.2
Bulgaria	3.2	3.0	3.7	4.2	3.9
Croatia	7.2	7.2	7.7	7.3	9.5
Cyprus	47.4	46.3	29.5	199.3	180.1
Czech Republic	7.2	5.8	8.4	9.9	9.3
Denmark	51.7	51.6	57.7	58.2	53.7
Estonia	24.8	17.7	24.1	26.9	24.3
Finland	55.5	48.8	58.9	71.6	60.7
France	44.2	43.6	48.6	48.5	44.9
Germany	42.8	39.8	44.7	45.1	41.0
Greece	14.2	16.6	18.0	15.5	14.3
Hungary	17.2	18.9	29.7	28.8	28.9
Ireland	155.4	139.0	185.6	231.1	254.8
Italy	23.0	22.8	25.4	24.4	25.5
Latvia	3.7	3.0	3.9	5.2	3.7
Lithuania	5.6	4.8	6.0	7.0	5.6
Luxembourg	358.0	284.1	483.3	325.0	240.2
Malta	446.1	416.3	468.2	471.8	420.5
Netherlands	119.9	114.6	124.6	129.3	113.7
Poland	5.1	5.6	6.2	13.5	11.9
Portugal	26.1	26.4	27.7	27.5	25.4
Romania	0.9	0.7	0.8	0.4	0.3
Slovakia	3.9	4.1	5.1	4.5	3.0
Slovenia	17.0	15.3	16.3	14.9	12.5
Spain	45.5	43.9	46.9	51.6	47.9
Sweden	76.7	67.4	71.6	72.4	66.6
United Kingdom	67.9	65.5	66.5	58.9	53.8

**Source: UNCTAD, FDI/TNC database**

The global economic crisis effects on FDI flows to the region of the Western Balkan countries have begun the transition process later than other countries, with more problems and challenges. Necessary changes are reflected in the political, institutional, economic, and social environment, requiring fresh capital and domestic sources and they were very limited. Initiated changes have become crucial to the European aspirations of these countries, and future membership in additional costs to achieve European standards in all directions. The level of national savings in the Balkans is insufficient in funding the major change. European funds are available to countries but depend on the country's ability to use them, so that funds

from external sources are necessary since they represent the largest source of FDI. The importance of FDI in the process of transformation and the countries of the CEE was critical. These investments have intensely contributed to the creation of domestic investment, technology transfer, assisted access to foreign markets, reinforced the private sector, contributed to the development of the market economy, and the elimination of macroeconomic imbalances from the previously planned system. While FDI flows have been very generous to the CEE countries in the last decade, only a small part of these flows has been directed towards South-East Europe. The expansion of capital flows on a global scale in the period 2010-2014 has caused a significant increase in capital flows to countries in the region. Inflows of foreign direct investment were important and had a positive effect on the economic and political environment of the region. The significant foreign capital inflow was recorded in Montenegro, which has attracted the largest FDI inflows per capita in Europe.

### **3.2. Western Balkan region as host countries for FDI**

Most of the Balkan countries are labeled as transition economies (IMF 2000). The definition of transition economy implies that economies are moving from centrally planned to market economies (Unctad Stat 2014). The Balkan region consists of ten countries: Albania, Bosnia and Herzegovina, Bulgaria, Greece, Kosovo, Macedonia, Montenegro, Romania, Serbia, and Slovenia. They share similar characteristics related to history, culture, and reforms. Western Balkans is important for the European Union because of location and geographical proximity with EU. After the European Union expansion towards Hungary with Slovenia, and Romania with Bulgaria in 2004 and 2007 respectively, EU began to share the same borders with Western Balkans. Therefore, the economic relations, as well as FDI between Western Balkans and the European Union, were fostered. According to the European Union official reports, Western Balkan countries are Albania, Bosnia, and Hercegovina, Croatia, Kosovo, Macedonia, Montenegro, and Serbia (European Union External Action 2014). Foreign direct investment (FDI) has contributed in the transition economies of Central and Eastern Europe by changing the structure of exports and production processes. Transfer by the accumulation in the regional countries enabled the use of modern technologies based on innovation and results of modern technological research, which was a condition for an increase in the competitiveness of exports and increase benefit as the basis for an increase in export revenues. The liberalization of the trade regime in the Western Balkans has contributed to increasing FDI inflows, which is a critical factor in financing the current account deficit. Thanks to the fact that FDI had a strong impact on the financing of the current account

deficit, the need for restructuring of the real sector of the economy has been postponed. Economic policy makers in the countries of the Western Balkans are expected to allow FDI transfer of modern technology to their countries, which would contribute to the growth of export competitiveness. Many research papers show that most of the Western Balkan countries faced with the fact that the inflow of FDI was mainly realized through privatization, and there are not enough modern equipment and technology through new investments. The result was a smaller impact of FDI on the restructuring of the real sector of the economy so that the competitiveness of exports from these countries is not increased. Insufficient investments in structural changes in domestic production and exports did not allow the creation of conditions for long-term sustainable development. The motivation for investing in the Western Balkan countries could be increased by creating attractive and stimulating the investment climate. The large inflow of foreign investments and structural changes in the Western Balkans could have resulted in increasing exports and reducing the trade deficit. The recent economic crisis has affected FDI inflows towards the Western Balkan countries. Therefore, Balkan countries should create an economic and institutional environment conducive to future FDI inflows. The decisions of future investors in the Balkans will depend on the expected profit and the estimated risk of investment. Modest domestic accumulation and high external indebtedness of most of the Balkan countries are a serious obstacle to future economic development so that for them FDI is crucial. The global recession has affected the reduction of FDI in the countries of Central and Eastern European EU members. Reduction of investment has particularly hit the country in the Balkans that did not participate in the distribution of benefits of the rise of the global economy in the second half of the nineties of the twentieth century, but they are here to share the consequences of the crisis. The reduction of foreign direct investment will create a problem of financing the balance of payments deficit. Large external indebtedness and a low share of exports in GDP of the Western Balkans do not stimulate the inflow of FDI. Creating a free trade zone in the Balkans could encourage FDI when the crisis ends. Despite the inflow of FDI in the countries of the Western Balkans in recent years has increased. Most of the FDI were going to Croatia, which is now part of EU, while the inflow in Albania, Bosnia, and Herzegovina, Macedonia, and Kosovo was trivial. The majority of FDI inflows to the region were associated with the privatization of telecommunications, banks, and oil refineries. There were only a few new industrial investments. The weak regime of intellectual property protection encourages investors to invest in projects that deal more with a distribution than production. Although they passed the Agreement on the Protection of the trade aspects of intellectual property

rights, in many developing countries, including in the Balkans, this issue is also important for attracting FDI, and they did not consider sufficient although it would benefit from adequate implementation.

### **3.3. Impact of Global Economic crisis on FDI in the Western Balkan**

As countries continue to develop, they reached the status of an industrialized nation. Inward FDI contributes to their expansion into the global economy by stimulating and advancing foreign trade flows, where several factors are incorporated. They include the development and reinforcement of international networks of related enterprises and the importance of foreign subsidiaries in international enterprises strategies for distribution, sales, and marketing (OECD 2002). Therefore, FDI can significantly contribute to increasing export competitiveness in the countries that have a higher share of FDI per capita have a greater share of capital-intensive products and products with a high content of skilled labor in export. If foreign investors were motivated to produce parts and components for the production network, they would bring technological and organizational know-how, capital, modern technology, management experience, and knowledge which will have a positive impact on domestic companies. FDI is positively correlated with private domestic investment. The highest level of FDI in GDP in the period 2000 - 2014 had Montenegro. In the countries of South-Eastern Europe recorded a positive correlation between FDI inflows and productivity, especially in the financial sector. Foreign accumulation, given its strong relationship with consumers, before it could be treated as a social shock absorber and as a source of investment, ensured the competitiveness of exports and faster economic growth. If the increase in the deficit in the balance of payments covers the growth in FDI, there is no threat of foreign direct investments accumulation, getting worse is not the level of indebtedness. In the process of transition from 1989-2014, the Western Balkan countries are without adequate external funding, in vain imitated the countries of Central and Eastern Europe. The process of de-industrialization has destroyed a large number of jobs. There was a massive employment layoff in all countries. Industrial centers were the most vulnerable. The lack of competitiveness has caused prolonged problems of balance of payments deficit, while the small level of FDI, caused by the high risk of investing in the region, keeps technological level underdeveloped. Revenues were low so that the majority of households depend on the inflow of remittances. All the problems in the European economy are even more marked under the influence of the destructive effects of the global economic crisis will have a negative impact on export revenues of these countries shortly, the labor market, and an influx

of foreign investment. However, we can expect a slowdown and rising unemployment. Forecasts for all countries in transition have repeatedly been revised downward since mid-2008. Transition countries were exposed to the two shocks: sudden stop inflow of foreign capital and a collapse in exports due to falling global demand. Economies in transition have previously managed to attract significant amounts of foreign capital due to the privatization process at attractive prices and high-interest rates. The lack of capital in the global financial market leads to difficult and unfavorable borrowing, and for the companies complicates the operations of the few Kosovo exporters and reduces demand for all products and harmonization. When it is decided to invest, foreign investors simultaneously assess the risk and potential profits that should bring business activity, so for the Western Balkan countries it is important to influence the future reduction in the risk of investment and improve infrastructure. The increase in competition within the free trade area should create conditions to facilitate the integration of countries from the Western Balkan in the EU. FDI would have a significant influence on changing the structure of production and exports, which would have an impact on the increase of exports to GDP and enhance the competitiveness of companies in foreign markets. A prerequisite for greater inflow foreign capital is to improve the investment climate and domestic investment in total investment. The current economic and financial crisis will affect all countries of the Western Balkans. There has been already a decline in economic activity and the reduction of FDI inflows. The projected FDI inflows in all countries are lower than the proceeds in 2008. Since all the Western Balkan countries already have significant trade deficits, reduced FDI flows will make it difficult to finance these deficits. Even though FDI inflows levels toward Kosovo have increased with some fluctuations, it is still modest in comparison to the rest regional countries. The Western Balkan countries are not reaping the benefits of the globalization process and feel the effects of its primary defects. If there is no acceleration of the process of joining the EU, local disparities are likely to increase, and the region can be quite long to remain on the European periphery, not only geographically, but also in the economic, cultural, and philosophical terms.

### **3.4. Chapter Conclusion**

The first part of this chapter has provided arguments in favour of the importance of attracting inwards FDI from the perspective of the host economies, in general, and Western Balkan countries, in particular. First, it was argued about major problems and challenges on FDI flows to the region of the Western Balkan countries that have begun the transition process

later than other countries. Further in the chapter it was discussed about the tentative and failure of making necessary reforms on political, institutional, economic, and social environment in these countries as major obstacle to the European aspirations of these countries.

The level of national savings in the Balkans is insufficient in funding the major change. European funds are available to countries, but depend on the country's ability to use them, so that funds from external sources are necessary since they represent the largest source of FDI. The importance of FDI in the process of transformation and the countries of the CEE was critical. These investments have intensely contributed to the creation of domestic investment, technology transfer, assisted access to foreign markets and reinforced the private sector, contributed to the development of the market economy, and the elimination of macroeconomic imbalances from the previously planned system. While FDI flows have been very generous to the CEE countries in the last decade, only a small part of these flows has been directed towards South-Eastern Europe. The expansion of capital flows on a global scale in the period 2010-2014 has caused a significant increase in capital flows to countries in the region. Inflows of foreign direct investment were important and had a positive effect on the economic and political environment of the region.

The Western Balkan countries are not gaining the benefits of the globalization process and feel the effects of its primary defects. If there is no acceleration of the process of joining the EU, local disparities are likely to increase, and the region can remain quite long on the European periphery, not only geographically, but also in the economic, cultural, and philosophical terms. The majority of FDI inflows to the region were associated with the privatization of telecommunications, banks, and oil refineries. There were only a few new industrial investments. The weak regime of intellectual property protection encourages investors to invest in projects that deal more with a distribution than production. Although that have passed the Agreement on the Protection of the trade aspects of intellectual property rights, in many developing countries, including in the Balkans, this issue is also important for attracting FDI, and they did not consider sufficient although it would benefit from adequate implementation.

## **Chapter 4: Overview - Human Capital**

### **4.1. Introduction**

The role of human resources in country economic development is evident. It has been already shown that the goal (final purpose) of the development is the welfare of the people who are at the same time the major factor and the recipient of development (Wright, P. M., McMahan, G. C., & McWilliams, A. 1994, Fongag, 2006, Shields, Michelle Brown, Sarah Kaine, Catherine Dolle-Samuel, Andrea North-Samardzic, Peter McLean, Robyn Johns, Jack Robinson, Patrick O'Leary, Geoff Plimmer 2015). Considered as a crucial element in the economic development, the human capital should carry out its potential represented by the effort through its job capitalizing the potential. In general terms, human capital is set of knowledge, abilities, and qualifications which facilitate the establishment of economic, social, and personal welfare (OECD, 2009). In a more precise economic sense, it is defined the as range of technical knowledge and skills that can be employed producing goods and services.

### **4.2. Human Resource Development**

The concept of human resource development (HRD) was introduced in the 1969 Miami Conference of the ASTD (American Society for Training and Development) by Leonard Nadler (Wilson, 1999). As stated by Snell, Scott A., Shad S. Morris, and George W. Bohlander (2015), HRD is a relatively young discipline that emerged in the middle of the 20th century and quickly evolved and grew in importance in corporate circles. According to Ulrich, David (2013), HRD is still shaping its identity, and it is still developing the best ways to make a better workplace for companies around the world. The HR function, according to Ulrich (2013), is crucial for any organization to achieve excellence as a result of learning, quality, teamwork, and fair treatment of people in the workplace. According to McLagan and Suhadolnik (1989), the field of HRD has extended outside development on training and has included a strong connection to corporate strategy, individual responsibility for learning, extension of team learning, incorporation of knowledge management, career development, organizational learning, emphasis on internal consultancy, and the nurturing of intellectual capital of an enterprise. HR management has replaced personnel management not only regarding terminology but also in its content. On the other hand, human resource development, in any case, cannot replace training, which continues to represent the imperative non-formal education. The essential difference between HRD and training is that the development includes a wider range of activities with less specific objectives of training.

Training is designed to learning specific objectives, is focused on the development of individual, and deals with long-term personal and career development.

### **4.3. The initial concept of human capital**

The concept of human resources dates back earlier as to Adam Smith. He said: "The acquisition of talent while education and training; apprenticeship is a practical bill that capital in man." The talent part of it also states the company (Glahe, 1978). The earliest official use of the terminology "human capital" in the economy is it by Irving Fisher in 1897. It was then adopted by different researchers but did not become an important part of a common language of economists before the end of 1950s. Becker analysis and empirical theory, with particular attention to the system of education, was published in 1964. Authors Denison (1962), Becker (1964), Schultz (1963) and many others have given the ground to the human capital theory. By researching of the contribution of the different factors such as production, financial capital, and labor to economic growth in the United States, (Denison (1962) and Schultz (1963) detected the existence of a residual product that they describe (to impute or attribute) to the level of education of employees. According to Kamanzi (2006), education then productivity and earnings increase as long as a similar tool for improvement is seen as an investment. Education then is regarded as an investment, as an instrument for improving productivity and increasing the income (Kamanzi 2006). This economic concept of education is made on two postulates by Jean-Claude Forquin (1997). He states that in an industrial society the proportion of employment that requires a low level of ability is reduced while a high degree of capability requires improvements, the levels of education required increases for the pursuit of jobs because the same missions require more skills. The different hypotheses prove a positive relationship between the accumulated education and income. On a microeconomic level, spending in the educational sector makes an investment provide to the people the opportunity to acquire knowledge liable to prepare them for the productive sector. Education or training then allows the citizens, to have their chances of access to higher-paying and more prestigious employment (Ballantine, J., & Hammack, F. M. 2015). From the macroeconomic angle, the additional revenue in the training of staff creates benefits for the community; the educated labor forces are better paid, and consequently, they are charged more. From the perspective of human capital theory, labor economists have argued that some groups are paid less because these groups have relatively low productivity, as indicated by their lower levels of human capital (Gill 1994, Becker 1993, Lazear, E. P. 1996). Thus, women's lower wages (compared to men's) are seen as a measure of their lower

productivity. Therefore, Sylvester (1988) admits that the neo-classical model of the hierarchy of incomes between workers is based on three fundamental concepts such as the production function for the employer, the utility for the workers, and the optimization of behavior and attitudes of these funds in the market. He shows that the Becker model represents a significant advance in so far as the explanations of the differences of income coming from an objective criterion.

#### **4.4. The other approaches to the human capital theory**

Unlike the neoclassical theory, highlights of the new approaches have included the influence of social factors on the relationship between employer and employee (Kamanzi, 2006). The new hypothesis challenges the linear relationship between education and the socio-economic status of the job performed. Also, the productivity and the content of each of the other factors are dependent. Therefore, Kamanzi (2006) summarizes the different methods of the human capital model in three concepts, each of which corresponds to one the economic theories.

##### **4.4.1. The filter theory**

This theory originates by Spence (1973) and demonstrates that employers in hiring take in consideration other non-economic characteristics of employees and also in regulating the functions and levels of salaries. The theory of the filter refers to properties by terminology such as "indexes" or "signaling" (Kamanzi, 2006). This concept of indexes represents the amount of non-economic and sociological immutable characteristics of workers under ethnic groups and socio-economic backgrounds. Martin Carnoy and Michael Carter (1975) give importance to the concept of signaling in the theory of the filter. This term refers to the modifiable aspects of personality, such as professional experience, general education, and the height of the vocational school (Sunhwa Lee and Mary C. Brinton, 1996). Under these particular conditions, the employer is motivated by a different signal in eliminating some candidates although they have the same level of education with those who have been selected. Education is more an adaptability criterion for the job than a skill criterion for the employment process (Kamanzi, 2006).

##### **4.4.2. Competition theory for the employment**

Thurow (1975) studies two kinds of "queues": a workplace queue and an individual queue. Each workplace has its skill requests, productivity characteristics, and pay scales. Individuals competing for workplace form a queue, their relative position in the queue are being defined by a group of different characteristics such as experience and education which suggest to the employer that the cost of training them in the skills required performing a given job. The

upper a person is in the individual queue there are lower costs of training them and this increases the chances that the person will get a job at the top of the job queue. Hence, in order to be placed higher up in the personnel queue, individuals will invest more in the education of themselves considering that the level of education will increase their relative chance of getting a good job. Gary Becker has introduced the concepts of universal on-the-job training. By doing a specific task, a worker will gain extra skills and capabilities, and that is the meaning of on-the-job training. If the training impact increases the productivity of the employer in doing that particular job, it is a result of on-the-job training. If it increases capabilities of the worker on other jobs, on-the-job training is general. Becker has argued that specific on-job training has to be paid by the employer since "the salary that an employee could get somewhere else would be independent of the amount of training he had received." Companies would have to pay the cost of training, since the employees would not pay for any training which would not benefit them directly (Becker 1962). From the other side, the wages of specially trained employees would only exceed wages which are paid to untrained workers by a margin which is paid by the firm to prevent the high a rate of labor turnover and induced additional training expenses. The major supporters of this theory consider that prearranged skills are not necessary since the skills are taught during the job when one gets a position in the hierarchy of the company. Nevertheless, the theory of competition recognizes the value of education in the individual's training and it questions the statement that education is the guarantee in creating required skills for productivity. The job-seekers are more recruited on their abilities to be trained than in function of their critical skills to produce. Every component of the labor market is considered to be rational. The employer will examine the candidates in line with expected productivity and the cost needed for their training. On the other hand, the employee adapts his/her demand for a function of the market particularity. They could use the level of education to maintain their position in the context of competition (Thurow, 1975).

#### **4.4.3. The market labour structure (the segmentation theory) and the distribution of employment**

Supporters of the theory of segmentation in employment (Peter Doeringer - Michael Piore, 1971; Piore, 1973) consider that the allocation of wages and socioeconomic status depends on the structure of the labor market and the level of education. Neoclassical theorists question the distinction between skilled occupations and unskilled occupations. They consider that the labor market is composed of two parts: the primary sector and the secondary sector. The distinction is required by the quality of the inserts to level the score. The jobs in the primary

sector are less demanding regarding the intellectual capacity. The employees, who come from disadvantaged backgrounds, are paid less. On the other hand, in the secondary, demanding sector regarding training, employees are better paid. This sector is characterized by a hierarchical organization of operations, opportunities for advancement, and certain stability. The segmentation theory admits that the economic pressure of schooling depends on the type of market where the individual is employed (GranhanJ., Shakow D. M, 1990). The human capital theory evaluates the links between the level of qualification and their remuneration. Despite the efforts and the constructive approach, all these authors were criticized. Human capital theory cannot be the minimum level of training of the staff. It does not know what extra level of education for marginal productivity is necessary. Also, education can only contribute in the economic growth when educated people (people with training provided) are capitalized in the labor market. Forquin (1997) minimizes the impact of education on productivity and emphasizes that educational profession specifically could be more to come from the field of experience as a classical school system. Assuming that the labor market is homogeneous, the theory of human capital in the short sample is the distribution of social groups within the company. It does not explain why people unequally are distributed when they have same skill level in the hierarchy. Moreover, it is not possible to determine the experience of employment by the employer or the job seeker in the context beforehand. Despite these limitations (failures), there are various theoretical concepts to establish a relationship between foreign direct investment and human capital.

#### **4.5. Theoretical relation between FDI and human capital**

According to different researchers, FDI is creating endogenous and exogenous effects on the human capital. Marc Dougall (1960) is considered as the developer of studies of the external effects deriving from FDI and their impact on general welfare. Toufik and Bouoiyour (2002) have analyzed its incidence on the welfare and in the structure of the industries. The interest of this research was considering FDI from the perspective of costs and benefits. These authors have presented that the FDI and their effects depended on external public revenue, tax policy, exchanges rates, and trade balance structure of the host countries. Recent studies are investigating causes and effects of the spill-over for the country of origin, as well as in the receiving country. Findlay (1978) worked on a model of FDI and technology transfer between developed countries and less developed countries regarding technical development. It assumes that the world consists of two areas, the advanced area and the backward region. The main criticisms of this model have related to the absence of practicality of the hypothesis

that investors are motivated to experience in a country's a technological backwardness. In postulating, foreign direct investment in a country are attracted by the profitability of investments, the skills of the workforce, and the existence of a sound structured system of innovation, Wang (1990) refers to the Findlay model (1978). Concluded a dynamic model with two countries, Wang (1990) emphasizes the importance of human capital as an element for the attraction of foreign capital and the impact of FDI in high technology on the rise of the macroeconomic aggregates. Wang and Blomstrom (1992) also interpret the technology gap discussed by Findlay regarding the distance between International Organization affiliates and local firms, and argue that its size is one of the determinants of technology spill-over. However, their model is more complex, and separates between the costless contagion-type spillover and spillovers arising from the competition between International Organization affiliates and local company bears a cost of training and realize a substantial investment for the acquisition of new technologies in production. The authors believe that the technology, consumer preferences, which are defined by a utility function, depend on the attractiveness of the products of the respective individual companies. The presented different models have undergone frequent empirical verifications. The results are different from one country to another.

#### **4.6. FDI and productivity of the labor factor**

For numerous researchers, FDI is considered more as technological and geographical distribution than a real sale of technology (Lipsey and Blomstorm, 1994). The technology transfer is also judged by the spill-over effects on the related research and development. Stephen Redding and Anthony Venables (2000) show that foreign researchers consider a positive role in the development when they interact with researchers' work of the host country. This interaction allows the adaptation of foreign technology and increases the transmission process of knowledge (Catin, S. Ghio, Van Huffel, 2002). When the company is providing training to individuals, then individuals receive the knowledge in a similar way with the educational system and parental education (Lévy-Garboua, 1994). Each trained individual receives and transmits knowledge. Subsidiaries of multinational companies employ the employees and the local managers to improve their qualifications. At the end of labor mobility, they can share their experience at the home office, which can be transmitted (Blomstorm and Kokko, 1998). The inflow of foreign direct investment favors a transfer of technology and knowledge. According to the information, affiliates of multinational companies will diffuse towards local firm's positive externalities or spillovers (Blomstorm,

1989) and coverage of positive externalities depends on the level of human capital (Lawrence Katz - Kevin Murphy, 1991). The presence of externalities confirmed the positive correlation between FDI and performance indicators established research using data section (Blomstrom 1994), which recognized that multinational companies contribute to the improvement of production efficiency. As a rule, externalities have an effect when the multinational corporations do not have to adopt the positive impact of the host countries (Blomstorm and Kokko, 1998). Therefore, the productivity of the recipient countries improves if foreign companies bring in new technologies and train leaders who exercise it later in the local companies. The control exerted by multination companies is forcing local companies to work more efficiently and with more positive externalities. From this perspective, Blomstrom and Kokko (1994) suggest that FDI should direct the local companies in the industries in which the technological capacity is relatively important in the way that the multinationals need. Therefore, technological externalities depend on the particular characteristics of the host countries such as human capital, cultural, industrial policy, and the initial technical capacity (Blomstrom and Kokko, 1994). Having in mind this perspective, human capital plays a significant role in influencing FDI performance (Lawrence Katz - Kevin Murphy, 1991). The idea, according to which human capital is a source, Acemoglu and Angrist (2000) tend to think that specialists are more productive and are paid more in a country that is highly endowed in human capital. The theoretical relationship between education and development is valued because of the human development index. Thus, many authors believe that investing in education leads to improved future human capital (Romer, 1986; Barro, 1991). Education is assessed as a mean of preparing and adapting a person in constant transformation and environmental conditions (World Bank, 1991 and 1995). From this perspective, the level of human capital is detained because of the rate of accumulation of human capital and reflects on the degree of education of the population (Robert J. Barro, Jong-Wha Lee, 1993).

#### **4.7. The organization and system of work**

The organization is an organized group of people with a particular purpose, such as a business or government department (Oxford dictionary). Common forms of organization may be from a group of people working together or a group of people working independently with the aim of achieving specific tasks. A business organization brings people together to make a profit and it can be of different shapes and sizes. A business organization may be a small private company with a few employees or a multinational organization with thousands of

employees. Initially Chandler studied three categories of organizations which are multidivisional, functional, and holding company, and for each structure there was an exclusive strategy.

A functional organization is a mean of implementing a single business strategy. A multidivisional structure is used for diversification into multiple related businesses. The holding company is appropriate when diversifying into numerous unrelated businesses. Academics called these structures as the multidivisional or M-shape or unitary or U-shape, and holding company or H-shape (Williamson, 1975). The unit company starts at one location with one product and one person that makes decisions. The transition to a functional organization includes specialization since the departments deal with different duties. If the work continues to extend in branches of different industries and products, then it is in the final phase of transition to the multidivisional company. Organizations do not operate solely, but in a broad and cooperative environment. Organizational environment refers to factors that may affect the organization and can be divided into internal and external. These factors create opportunities and threats for the business. The organization can be seen as a tool for converting resources that are taken from the external environment and make them useful products, goods, and services which are offered to customers in the market. The organization's internal environment is composed of elements within the organization such as employees, management, and corporate culture in particular, which defines employee behavior. Even though few elements distress the organization as a whole, others distress only the manager. The external organization environment comprises of all entities that exist outside its facilities but have a significant influence on organizations growth, survival, and achievement of its objectives. The external environment can be divided into several groups such as competition, technological, political, and legal. People as resources in the organization can also be classified into several groups. Workers (employees) are the main resource for the organization. If an organization employs only unqualified employees, it will be tough to carry out operations. Managers are trained and qualified in analyzing and improving the organization in such way that they place themselves in a complex and constantly changing the market. Trade unions are associations of employees whose objective is to protect and develop labor conditions which derive from relations between employers and employees. The shareholders are the owners of the organization. All these groups represent human resources and they are important for business performance. Management of the organization is a challenging and complex task. The theory on which is the best way to

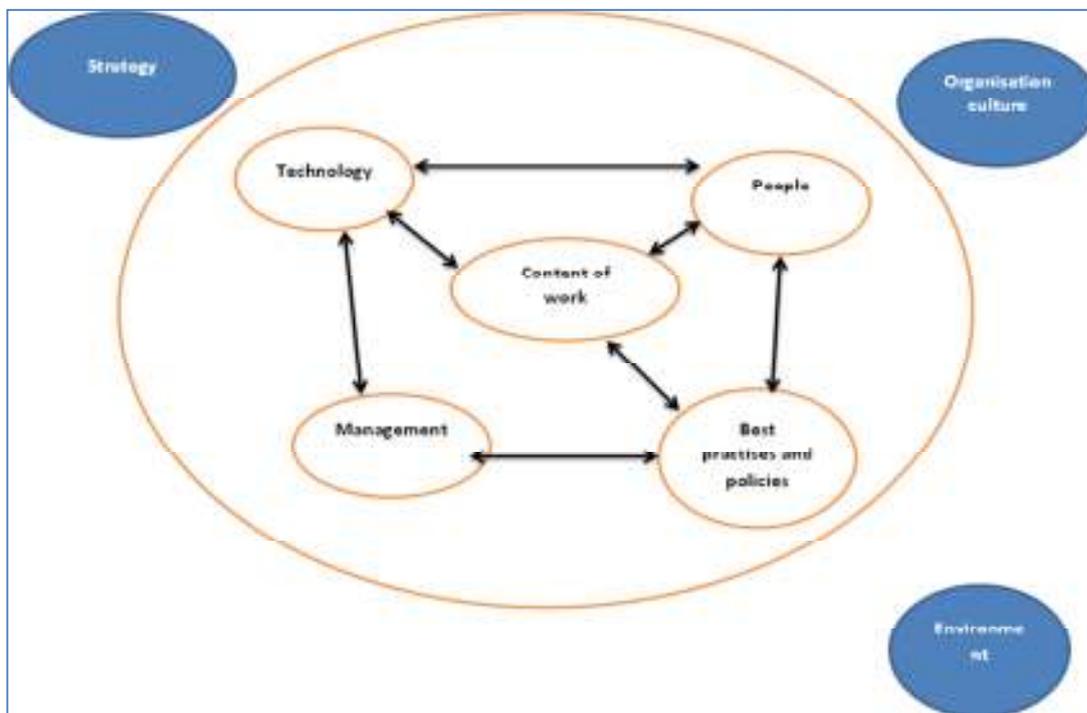
organize and manage business activities significantly changed in the last 250 years. These changes would be best described through four main interpretations that existed in the past:

- "The organization are starting to implement fundamental new approaches and step by step leaving the strict concept of the job description. One factor that is backing the reducing the importance of the traditional business is the increased use of self-organizing teams. Even though the management takes a key role in decisions about which skills are necessary for participation in teams and individuals who will form the team, it is expected that the team will decide about what and who perform the task among the members. By the evolution of the team, the members are becoming more multi-disciplinary, and the tasks that individuals perform often is adjusted not only to the business but also to personal requirements" (Finegold, D, and Lawler, E. E, 2005).
- "The employees do not perform at their best and in the most creative form when they are strictly controlled by management, with very detailed and specific job description, but when they are given more responsibility this encouraged them to contribute more and make them more comfortable at their working places" (Walton, 1985).
- "The greatest improvement in the productive powers of labor, and the greater part of the skill, dexterity, and judgment with which it is anywhere directed, or applied, seem to have been the effects of the division of labor" (Adam Smith, 1776).
- "Possibly the utmost useful particular factor in the modern scientific management is the term working tasks. The management fully plan and organize , at least, one day in advance work of each employee, and every worker in most cases receive complete written instructions, in which are described in detail the tasks to be performed, as well as funds that should be used in the work. The "average" worker will work with the greatest pleasure and competence if his daily tasks are set to be performed in specific time" (Taylor, 1947).

In the past three decades, we have witnessed substantial changes in the organization and the work of its members, and these changes are coming mainly due technological advancement and global competition. Phrases such as dedicated production, re-engineering of production processes, outsourcing, teamwork, production just-in-time, call centers, temporary workers, virtual teams, and virtual operations are just some of the expressions that have been introduced in the management language, and thus, they show how the organizations are trying to respond to changes. There was created a system that coordinates and structures business activities in accordance with technological, economic, and social requirements.

According to the Wall and Clegg-in (1998), designed work is related to the "specification of the content and methods of work" while business organizations "typically characterize a broader perspective that is linking business within the organizational context". Accordingly, we can define the organization of the work as "a way to organize and coordinate business tasks in the broader context of the business system". According to Sinha, Van de Ven-in (2005), and Stafford Beer (1985), an operating system is "an appropriate structure interconnected with subsystems that include the content of labor, technology, skills of employees, leadership style, and practice and policy controlled", as shown in Graph 3.

**Figure 3. Organogram of working system**



**Source: Adjusted according to Stafford Beer (1985), Sinha, and Van de Ven-in (2005).**

Acceptance of the system concept of the business organization has a number of advantages. Initially, it provides a common framework for describing different organizations and coordination of work processes that occur during different circumstances and the use of different terminology. Moreover, this system concept recognizes that productivity in some business organizations is created as a result of complex relationships between numerous business subsystems. Finally, the system takes into account the concept of the interactions with the environment, which is mainly defined by corporate strategy, culture, social norms, economic situation, and political and legal framework. To better understand the concept of

systemic business organization, it is necessary to analyze its main components and relationships.

**The structure of the work** - the structure of any business system is the role of employees in their workplace. The structure of the work is a set of activities that are undertaken in the development, production, and distribution within the organization (Sinha and Van de Ven, 2005). We focus only on a limited number of essential characteristics of the structure of work that do not affect other aspects of the system work in general and which are important for both the organization and employees. These characteristics include the area of operation, control, diversity, needs, and feedback that are directly related to job tasks. The working area varies according to the horizontal and vertical specialization. Some jobs are highly horizontal and require specialization on routine activities that are often repetitive. On the other, the vertical specialization means that jobs can be complex and include planning, decision making, and a high level of capabilities. Control refers to the degree of employee control and has its operating aspects of work such as working speed, respecting deadlines for the performance of certain activities, or adoption of any new strategy. The discretion that an employee has plays a great psychological role for employees regarding motivation and satisfaction at work. Diversity refers to the aspect of the work that shows the level of stability in operating activities over time. In some operating systems, employees rotate jobs or functions in working groups without changing the contents of the work. Although job rotation increases flexibility and allows employees to use more skills and talents, some critics consider that the rotation adversely affects expertise in performing work activity and productivity (Hackman 2002). When we talk about needs of work they may be viewed as physical needs or requirements, although growing need for intellectual-based operation increases requirements that are more intellectual (cognitive) in its nature. In the case of the services industry, recently there is a growing influence of hypothesis that these activities include the need for emotional intelligence and emotional requirements can become very stressful, especially in jobs that are cognitively demanding (Glomb, 2004). Emotional demands can also occur as a result of conflict where from an employee is required to do more than one duty and which have conflicting goals. Conflict can also arise as a consequence of business and other activities, particularly in when we deal with long working hours (MacInnes, 2005). In some working organizations, there is a system of automatic generation of feedback for employees which allows management to assess on how well the job is done. On the other hand, some jobs cannot have automatized feedback resulting in the need to create a system of evaluation. Although the collection of feedbacks can be very useful for

both organization and employees, the feeling that you are constantly under surveillance can lead to mental disorder and a bad influence on business (Stanton JM, Balzer WK, Smith PC, Parra LF, Ironson G, 2001).

**Technology** – Structure of working activities and responsibilities is heavily influenced by technological subsystems. Initially, the technological benefits can directly affect the ability to control work activities (Mintzberg, 1979). In highly regulated and automated technical systems such as robotic drivers or automatic call centers, the possibility of discretion regarding the ways how the workflows (speed, sequence) practically does not exist. Some technological systems are so sophisticated and complex that they fully automatize the cognitive demand for tasks, which results that employees are no longer even aware of the work and task roles they do (Wall and Clegg-in, 2002). Different levels of technological development lead to the fact that some job results are entirely predictable under the specific rules and standard of operating procedures while there is a task which is completely unpredictable due to its nature.

**Leadership** - The style of leadership (managers and supervisors) can shape the structure of the work and connect it with other elements of the business system. For example, a high level of autonomy in work (the right to decide) may be used as a substitute for the transformative behavior of a leader (J. Lee Whittingtona, Vicki L. Goodwinb, Brian Murray, 2004). In contrast, direct involvement of managers or supervisors in the process of allocating the tasks to employees, setting the dynamics of work, and deciding on methods of work will directly reduce the level and scope of discretion enjoyed by the employees. If a job requires highly specialized tasks, there is a need for the first line of management to act as a mechanism for connecting and coordinating the activities of other individuals. If there is a group of related activities and tasks within one organization or activity, then the need for coordination of activities by the management is significantly reduced.

**Employees (People)** - Successfully carrying out of any business activity is directly depended on the level of dedication and ability shown by the employees. Knowledge, skills, and abilities that employees have and are ready to use, create the opportunity or threat in the specialization and increase in the content of work. Working roles frequently do not capitalize completely current knowledge, skills, and talents of employees (Morrison 2005).

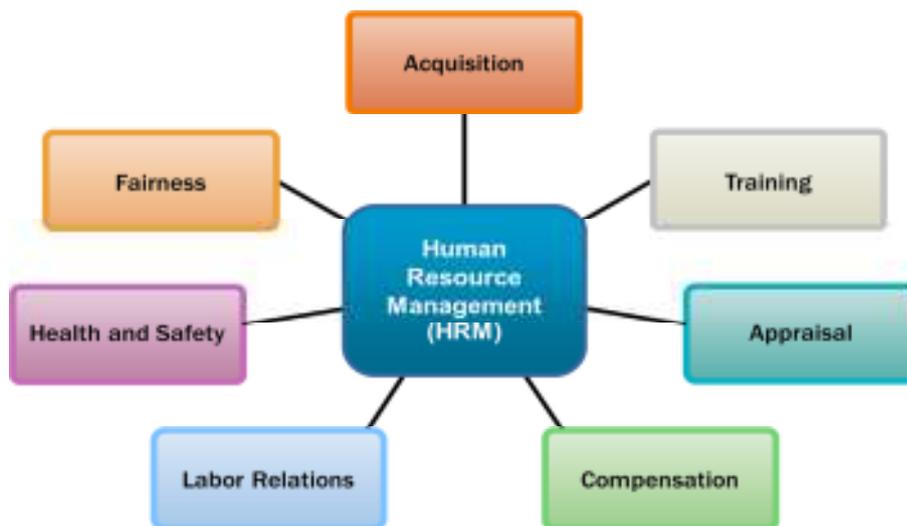
**Management policy** - At the end of each group of tasks and responsibilities, there is a need for a range of appropriate practices and management policies. For an extended period of time, scientists have recognized the fact that different approaches to business systems often associate with the various stacks of human resource management practices (John MacDuffie -

Frits Pil 1996). Models of team effectiveness usually indicate factors of quality organizational context (training, information, and systems bonuses) as key inputs in effective teamwork. In other sources about human resource management, the value of rigorous selection techniques, earnings uncertainty, intensive training and development, the stability in working place, and other methods of pressure on the workers are under criticism (Pfeffer in 1998, and O'Reilly and Pfeffer 2000).

#### **4.8. The development of human resource management**

We have witnessed enormous changes in managing business activities in the last two centuries. The organization has ceased to be the only center of economic activity, but it has developed into a structure where employees work and find safety, create opportunities for career advancements, and fulfill professional and private needs. However, the development of the organization is a consistent process. Today, we witness great diversity regarding size and form of organization, and in particular new approaches to performing work activities. Organizations are becoming smaller and unreliable. Entrepreneurs are no longer able to produce long-term jobs, but they face a market situation where the short term jobs are predominantly present. In large organizations, there is a reduction in the number employees and the emergence of other ways of doing business such as temporary engagement contracts or outsourcing. As a result, in the 1980s appears the expression human resources and which includes scientific discipline, organization, and control function and relationship to the human factor in the organization (Thomas Peters, Robert Waterman, Harper & Row, 1982). As a scientific discipline, the human resource was created by integrating the knowledge of various sciences that have to deal with the issue of people and organizations as shown in chart 2. The aim of the scientific discipline of human resource management is the establishment of the lawfulness for employee commitment and creates the basic scientific assumptions, methods, and procedures for the successful integration and development of human potential in achieving both organizational and individual goals. Human resource management is not only a theoretical scientific discipline, but also, oriented to the practical application of scientific knowledge to (or intending to) the development of organizational expertise, most efficient way of use of human resources potential, and to achieve the objectives of the organization which is primarily oriented to profit.

**Figure 4. Human Resource Management Processes**



**Source: Pearson Education, Inc. publishing as Prentice Hall (2011).**

Many critics of the development of human resources management believe that the new approach initiated at the beginning of the 1980s is not a fundamental change. In the beginning, it was nothing more than a change of name from personnel management to human resources management. Actual changes were made when it was realized that the organization is not unchangeable but constantly evolve in the process of business. These changes resulted in a different understanding the role of human resource managers which is more oriented towards the conclusion of business contracts than towards employment contracts. The key difference between these two types of agreements is that it requires making work becomes easier and more flexible and achieve higher efficiency in the long term, with a focus on competitive advantage (Derek Torrington, Laura Hall, Stephen Taylor, 2004). According to Susan Jackson and Randall Schuler( 2000), human resource management is the basis for comparison of international and strategic management of human resources and includes people management activities, policies, and practices of the company in order to achieve greater competitiveness in the market, it includes all variables that the organization must recognize to respond to challenges in order to secure its own position and competitiveness for an extended period. Dressler (2007) provided the most complex definitions about human resources management: "Human resource management refers to the policies and practices one needs to carry out the people or human resource aspects of management position including screening, recruiting, training, appraising, and rewarding." Although until recently the practice was that the human resources activities are organized by function such as staff documenting, care for awarding, and labor relations, in recent studies there is new an

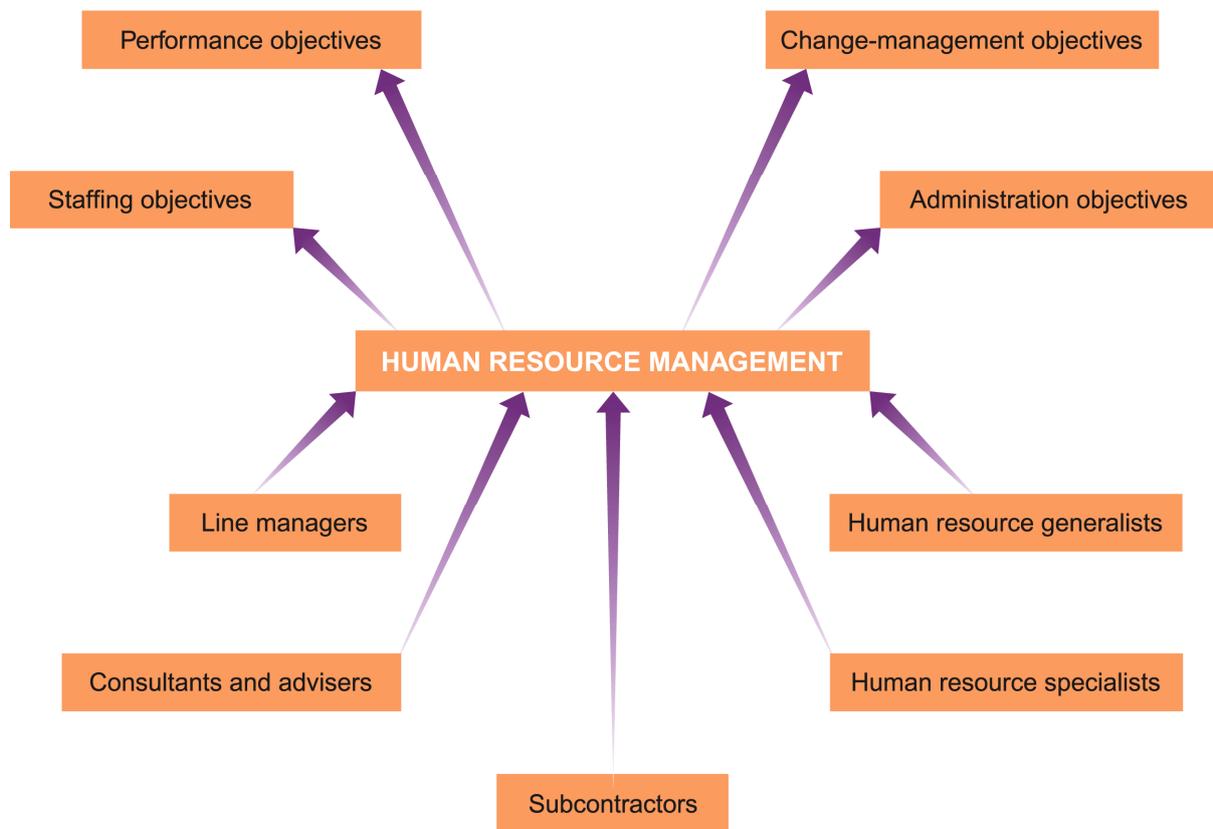
understanding by which the management of human resources represents the starting point that provides support in the organization, plays the role of service, and coordinate various differences between people. Torrington (2004) explains that the term human resources can be divided into two basic functions. One is the traditional and a legacy of personal managers and includes a number of different goals:

- Objectives related to employees;
- Objectives related to work;
- Objectives related to change management; and
- Administrative goals.

Major tasks of human resource managers are providing a sufficient number of suitable people in the organization so that the company can use the quality of human resources that is needed. Among other responsibilities it includes the formation of the organizational structure, the allocation of the necessary human resources, and the selection of people that will carry out assigned tasks. When providing, human resources is ensured that managers are dealing with motivation and dedication to work with assigned people. This is achieved through training and development of systems of rewarding and negotiations with the unions if there are in the organization. The third activity in this function is to position human resource management in the organization to (or intending to) effective change management. Changes are no longer exclusively related to external influence, and they have become an integral part of everyday business. Changes can appear in various forms, but mainly are structural and require a reorganization of activities or the introduction of new people in certain roles. The main activities are related to the recruitment and development of employees who have the ability to lead (leaders), and initiate the process of change and establish a reward system for the ones that resisted changing. Latest activities in this function are administrative and are committed to assisting the successful management of the organization. This includes the collection of employee data, measuring the results of their work, and compliance with laws and regulations. As the organization grows there is an elevated need for a larger number of people involved in human resources management. The importance of training and development has increased significantly. Although for human resources management the organizations usually involve external consultants, within the organization inside experts are involved in the development of management. In modern sources, contracted human resources managers are referred to as consultants, in contrast to previously called as managers. They train line management to such an extent that they can independently determine what kind of training

they want for their employees instead of organized and standardized courses. In addition to these roles experts or specialists, human resource management department deals with recruitment, selection, health, employment, safety, working conditions, compensation, benefits, and human resource plans. If the organizations are smaller, they hire specialists only occasionally. The activities are carried out by so-called generalists, who perform all the above functions individually or in small teams. In larger organizations there are also generalists, but their role is different and prefers a higher level of development policy. All of the above can be best see the chart 4.

**Figure 4. HRM functions and objectives**



Sources: Torrington, Hall & Taylor

The second function according to Torrington is a relationship to the human factor in the organization and which can be seen as a philosophy that regards to the activities of an organization oriented to the people and that is, according to the modern organization, more effective than the personal manager. Since there have been considerable changes on how the organization functions during the recent history and the perspectives on how human resources perceived, the need for the human resources management department became inevitable and critical. Unlike personnel managers dealing with employees as a factor production, human

resources manager role is concentrated on the potential development of employees as a resource for the organization. While personnel managers rarely were managers and dealt with the exclusive use of the existing workforce, the new role of human resources management is directed towards management needs in employment, hiring, and developing of human resources who have permanent employment contracts with the organization or can be outsourced to perform specific tasks.

**Table 4. - Comparative review of personnel management and human resource management**

Dimension	PM	HRM
Perspective	Short-term perspective	Long-term perspective
Point of View	Compliance	The psychological contract based on commitment
Control	External control	Self-control
Perception	Pluralist perspective	A utilitarian perspective
Role	Specialist role	Strategic role
Outlook	Cost-minimization	Maximum utilization

**Source: Torrington, Hall & Taylor (2004)**

The activity of human resources management is based on demand and not on supply, and the recruitment of human resources specialist is a preventive approach to potential problems in the organization. Their work is based on planning, monitoring, and controlling, and it is not mediating between staff and management of the organization. Potential problems are solved in advance at the highest levels of organization management, and not with employees or trade union representatives. The difference between classic personnel management and the human resource management is shown in Table 4. In order to avoid the misconception that the process of changes on how is called personnel management, it is important to mention that in various researchers very often we have term human capital. Human capital is a step forward in assessing all employees and potential employees of an organization. If the employees are seen as capital, then it is understandable that the investment in them is worthy of analyzing, and of course, that is the subject of accumulation capital.

#### **4.9. Forms of investment in human resources**

Human capital is one of the key elements of economic development in the recent knowledge-based era. Education, attitude, skills, knowledge, competencies, welfare, and health have an influence on human capital. Investing in human capital in the same way as investing in other forms of resources is a crucial factor to increase labor productivity of individuals, who have a substantial impact on the quantitative and especially qualitative development of labor force. Availability of qualified labor force ensures both increases of labor productivity and attraction of investments towards entrepreneurship. Investment in human resources requires an understanding of human life in a wider spectrum of existence, including family, school, and work (OECD, 1998). Investments in human capital are contributions in education, professional qualification, health care, and other activities which empower human being more efficiently. According to Schultz, the human capital can be defined as a set of skills and knowledge achieved by individuals as capital in the process of professional and technical education. Such a capital is a yield of well-considered investments, and it generates income (JCJM Van den Bergh 1999). According to Woodhall (1997) and Schultz (1971), the theory of human capital relies on the core hypothesis that education obtained formally is highly influential, in the process of improving the production capacity of a population. The human capital theory claims that individuals and the whole society advance in economic benefits from investments in people (Sweetland, 1996). In short, human capital theorists claim that an educated population is a productive population (Olaniyan, Okemakinde, 2008). According to Babalola (2003), the rationality of investment in human capital is based on three arguments:

- People must be encouraged to be creative and develop completely new approaches to new processes, approaches and products through inventive ideas;
- The upcoming generation must be given the proper parts of the knowledge which have already been collected by previous generations;
- New generation should be educated in how existing knowledge should be used in order to develop new products, introducing new processes, and production methods and social services.

Human capital theory highlights on how education increases the efficiency of workers and productivity by increasing the level of intellectual stock of economically productive human competence which is a product of inherent abilities and investments in human capital (Olaniyan, Okemakinde, 2008). There are several reasons why investing in human capital is an unavoidable part of economic policy discussions. Initially, it is one of the most important

factors for the creation of modern knowledge-based economy, and as such stands out in strategic documents such as the Lisbon Strategy (The European Union, 2000). Then, with the positive impact on growth and development, education stands out a priority of economic policy of countries because of its potential for social involvement and providing additional opportunities for reducing of unemployment and poverty. In other words, it is often considered that formal and informal education can reduce problems like high unemployment and grow social inequality in developed countries (OECD 1996 and The European Union in 2003). Finally, these investments have significant financial levels (on average, nearly 6% of GDP of member states of OECD), so it is important to know whether there is return on investment, at least, equal to the returns on alternative investments. Today, education represents an important factor in economic development, and it is part of one of the most important forms of investment in strategic policies of the countries. Education can be analyzed in a narrower and broader sense. In a narrow sense, education obtained from educational institutions is defined as formal education. It includes activities consisting of the formation, acquisition of general and specialist knowledge, building an important instrument of acquiring these skills such as schools and colleges. Education in the broad definition includes non-formal education. It is not related to any educational institution and includes all phenomena that are out of specific channels of education for people with specific knowledge, which also affect behavior, attitudes, perception on quantity and quality of knowledge. The educational effect, in this case, is the effect of the influence of family environment, as a result of professional experience or a very broad impact on the social environment in which the individual is located. Education is representing the key potential for economic growth. Currently, the contribution of labor to the economy measured by production capacity of people is greater than all other forms of wealth taken together, because investment is very high and people invest in themselves. In the past, labor and capital were taken as the basic factors of production, where the labor factor represented the only executor and it is considered as a quantitative indicator. Education and learning are considered as capital, because they are a source of increasing the value of the organization and employment. This tells us that the investment in human resources is an investment as it is the construction of a factory or a bridge. It also should be taken into consideration that education has an impact on the well-being of the individuals after education as well as ultimately on the whole society. The indirect impact of education is articulated in sharing and spreading knowledge which is typical in the working environment of well-educated people, therefore, increasing the efficiency of each who has gained knowledge from their well-educated colleagues. Moreover,

the individuals and society benefit from an increasing number of well-educated people due to the growing health conditions, decreasing the level of crime, increase of political, and/or economic stability (McMahon, 1999). The greatest form of investments in Eastern and Central European countries are made within investments on formal education or training at work. They achieved to increase productivity, wage/salary, profits and income as a return on investment on the education system, but the amount of investments in human resource development in job places is relatively low (Ederer, Shuler, Willms, 2007).

#### **4.10. Formal education and the environment**

Contemporary research is focused on early education as an investment. Many legislators have considered early education initiatives as a school preparation strategy or as a way to close the achievement gap. Economic experts are arguing that investments in early education may be considered as an economic development strategy. According to Piketty (2015), purchasing power of workers in underdeveloped countries is only one-tenth compared to developed countries, and the fact that the majority of workers in the developed countries have completed secondary education, whereas half of those in the less-developed countries are illiterate, surely education plays a key role on the closing the gaps. Art Rolnick and Rob Grunewald (2003) published a paper regarding the returns on investment of early education in Minnesota (USA). Their results have shown such broad appeal that the authors from different states have been invited to a discussion of these findings. Some of the major findings of research concluded that the investments on early education compared to other state investments yielded a return that far surpasses the return on most other public projects that are considered as a driver for economic development. The report raises relevant issues, like how to build and maintain a sustainable economy of the state. The authors emphasized the role of subventions of state whereas drawing on state experiences, and where subvention did not create substantial gain on the economy. Nevertheless, subsidies to education have been for long time active but authors argue that funding should be directed to early education because of the long-term effects. The report considered numerous researchers when taking into account the Perry Preschool program, where the return on investment was 16 percent, with 80 percent of the benefits going to the general public. The data about model programs such as Perry Preschool for every \$1 invested yielded more than \$8 which is the best way of describing the investment. Rolnick and Grunewald's (2003) use of the rate of return clearly shows the benefits of this investment compared to other investments. Heckman (2004), who is also Nobel Prize winner, has devoted part of his work creating a scientific basis for

assessing the impact of education on economic development. Key findings of his study suggest that the cognitive and non-cognitive skills are relevant to the productive labor force and that weaknesses that occur in childhood are tough to correct later. Since capabilities accumulate from an early age, investing in children is an investment that yields productivity in the future and leads to greater public safety. The majority of analysts agree that today's demand for skilled employees is higher than it was in the past. The contributing factors to the increasing demand for skills in the labor market are organizational and technological changes, the trend of deregulation of key industries trade, and the decline of unions. In response to the requirements of the labor market, where wages of highly educated and highly qualified labor force increased and wages of less skilled and lower educated personnel reduced, the creation of public productive knowledge in economies around the world became crucial. Politicians and social behavior scientists often express concern about political and social consequences of the growth of inequality in the economy. From the end of the nineteenth century to the 1970s, wage inequality reduced in all the developed countries. The timing of reducing inequality correlated with skill gaps narrowing considerably thanks to rapid development of mass education and training, and growing demand for industrial workers with mid-level skills (Piketty, 2015).

There is a consensus that by an increase of expertise and knowledge of unskilled people will enable them to evolve in the modern economy and thus reduce inequality. Also, the increased level of supply of skilled workers would help to reduce differences in wages and inequalities. Thomas Piketty (2015) blames wage inequality in part on "rising inequality in access to skills and to higher education." He put a lack of investment in higher education as the reason Europe is not growing as strongly as the United States.

He thinks that Europe needs to invest more money in training our young people, and in innovation and research. That should be the most important goal of an initiative to promote European growth. According to Piketty, "It isn't normal that 90 percent of the world's top universities are in the United States and our best minds go overseas". The Americans invest 3 percent of their GDP in their universities, while it is around more like 1 percent in European Union countries. That's the main reason why America is growing so much faster than Europe."

In theory, human resources see investment in education as a result of free decisions by people who expect a return on investment. Hence, only an increase in the investment of public funds in education is not enough for an automatic increase of people who choose to educate

themselves. There is a need for more attention in the private return on investment in education, discounted value of future earnings, and current costs of education. In simple terms, the return on investment in education will depend on its costs and future wage premiums. Empirical evidence confirms that countries with higher rates of return on investment in education can expect more people willing to continue with higher education. Education can basically be divided into compulsory and optional. Obligatory education refers to education that is obligatory by law. Obligatory education in most countries in the world lasts between 8 and 12 years and includes basic education and in some countries possibly a secondary education. The optional education today in general means high and postgraduate education. The tendency is to extend the duration of compulsory education, although it is more in the form of state-funded education through subventions or free education for students. Public financing is the traditional way practiced by most countries to promote continuing education after the compulsory program. Secondary schools in most of the countries academic funding is done by the state, while for higher education state subventions are moving in the range from 50% in countries such as Japan, Korea, or the US to almost 100% in some European countries such as Austria, Denmark, the Netherlands, or Switzerland (Blondal, Girouard and Wagner 2001). Regardless of the extension in the average duration of education and increase in the number of people with higher education in the developed market economies in the last three decades, there was shown an increase of wage premiums for educated employees. Thus, in the United States since the beginning of the 1980s, the return of investments in education grew, while EU member states experience this increase at the beginning of 1990. Denny, Harmon, and Lydon (2001) concluded that most of the empirical researchers have shown that international differences in the return on investment in education are affected by structural characteristics of the national economy while the level of country openness did not have a concrete impact on the distribution of income. In other words, growth in premiums on education can be attributed to the rapid technological development and the adoption of information and telecommunication technologies, which led to increasing demand for educated workers. Although discussion regarding trade impact of technology is still ongoing, Henri Desjonqueres and others (1999) emphasize three facts that appear in the sources. Initially, the increase in bonuses for education regarding increased earnings lead to higher involvement of higher education workers in all sectors, not only in that sector that employs intensively educated workers. Secondly, bonuses in all countries are increased. Finally, there is no noticeable decline in the relative price of a product for whose production is used less skilled work. None of the above theories do not support the thesis that

the increase in bonuses dedicated to education was the result of cheap imported produced mostly by less qualified workers. Return on investment in education based on the theory of human capital started to being a record in the 50s of the last century. Many studies around the world in the period of the previous 50 years were conducted based on econometric techniques and supported the theory of human capital (Psacharopoulos and Patrinos 2002). Murphy and Welch (1992) argue that the increase in the difference of wage has emerged in the 80s and 90s of the XX century. Many countries renewed interest in the assessment of return on investment in education. Basically, the return can be divided in the social return or benefit to society gains from investment in the education of people, and personal return or the benefit that individuals receive through their own education. Return on investment in education for an additional year is shown in the table below.

**Table 5. Private and social returns to higher education in 31 countries**

Country	Year	Private %	Social %	Source
Belgium	2004	12.7	10.6	OECD (2008),
Belgium	2004	12.7	10.6	OECD (2008)
Bulgaria	1993	6.5		Giddings (2002)
Croatia	2004	2.1		Vujcic (2009)
Cyprus	1979	5.6	7.6	House and Stylianos (1981)
Czech Rep.	2004	26.5	8.9	OECD (2008)
Denmark	2004	4.3	1.5	OECD (2008)
Estonia	2003	10		Torgo (2007)
Finland	2004	10	6.9	OECD (2008)
France	2004	7.9	7.4	OECD (2008)
Germany	2004	6.4	8.4	OECD (2008)
Greece	2005	7		Mitrakos (2008)
Hungary	2004	16.8	16	OECD (2008)
Iceland	2003	1.9	7.7	OECD (2006)
Ireland	2004	11	11.3	OECD (2008)
Italy	1995	9.3		Brunello (2000)
Latvia	2002	10.6		Hazans (2005)
Lithuania	2004	4.6		Hazans (2003)
Luxembourg	1996	7.6		Heinrich (2005)
Netherlands	1996	8.1		Heinrich (2005)
Norway	2004	8.1	4.1	OECD (2008)
Poland	2004	20.7	14.6	OECD (2008)
Portugal	2004	22.7	11.2	OECD (2008)
Romania	2000	8.5		Andren (2005)
Slovak Rep.	1992	4.2	4.2	Newell and Reilly (1999)
Slovenia	2004	10.2	10.2	Polanec and Ahcan (2007)
Spain	2004	8.2	5.8	OECD (2008)
Sweden	2004	4.7	3.7	OECD (2008)
Switzerland	2004	10.3	2	OECD (2008)
Turkey	2005	22.9		Tansel (2008)
UK 2004	2004	14.4	6.5	OECD (2008)

Source: Returns to investments in higher education -a European survey – by George Psacharopoulos.

There are more private return estimates compared to social rates. This is because the estimation of social rates of return is more demanding and requires direct cost data by level of education.

- The private returns exceed social returns by 2.3 percentage points in this case;
- All returns (private or public ) exceed any reasonable opportunity cost of capital by 5%;
- The returns are the highest in “new countries” such as the Czech Republic, Poland, Hungary, and Turkey, while the lowest are in Scandinavian countries such as Denmark and Sweden.

In practice, there are examples that the government or other agencies of individual countries funded a study on the return on investment in education, which led to the adoption of macroeconomic policies in organizing and financing educational reforms. This was the case in Great Britain when implemented the reform of secondary education, or in Australia in reforming higher education. It must be noted that in most countries, the government or relevant institutions are not even familiar with the fact that investment in education and the return on such investments is a measurable category so that the educational reforms are implemented without such data. Above all, the availability of such data is an excellent indicator of educational productivity and supports individuals to invest in their own human equity. Public policy should use this information to design support policies to promote investments in families with low income in education. The educational system is necessary to look at a broader scope in order to reach a system in which the qualifications of people create a way that corresponds better to a modern economy. Current practice in educating and qualifying people for a job-based orientation has erroneously created standards of how to build socially useful knowledge. Such policies are viewed through the prism of acquired knowledge and tested different types of tests without reference to social skills, self-discipline, and various non-cognitive skills that enable success in life. Regarding preoccupation with cognitive and academic intellect, there is no evidence that social adaptability and motivation lead to serious doubts about the evaluation of many investments in the development of human resources. The traditional knowledge that represents the politicians, educated individuals, even many scientists, particularly teachers in educational institutions, places formal educational institutions at a central place in the procession dreams of the necessary knowledge in a modern economy. It denies the decisive role in environment, family, and organization in improving knowledge, and other skills that are essential in a modern

economy. Popular discussions on the creation of knowledge almost always focus on investing in education or educational reforms and ignoring important informal sources of knowledge creation, which influence the creation of various skills that are needed in a modern economy. From the time of publication of Coleman Report (1966), we found out that the family and the environment, not just schools, play a fundamental role in motivating and raising levels of educational achievement (as measured by tests). Collapsed family created poor ability and poorly motivated students who are failing in school. Specific policies for the improvement of the household's life can be more efficient in improving the success of the school than direct investments to pay teachers or computer equipment. Certainly it is true that the cognitive skills are essential to humans, and there is evidence that the investment in them is profitable (Cawley, Heckman, 1999). However, this narrow focus on cognitive ignores the full range of social and economic critical non-cognitive skills and motivation, incurred both in schools and in the family and other economic and private environment. Particular emphasis should be placed on the way how to assess the results of the investment program. Enriched investment schemes in early stages of life do not change significantly the IQ level or the results achieved in these types of tests. On the other hand, they significantly affect the non-cognitive skills and social status of people. The third factor in the lack of understanding of the vision of the majority of planner's education and policy makers is the lack of confidence in the ability of parents to choose the rational way of educating their children. There is a lack of trust in the competition and a system in which there are more choices as a way of raising the level of performance in school. Another common mistake in policy analysis of investing in human resources is the assumption that the development of capabilities ends early in life. Static concept capability is contrary to many studies on the development of children. In the early years of life, basic abilities can be changed. Education creates capability which creates the need for education, analysis and proving these claims and their importance in the education system. It is essential to separate conclusions in systems where there is an educational policy and in those in which there is not. The relevant question is not whether to invest in education and to give subsidies, but at what level these subsidies should be. Compulsory elementary education is no doubt the most important of all instruments for efficient redistribution, and research on growth and convergence suggests that the considerable improvements in standards of living achieved in the West since the nineteenth century would not have been possible without such schooling (Piketty 2015).

#### **4.11. Informal education learning by whole life, Non formal education and training, and development**

Informal education mainly focuses on the practical skills and cultural knowledge that children and adults receive interacting within their culture (Smith, 1996). Malcolm Shepherd Knowles (1913 – 1997) was an American educator well known for the use of the term andragogy as synonymous to the adult education. According Malcolm Knowles, andragogy is the art and science of adult learning, thus andragogy refers to any form of adult learning. (Kearsley, 2010).

Many international organizations (UN, UNESCO, OECD, World Bank, International Labor Organization) and the EU institutions such as the Council of Europe and the European Commission on the Lisbon Declaration of 2000 intensively promoted and encourage lifelong learning as a concept according to which every individual should be open to continuing upgrade their skills, knowledge and skills in order to survive in a constantly and rapidly changing social and economic environment. In addition to continuous learning and education, especially adults learning, has a key role, since it is a fast and targeted acquisition of knowledge and skills needed in the labor market.

Lifelong learning or informal education is an integral part of the strategy of many countries and their education systems, as well as the EU as a whole. A series of international declarations, documents and conferences, and action plans indicating the importance of expanding and strengthening this approach.

The recommendations of the European Commission “Making a European Area of Lifelong Learning Reality” (Commission of the European Communities, 2001) and EU Council Resolution on lifelong learning (Official Journal of the European Communities, 2002) emphasize the need for transformation of traditional education systems and become more open and flexible so that students can develop individual pathways learning according to their needs and interests, and thus genuinely take advantage of opportunities in life. The European Parliament and the EU Council in 2006 adopted recommendations called key competences for lifelong learning - European Competence Framework instrument (European Education DG, 2007) which points the need to acquire and develop these competencies in all forms and types of compulsory and an optional learning and education, as the basis for the functioning the current and future dynamic and changing environment. According to the recommendations key (core) competencies include communication in the mother tongue, communication in foreign languages, mathematical competence and basic competences in

science and technology, digital competence. learning to learn, social and civic competences, sense of initiative and entrepreneurship, cultural awareness. and expression.

Initiative youth on the move and European platform against poverty and social exclusion (EC, 2010) are derived from the Europe Strategy 2020 which also indicates the need for lifelong learning policy development especially of young and vulnerable people.

The document EC Rethinking Education: Investing in skills for better socio-economic outcomes (European Commission, 2012) from November 2012 re-emphasize the most important challenges in relation of the need to acquire key skills for the 21st century, in all EU countries. The European strategy 2020 (European Commission, 2012) aims sustainable and inclusive economic development and global competitiveness based on knowledge and innovation. The success of this strategy depends mostly on the acquired skills of the labor force because citizens should have or acquire appropriate qualifications to find a job. Individuals with no or low levels of qualifications are about three times more likely to be unemployed than those with qualifications at the lower levels (OECD, 2010). Unemployment levels of people with low educational attainment in EUR is also very high at 17.4 %, compared with 5.6 % for people aged 15 to 74 with a tertiary education (Eurostat, 2016). Many of these goals and recommendations, as defined by international organizations and European bodies, become benchmarks and guidelines for the developing countries in the preparation of this strategic document, and to develop and apply the concept of lifelong learning and adult education, in process of European aspirations and practices.

#### **4.12. Non-formal education**

Non-formal education consists of an assembly of educational carry out which are not included in the formal system of education. Education falls mainly under formal, non-formal, and informal groups. Formal education refers to standardized, classroom-style learning, informal education refers to skills that people learn throughout childhood and adulthood, and non-formal education is a term which defines any educational course that has educational objectives, but it is not part of the formal learning process. Non-formal education has been part of the educational process since the 1960s. As countries worldwide make formal education available to more and more people, alternatives to the formal education have also been advanced. Non-formal education is principally required in developing countries, often because formal education has not regularly produced its planned results, and in some cases has created problems for citizens and economies. Non-formal education programs offer

educational forms that can assist in overcoming challenges created by formal education. It can be equally an alternate and supportive complement to formal education platforms.

Non-formal education is a broad category for any scheme of learning and a process with specific learning objectives that fall outside of standardized education systems of a particular country. Non-formal education is a more thoughtful process with the aim of gaining new skills but also helping people become literate and educated. Rogers (2004) pointed to two major areas of change which were effective in carrying the idea of non-formal education, which began to develop during the 1960s. First of all, over the past several decades there has been a worldwide concentration on educating as many people as possible. Historically, formal education was limited to a selected class of people and families. Lately, education is considered not as a privilege for the elite, but rather as the right to which all people have access. One of the major drivers in changing the notion of education has been the United Nations, realized through the activities and efforts of the United Nations Educational, Scientific, and Cultural Organization (UNESCO), which is active to implement its Education for All (EFA) programme to provide admission to a primary education to all people of the world by 2015. The worldwide interest in education has obviously turned nations' attention to increasing access to high-quality education. In both examples, practical alternatives to formal education have often been required to guarantee both quantity and quality of education. The additional change which raised the interest in non-formal education was a global focus on how education could contribute to developing countries in particular. Education provides to nations the possibility to achieve development goals and make imperative advances. Both these changes in perspectives helped the birth of the concept of non-formal education (Rogers, 2004). Regarding problems with formal education, non-formal education is often supported as an alternative or supplement to formal education. Non-formal education is usually more flexible and more inventive in its approach to education, and therefore is able to better serve the needs of disadvantaged students. It allows individuals to take more control and rights of their education (UNESCO, 2006) and often can help individuals connect learning with real life experience and previous knowledge. Since non-formal education has its roots largely in humanitarian activities (La Belle, 2000), it is an influential force towards affecting important improvements in different areas of the world. Companies today are under the influence of technological innovation and demographic changes, as well as increasing competition resulting from the globalization of economic activities which are changing attitude towards the work process, and they are accepting knowledge as a key resource that

occurs through a process of non-formal education. Organizations today accept education through training and development as a necessity without which they cannot survive in the market. Although there are differences in national systems and traditions of training and development, globalization of markets and the internationalization of production are the main initiators of the processes that led to the involvement of international organizations such as the IAL (International Association of Labor) and the OECD, in order to define training and development as an important factor in economic developing activities. A study conducted by OECD (1994) for job creation has influenced a lot of worldwide opinions. This study states that the main reason for the increase in unemployment and growing differences in salaries are coming from mismatched needs of member countries of the OECD countries and the ability of governments to implement necessary changes. The same study calls for increasing the knowledge base and innovative capacity through the advancement of knowledge of employees, due to the fact that on average in OECD countries between 15% and 20% of those who complete their education do not have necessary qualifications for the job and that 20% of the working age population is functionally illiterate.

#### **4.13. Training**

Training has an important role in the achievement of organizational objectives by incorporating organizational interests in the labor force (Stone R J. Human Resource Management, 2002). Modern time training is the one of the most important elements in the business development worldwide since training raises efficiency and effectiveness of both organizations and employees. The organizational performance relies on the employee. The aim of training is to provide all employees possibilities to establish and maintain necessary abilities to carry out their operations in the business process. While governments through public financing of education are responsible for ensuring new entrants in the labor market with the appropriate qualifications, the theories of training lean on theories of learning. This means that the effectiveness of training is measured by testing individuals who have been trained. The evaluation tests consist of whether the individual learned what it is expected from them to learn, and whether they are able to do the work, and whether the individual is accepting the behavioral pattern. Cognitive learning, which refers to the understanding and using new concepts (knowledge), may oppose the teachings of conduct, which apply to physical ability on doing a certain duty (skills). Paul Fitts (1964; Fitts & Posner, 1967) has anticipated three phases of learning which are cognitive, associative, and autonomous (see Table 6). The cognitive stage is characterized by trying to figure out what exactly the learner

needs to do. Considerable cognitive activity is typically vital at this stage, in which actions are controlled in a relatively conscious manner. Because learners sometimes use self-talk, this stage has also been branded the “verbal stage” (Adams, 1971). Through this phase, learners often test different strategies to find out which ones work and which ones do not, in order to get them closer to the program objective. Also, learners have a tendency to focus on the step-by-step execution of a skill. The yield of using conscious control strategies is that the movement is unexpected, inefficient and relatively slow and that performance is rather inconsistent. At the moment that the learner has acquired the basic knowledge, the second (or associative) phase of learning begins. This phase is characterized by more delicate movement changes. The movement outcome is more reliable, and the movements are more consistent from trial to trial. Inefficient contractions are gradually reduced, and the movement becomes more economical. Also, at least parts of the movement are controlled automatically, and more attention can be directed to other aspects of performance. After extensive training, the performer reaches the autonomous phase, which is characterized by fluent and apparently easy motions. Movements are not only precise with few or no errors, but also very steady. In addition, movement production is very efficient and requires relatively little physical energy. The skill is performed almost automatically at this stage, and movement performance requires minimum or almost no attention. Thus, one element that seems to change considerably as we advance with an additional skill is the level of attention that we need to commit to its implementation. Many studies have observed more carefully at how attentional demands change as individuals go through different phases of learning as reviewed below:

**Table 6. Stages of Learning according to Paul Fitts (1964)**

Stages of Learning	Characteristics	Attentional Demands
Cognitive (verbal)	Movements are slow, inconsistent, and inefficient	Vast areas of the undertaking are controlled consciously
	Significant cognitive activity is mandatory	
Associative	Movements are efficient and reliable; activities flow fluently	Few activities are controlled consciously, and only a few automatically
	Less cognitive activity is required	
Autonomous (motor)	Movements are consistent, efficient and accurate	Movement is mainly controlled by automatic means
	Almost no cognitive activity is required	

Source: Attention and Motor Skill Learning by Gabriele Wulf (2007)

Anderson (1983) in his work introduced a system for the acquisition of cognitive knowledge in which declarative and procedural stages correspond to Fitts & Posner's cognitive and autonomous phases, whereas the associative phase expressed as a long-lasting process of "accruing knowledge" which involves transforming declarative knowledge in procedural implementation. Robert W. Proctor and Addie Dutta (1992) in their most distinguished research on acquiring skills define skills as a "target-controlled, efficient behavior that is acquired through practices and activities carried out in the economy."

According to Robert W. Proctor and Addie Dutta (1992) there are different approaches in the implementation of training and this depends depending on the economic, political, social, and traditions. The three basic models can be classified as:

- School model;
- Dual model;
- Market and organizational model.

**The school model** is implemented through school training and can be integrated into the educational system or in specialized educational institutions.

**The dual model** includes learning through practice conducted parallel with education or training, while the **market and organizational model** are voluntary based and on the strategy of the organization. If we look in practice, the training cycle is composed of three following phases: needs analysis, development, and implementation of training and evaluation. On the organizational level, the objective is to define training priorities in accordance with the organizational strategy and relevant basic skills. On a team level, the goal is to ensure that the team has complementary skills that are necessary for the effective operation and functional flexibility. At the individual level training, the objective is to align personal aspirations concerning the career expectations with the organization's needs. Analyzing of the skills required for the performance of the individual task with the skills that employees have is just the beginning of a process that will continue in the functional analysis which identifies necessary knowledge, skills, and in the development phase, the definition of the content of training programs is based on analysis of needs and existing training model. If it is about the newcomers, the content of training programs is more structured, because this period of training serves to reduce staff turnover. Operating training begins after the trial period ends. The operational training explains the reason and logic for carrying out activities. There are two basic models of operational training. The first is still widespread and highly

effective, in which existing employees teach methods of training that will subsequently be used in training new workers (Crichton 1968). The second model is in training centers. The advantage of training centers over the traditional model is that they rely on the involvement of qualified lecturers. In the evaluation phase, there is constant feedback on the training process. According to Kirkpatrick (1967), training can be evaluated at four levels:

- The reactions of students – their opinion about the training;
- Learning - the yield in knowledge or capability;
- Behavior - the degree of behavior, competence improvement, and implementation/application;
- Results - the effect and externalities on business or environment resulting from the trainee's performance.

All these measures are recommended for full and meaningful appraisal of learning inside the organizations, even though their application largely increases in difficulty and usually costs.

**Table 7. Kirkpatrick's four levels of training evaluation**

Level	Evaluation type	Evaluation description and characteristics	Examples of evaluation tools and methods	Relevance and practicability
	(What is measured)			
1	Reaction	Reaction evaluation is how the delegates felt about the training or learning experience.	'Happy sheets', feedback forms.	Quick and very easy to obtain.
			The verbal reaction, post-training surveys or questionnaires.	Not expensive to gather or to analyze.
2	Learning	Learning evaluation is the measurement of the increase in knowledge - before and after.	Typically assessments or tests before and after the training.	Relatively simple to set up; clear-cut for quantifiable skills.
			Interview or observation can also be used.	Less easy for complex learning.
3	Behavior	Behavior evaluation is the extent of applied learning back on the job implementation.	Observation and interview over time are required to assess change, the relevance of change, and sustainability of change.	Measurement of behavior change typically requires cooperation and skill of line-managers.
4	Results	Results evaluation is the effect on the business or environment by the trainee.	Measures are already in place via normal management systems and reporting - the challenge is to relate to the trainee.	Individually not difficult; unlike whole organization.
				The process must attribute clear accountabilities.

Source: The Four Levels of Evaluation by Donald Kirkpatrick - 2007

Development of managers and other talented people is part of human resource development, and refers to the skills and approaches of attracting highly skilled workers integrating new workers and developing and retaining present workers to meet current and future business goals. The enterprises which are engaged in the strategy for talent management changed the model of management for employees from the human resources department to all managers through the organization. The activities of attracting and retaining productive employee include:

- Ability, aptitude, determination, capacity, endowment, faculty, flair, genius, gift;
- Uncommon natural ability to do something well that can be developed by training;
- A person or individuals with exceptional ability.

These activities are performed by studying and evaluating each on their skills, talents, character, personality, about satisfying a specific vacancy within the company. Each has to offer different skills required and the hard part for a company is to identify those that fit best with the current company culture. The functional HR procedures will be able to identify these individuals and appoint them appropriately. According to Rothwell and Kazanasu (2004 and 2005), this process is still in progress along with other processes in management, and it is recommended to be applied to the top 10% of best employees bases on their results and potential. The Washington International Group in its research in 2007 defined two logical laws for talent development:

- At the beginning of business, every technologically advanced operation is accompanied with a lack of technically educated people who are necessary to support the rapid development;
- The resources will come when the work reaches its peak, and the best employees will adjust their skills to become part of new business chances (WGI 2007).

Developing talent is the organization's ability to harmonize strategic training and career development with new employees. Most employees after a period of training gain experience through the job process and become productive personnel that the company could rely on them performing quality performance of business activities. Based on the learning curve, for most employees is possible to predict accurately the time needed for training and the level of productivity that will follow during his/her career. Standard training and development of the average employees should not be implemented for new talents who learn quickly and implement knowledge to work with worthy ability. Managing these people is a complex and

often frustrating process, but if it is well implemented, the benefits for employers will be significant. Talented people are independent; they like to do jobs that are challenging, highly productive, as long as they are interested and allowed to have freedom at work. Hussey (1998) in his definition of development management included not only education and training but also reading, job rotation, work on projects, and other systemic ways in which one can learn through experience. Management development refers to any attempt to improve results. Managers work through the transfer of knowledge, changing attitudes, or skill development. Overall management development consists of needs assessment of the company, assessment of management performance, and training managers themselves. As already stated, it is essential that organizations in management development programs involve young talents who will become managers. The effectiveness of an organization depends mostly on the quality of management. If the organization works without quality management, the best result is achieving the average success level. In the long run, many organizations will not survive the competition. In this sense, the development of management must be approached in a systematic way by managers to provide skills and knowledge necessary to manage the organization successfully. Management development is closely linked with the training of lower-level employees in the organization. Training and development emphasize the process in which employees approach skills that will enable them to be competent and prepare them for future responsibilities. As mentioned above, development is focused on a broad range of skills, and training programs focus on a small number of technical skills. Every manager regardless of his position in the hierarchy uses a mix of technical and conceptual skills in relations with employees. According to Carrell and Kuzmits (1986), technical knowledge is needed mostly in the first line of management, who often conduct training to work for low-ranked employees. Conceptual skill is the ability looking at the organization as a whole, and coordinating and integrating various organizational functions, activities, and goals. As per the definition of manager, "the person who completes his task through others," every manager and leader is considered equally important with employees in all levels of management. This includes communicating with employees' ability to generate strong interpersonal relationships, and capacity to create cooperative relationships between employees.

#### **4.14. The Importance of Human Resource Investments**

Planning and programming of organized educational activities include a set of well-planned activities. Planned training and education cannot be isolated from the overall activity of planning of human resources, which is based on needs and strategic plans of the organization

(M .Paulk - 1993). Organizations that consider human resource development as strategic activity usually find that it is crucial for the implementation of business strategies on the sensitive way. As already mentioned in the previous section, "needs-driven" or approach based on the needs that aim to create human resources strategy through the identification and elimination of weaknesses in skills about organizational strategy. The ability to learn is fundamental to the development of the organization. According to Torrington (2004), to create an entrepreneurial and innovative culture, of which is an integral part of learning, it is important to provide strategic capabilities of the development that are focused exclusively on achieving business goals. Many features of strategic human resource development are found in the literature (McCracken & Wallace 2000; Grieves, 2003; Meera 2013). These features can be used as a recommendation to conclude whether the scope and nature of human resource development found in companies can actually be viewed as strategic, since McCracken and Wallace (2000) claim that "there have been moderately few studies on which are the characteristics of an organization with a strategic approach to human resource development." Strategic human resource characteristics development, as found in the sources relate to four aspects (McCracken & Wallace, 2000; Grieves, 2003; Meera 2013) which are the following 1) The of alignment between the strategic orientation and grand strategy of the company, as well as development of strategic human resource management; 2) The relationship between the development of HR of the company and the management board; 3) The relationship and the responsibilities between stakeholders in strategic human resource development; 4) The effect of strategic human resources development on the company.

#### **4.15. Measurement of investment in human resources**

The economic environment in which there is not enough information and inadequate measurement of investment in human resources, according to Bassi and McMurreru (1999), comes with three inevitable following consequences: 1) Some of the human capital investments will be ineffective; 2) The failure to identify good investments from poor ones will result in underinvestment; and 3) Firms will further underinvest in human capital because of external forces; most importantly financial markets are unable to value these investments adequately.

According to Becker (1964), the acquisition of human capital is much like any other investment. If the cost of the investment is lower than the "return" on investment, then the market will find the necessary funds to finance the profitable investment, just as the market model predicts for investments in physical capital with perfect credit markets. Similarly, if

the experience and on-the-job training afforded by a certain job yield a significant increment of human capital, then the worker who is free to choose will accept a lower wage or even pay the employer to have the job in order to acquire the additional capital. For companies listed on the stock exchange, according to the available information about the business, financial markets fundamentally shape the evaluation of these companies through changes in the value of the shares or the availability of capital. Because information about investments in human resources often is not available or they it is not in measurable amounts, it happens that investors do not value these investments, even if they are profitable in the long run. Preferably, the above problems would be solved by market forces, or by a public entity taking the action which is essentially a public good problem and a lack of sufficient information. However, neither solution seems likely. It would be nearly impossible for the organization to solve this information problem on their own resources. A great amount of information needs to be collected and analyzed to determine the relative effectiveness of investment in human capital under a variety of circumstances and in different forms of work, which means that no organization will be able to measure the problem solely. The information must be collected with a common set of measures and indicators that will be shared across businesses. Recognizing the need for action in this area, the American Society for Training & Development in recent years has worked to create an identification system of relevant indicators to measure the human capital investment and results, and to create systems that enable broad collection and use of these data. Much of this work has so far focused on the indicators for measuring the provided training to employers as the most important component of the workplace for human capital investments. As the premium organization membership for training and development of professionals (with more than 50,000 members), ASTD has unique access to these people and is well positioned to play such a role in the creation of standard indicators for use in the training industry. The work process was followed in a few steps: Identification of the indicators of investment in training and practice which is a process that lasted for seven years and where the ASTD together with other companies developed a set of indicators to measure investments in human resources; and identifying the right indicators for the results of training with the aim of developing methodologies and measurements that can be universally applied in various organizations to isolate the results of investments in education and training, without the influence of other factors. In that way, they developed a model to measure the reaction of employees in training or learning programs in which they participate on the one hand and monitoring changes in the behavior of employees that have arisen as a result of training on the other. The introduction of the indicators in the

organization, which is the last step in the implementation process, was the submission of monitoring indicators in organizations. It was created Measurements Kit of “ASTD” that incorporated different indicators to measure investment and to measure investment performance. On the other side, the Crane network was founded in 1989 by Sweden, Spain Germany, France, and the United Kingdom. The Coordination Centre is located at Cranfield School of Management in the UK. Today Cranfield School of Management network comprises of 39 universities and business schools from 39 countries around the world that are work on an ongoing basis of international comparative research on policy and practice of human resource management in organizations. Since 1990, Crane conducted a research using a standardized questionnaire which was sent to public and private organizations with more than 200 employees. Questionnaires are filled from highest-ranking employees of the departments of either area of the organization. The study, which was introduced in 1999, was sent to 50,000 addresses, and each of them has obtained 8,050 responses which represent an excellent empirical and scientific value. The research includes two direct questions about training in organizations. The first concerns the proportional share of funds invested in training compared to an annual level of wages. The second question refers to the percentage of employees participating in training annually. They did not elaborate on whether the training is related to a verbal, basic, practical, or another type of training. Other issues concerning human resources include an analysis of whether the organization has a written procedure for training and development, whether there is a system to analyze the training needs of employees, and whether they have a monitoring phase in place. The survey collected data on the organization's business results for the previous three years. Results from the survey are used by comparing data from a sample of business success with an average of all companies operating in the same economic sector. Comparisons are made in productivity, level of innovation, service quality, profitability, and stock prices on the stock exchange. Variables are measured in three levels: a) for the best 10% in the sector, b) for the middle half, and c) for the bottom half of the companies in the sector. The highest quality data is obtained to track the movement of share prices and the level of profitability. This measurement research has high quality as it provides information on the impact of investment in human resources in the operating results of the organization in relation to the average of all companies in that sector. It also measures the level of the internal labor market and syndicate. The internal market is an indicator of the way in which the organization fills managerial vacancies, where it can be chosen one of the four responses:

- Internally;
- Headhunters or consultants for employment;
- Ads in newspapers;
- Recommendations.

This question is to determine what kind of organizational culture exists regarding developing their own human resources and talents on what was discussed in previous chapters. Trade union level is measured on a scale from 1 to 6, and it is obtained on the percentage of employees who are union members. Outstanding issues include the measurement of the percentage of highly educated employees, age structure in terms of percentage of over 45 years, the participation of the manual workers, the total number of employees, and the importance is given to innovation in business. Table 8 shows the results of Canfield School of Management research.

**Table 8. ASTD Measurement Kit**

Country	1995 expenditure training %	1999 expenditure training %	Change	1995% of participants in training	1999% of participants in training	Change
Great Britain	2.6	2.9	<b>0.3</b>	42.1	52.9	<b>10.8</b>
France	4.8	4.2	<b>-0.6</b>	44.2	49.5	<b>5.3</b>
Germany	2.8	2.8	<b>0</b>	26.4	32.8	<b>6.4</b>
Sweden	4.3	3.7	<b>-0.6</b>	51.5	66.1	<b>14.6</b>
Spain	2.1	2	<b>-0.1</b>	37.6	51.1	<b>13.5</b>
Denmark	2.8	2.8	<b>0</b>	37.2	49.6	<b>12.4</b>
Netherlands	3.8	3.4	<b>-0.4</b>	34	42.2	<b>8.2</b>
Italy	1.9	2.2	<b>0.3</b>	21.4	36.2	<b>14.8</b>
Norway	2.7	3.3	<b>0.6</b>	40	41.5	<b>1.5</b>
<b>Switzerland</b>	2.9	2.6	<b>-0.3</b>	36	42.8	<b>6.8</b>
Ireland	3.7	3.2	<b>-0.5</b>	36.2	47.1	<b>10.9</b>
Portugal		3			36.9	
Finland	2.7	2.5	<b>-0.2</b>	45.2	61.1	<b>15.9</b>
Greece		2.5			36	
Austria		2.2			36.4	
Belgium	2.4	3.3	<b>0.9</b>	27.9	45.5	<b>17.6</b>
Northern Ireland		3.1			54.4	
Estonia	4.3				47	
Bulgaria		2.9			17.4	
Czech Republic		2.3			45.3	
Cyprus		1.4			34.1	
Turkey	3.8	3.9	<b>0.1</b>	27.9	49.4	<b>21.5</b>
Tunisia		4.3			24.6	
Israel		3.3			47.5	
Japan		1.7			3.6	
Australia		3			56.3	
Average	3.173333	2.9	<b>-0.03571</b>	36.2571	42.5885	11.4429

Source: Hansson (2004).

This model has been used as an approach to evaluate training that can be present in the following way, and that will be the basis for research in the next section. Elaboration is as follows:

Investment = policy + needs syndicates + years + diplomas + craft workers + size + previous profit + innovation, where:

- Investments - the total value of training or investment in organization
- Privacy - assessment of whether the company has a written training policy
- Needs - assessment of whether the company is analyzing the requirements for staff training
- Internal - way to fill up vacancies for managers
- Trade unions - the percentage of employees who are union members
- Years - the percentage of employees older than 45 years
- Manual - the percentage of manual workers
- Graduated - the percentage of graduates employed
- Turnover - percentage of the turnover of employees
- Size - number of employees in the organization
- The previous profit - measure levels of profitability in previous years
- Innovation - whether the company sees innovation as essential for business

The table presents data on the correlation between individual variables that were analyzed in the study. From these data, we can see interesting relationships between certain factors, such as the existence of internal vacancies managerial positions in correlation with a turnover of staff (negative correlation).

**Table 9. The correlation between the variables used in the Crane research is as follows:**

	% Trained	Turnover of employees	Absence	Trade union	Internal labor market	% graduates of	% Manual	Size
% Spent on training	0.789(a)	0.041(b)		-0.109(a)	-0.105(a)	0.102(a)	-0.110(a)	
% Trained		-	-	-	-0.031(b)	0.137(a)	-0.167(a)	
Crafts employees			0.089(a)	-0.179(a)	-0.131(a)	-0.066(a)	0.053(a)	
absence				0.48(a)	-0.133(a)	-0.266(a)	0.191(a)	0.047*
Trade union					0.059(a)	-0.232	0.245(a)	
Internal labor market						0.207(a)	-0.057(a)	
% of graduates							-0.468(a)	
a) represents the level of significance of 1% , b) represents the significance level of 5%								

Source: Hansson (2004)

Models that AST and Crane formed in the past decade have led to the increased number of research regarding the impact of investment in human resources to profitability. As already stated, the effects of investment in formal education are much easier to measure than investment in non-formal (training and development). Compared with training in organizations that varies from year to year, the level of investment in education is much more consistent. In most studies, the degree of education is usually included as a control variable, and rarely as the main variable. Some exceptions were the measured results of investment in formal education. Black and Lynch (1996) found that the percentage of highly educated employees significantly influences the level of productivity (value added) and profitability. Similar research conducted by Gunnarsson (2001) compares the level of education with productivity growth over a period of 10 years and shows that the resulting increase in the level of education was the major cause of productivity increase in the IT sector in the period 1986-1995. Based on indicators that are published by Eurostat, it is possible to see that investing in education in European countries moves at the level of 2-8% of GDP. A study conducted by Bassi (2004) on the impact of investments in human resources in the value of shares of American companies is the result of using data that is created by ASTD model. In a study in which they used various econometric models led to the valid evidence of the importance of investment in human resources. The study used over 450 US companies listed on stock exchange. One part of the survey is shown in Table 10, which indicates that the investment in training is positively correlated with the return of the stock price. Also, the

same indicators were much more favorable to companies that had a high level of investment in training.

**Table 10. Effects of the level of investment in training on business**

	The level of investment in training per employee by quarters			
	I quarter	II quarter	III quarter	IV quarter
Number of companies	118	120	121	117
Changes in prices on the stock market (%)	15.3	20	34.4	30.7
Sales per employee (US \$ 000)	175.7	302.5	343.8	320.8
Profit per employee (US \$ 000)	11.5	15	19.3	24.5
Change in gross profit	22.8	37.4	35.7	40.4
Return on assets	4.2	4.4	3.2	5.5
Market capitalization per employee (US \$ 000)	263.2	533.5	638.5	668.2

Source: Bassi (2004)

In the paper published by in the Hayward business review Bassi McMurrer (2007) presented a model that explains how to maximize return on human resources. Today managers emphasize the facts are employees are the greatest assets, yet most managers view employees as expenses which can be dangerous knowing that today for a large number of institutions the only competitive advantage are human resources. A model called the human capital management (HCM) starts from the premise that the traditional measurement of human resources that monitors the turnover of employees, the average time needed to fill positions or a total number of hours spent in training cannot predict the results of the business organization. The empirical research conducted by 42 organizations over a period of five years defined the five starters - categories that influence the development of human resources. In each of these categories, there are at least four groups as shown in Table 11.

**Table 11. The drivers of human resources**

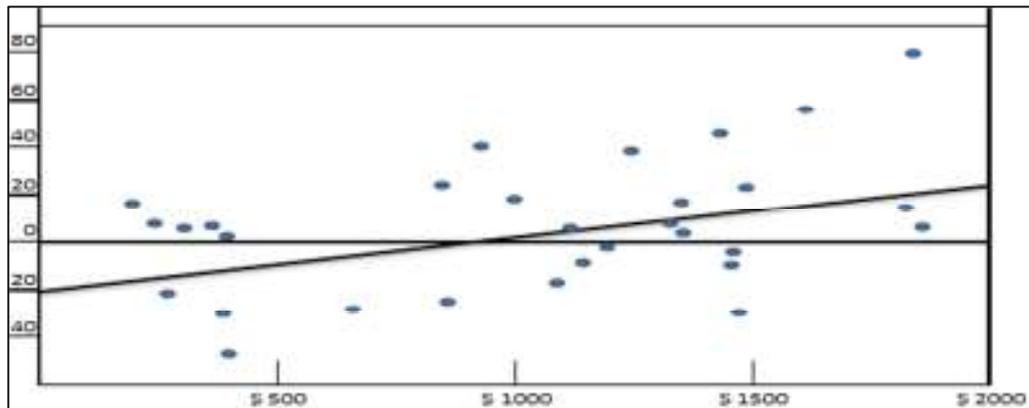
The practice of leadership	Hiring employees	The availability of knowledge	Workforce Optimization	Learning capacity
Communication - Communication management is open and effective	Design work - work is well organized and fits the skills of employees	Availability - information related to job training and are ready	Processes - work processes are well defined and training is effective	Innovation - new ideas are welcome
Involvement - management is working with employees and seeks input	Commitment - jobs are safe, the staff is recognized, the progress is possible	Collaboration - supports and enables teamwork	Terms - working conditions support high performance	Training - training is practical and supports organizational goals
Skills supervisors - Managers eliminate barriers, provide feedback, and promote trust	Time - the amount of work allows employees to function well and to reconcile work with private life	Information sharing - best practice to promote and improve	Responsibility - expected high quality of work that is rewarded	Development - employees have a formal career development plans
The skills of top management - top managers manage work, provide feedback, and promoting leadership	Systems - Employee participation is constantly evaluated	Systems - data collection systems provide easy access to information	Employment - Employees are selected on the basis of skills and undergo orientation training	Value and support - leaders have shown that learning is evaluated
Systems - leadership development and transition systems are effective			Systems - systems performance management employees effectively	systems - learning management system automates all aspects of training

Sources: Laurie Bassi, McBassi & Company (2007)

Using questionnaires to monitor rigorously the organizational activities makes possible to do a benchmark of human resources organization, identify strengths and weaknesses, as well as to link the success or poor operating results from certain practices in the area of the human capitals (Laurie Bassi Daniel McMurrer 2007). During the implementation of the HCM research methodology, data obtained directly from the organization are matched with available indicators of organizational performance. Various statistical models can be linked to variations in the movement of the indicators and on the continuous research, which makes it possible for an organization to demonstrate the practice of human resources and be closely linked to the performance of the business. In the latest survey, which was released in February 2009, Bassi and McMurrer (2009) followed the banks' operations in the United States, where they have analyzed market performance through the movement of share prices on the stock exchange and compared with investing in training which is carried out in previous years. The results showed that investment in training is statistically correlated with predicting the movements of share prices on the stock exchange. The survey covers the

period of the second half of 2008 when all the banks in the US were affected by the financial crisis and even in that period banks with greater investment in human resources had significantly better indicators than others. Figure 6 shows a comparison of price movements of shares of the analyzed banks compared to the average price changes for all banks depending on the level of investment in human resources in the preceding year.

**Figure 6. The amount of investment in training per employee (the period 2003-2007) and the relative movement of stock prices in the coming year (2004-2008)**



Source: Bassi and McMurrer (2009)

In the previous part of the study, we have introduced the impact of investment in human resources at the individual and organizational level. Studies conducted over the past twenty years clearly show that from worldwide experience, the investment in human resources is becoming a form of long-term investments that will provide long-term competitive advantage.

#### **4.16. The competitiveness through training and human resource development**

The idea that human resources can serve as a competitive advantage is not new (Ulrich, 2013; 1991; Schuler & MacMillan, 1984). However, research has taken a practice - oriented viewpoint, highlighting the value of HR practices reasonably than the HR pool quality. Schuler and MacMillan (1984) presented a model which is focused on target/thrust matrix to discuss the potential of exploiting on human resource management as a mean of gaining and sustaining a competitive advantage. In this approach, targets of HR practices characterize both downstream and upstream, containing the company itself, its suppliers, its distributors, its servicers and customers. The possible drivers are product differentiation and cost efficiency. Ulrich (2013) also argued on how human resource practices can utilized by organization in process of developing strategies that will lead to a continued competitive

advantage, declaring that there must be a focus on the relationship between competitive advantage, strategies, and human resources. Ulrich (2013) partly depended on the resource-based theoretical perspective in describing human resources as a competitive by expanding Porter's (1985) model of competitive advantage containing the elements of distinctive competence, organizational culture, and strategic agreement as mediators in the strategy or the competitive advantage link. Schuler MacMillan (1984) and Ulrich (2013) provide a different perspective called “practice-oriented,” representing the behaviors in which they considered that HRM can contribute as reliable, competitive advantage tool. This viewpoint emphasizes the human resource practices that enable a company to have a competitive advantage compared to other firms. The abovementioned authors considered that human resources as value added for the company and that HR approach could be the source of continued competitive advantage. The competitiveness of an organization formed out of the same characteristics and attributes that enable it to be situated in such way that the market can enjoy the superiority compared to direct competitors. To achieve competitive advantage, it is necessary that the organization meet three factors:

- It must be different from the competition
- Diversity should generate economic benefits
- The key element in organizational success must be such that competitors cannot easily imitate

**Table 12. Stages and participants in the transfer of knowledge**

	Before training	During training	After training
management	<p>Heads of Departments and coaches analyze training needs.</p> <p>2. The coach helps in linking the strategic objectives of the organization with the objectives of the training.</p> <p>3. Management selects students</p> <p>4. Heads of departments and trainers plan the training and after training</p> <p>Defining the fifth level of involvement of individuals during and after training</p>	<p>Participation in the plan of transfer in accordance with a predefined schedule</p>	<p>Plan participants return to work: managers must develop a plan and facilitate employees to apply the knowledge they have gained in training</p>
coach	<p>1. Custom Country Training Plan organization's strategic plan</p> <p>Adjusted second Country training methods technology learning students</p> <p>3. Promotes a willingness to learn</p> <p>4. Preparation of materials for the training plan</p> <p>5. The right behavior contract between the management and employees in training</p>	<p>Develops training objectives that apply</p> <p>2. Proposes practical examples of learning who are closest to the working conditions</p> <p>3. Benefits training techniques that help participants to visualize their future work activities at work</p> <p>4th Advise and refers to technology how to improve performance on the job place</p>	<p>1. He spends the first evaluation and gives feedback information management</p> <p>Main issues:</p> <ul style="list-style-type: none"> <li>* How many participants are able to transfer the knowledge they acquired during the training</li> <li>* the problems met during training</li> </ul>
student	<p>Actively participate in the review of options training</p> <p>Main issues:</p> <ol style="list-style-type: none"> <li>1. Why I have chosen for this program</li> <li>2. What can you learn what will be relevant to my work</li> <li>3. Which I have to support apply this knowledge in my work</li> </ol>	<ol style="list-style-type: none"> <li>1. Actively participate in Training</li> <li>2. Avoids returning to the old practice and develop the structure of learning</li> <li>3. Constitutes agreement with management behavior</li> </ol>	<p>These aspects must be provided to facilitate the transfer of knowledge:</p> <ol style="list-style-type: none"> <li>1. The ability to apply lessons learned</li> <li>2. Possibility of implementation</li> <li>3. Confidence necessary to try.</li> <li>4. The understanding that is worth a try</li> <li>5. Manage themselves each training program should support the ability of an individual to the analysis of what can and what can not apply</li> </ol>

Source: González Fernández, Beatriz, and Norbert Schmitt (2015)

If these three factors are considered from today's perspective of globalization and technological development, it is clear that the only factor that cannot be imitated is the human capital. Such capital has a lasting value if there are three basic qualities that are a precondition of being competent: knowledge (cognitive aspect), know-how (ability), and the desire to succeed (aspect ratio). The value of human capital is growing with the development, but it is necessary to have a long-term strategy development so that the competitive advantage remains for a longer period. The transfer of know-how should be based on the structure that includes many actors who participate in the training process, and each of them has its own specific roles and responsibilities as seen in Table 12.

#### **4.17. Chapter Conclusion**

This chapter synthesizes the existing literature on human capital formation in countries. The goal is to take a look at the complex relations between the policies of country activities and multinational enterprises. From the literature point of view, high level of human capital is one of the key elements for economic development. In many of developing countries, underinvest in human capital, and the investment that is actually taking place is unequally distributed across countries and regions that have adopted different human resource development policies. To increase human capital formation and hence to attract more FDI would consequently require a clearer approach of the countries in addressing constraints such as limited budgetary resources. Alternative policy selection is to simplify HRD for small and medium sized domestic enterprises which typically do not invest adequately in training of employees, thus these enterprises stand to gain utmost from education and training. In addition, FDI promotion policies can aim high value-added MNEs that have more chances to bring new knowledge and skills to the economy that can be employed by domestic enterprises. Finally, it shows the importance of crucial components of HRD policies such as formal schooling, training policies, and vocational education are well coordinated so as to prepare students with skills and knowledge that in the future will be complimentary to training opportunities in the labor market.

## **Chapter 5: Foreign direct investments and human resources**

### **5.1. Effects of FDI on economic growth**

Development and investment in human resources and foreign direct investments (FDI) belong to the key drivers of economic growth in the transitional countries. The process of acquiring of people who have skills, education, and experience are crucial for the development of a country, and foreign direct investment demonstrated their usefulness in the development of human capital. The possible effects of FDI on economic growth are measured by various econometric models created by different authors such as Solow (1957) Mankiw, Romer and Weil (1992), Borenstein, De Gregorio and Lee (1998), Easterly (2001), Blonigen, Bruce A., and Jeremy Piger (2015) and others.

Regarding the foreign direct investments, there is no need to suggest any work in which is not demonstrated their helpfulness in the development of the economy by:

- Providing capital accumulation from abroad in the form of ownership has positive short-term effects from the standpoint of the balance of payments because the country cannot borrow abroad;
- The possibility to finance new investments affects the increase in employment, income, technical composition of production factors and technical equipment of labor, and in productivity;
- The involvement of foreign capital ensures the transfer of new technology and knowledge without purchasing licenses;
- Reduces costs of production, thereby increasing competitiveness and creating better prospects for exports;
- Allows substitution of imported products and facilitates imports resulting in a better supply of scarce raw materials and reproduction materials;
- Provides capital increase, budget revenues, and increase in tax revenues.

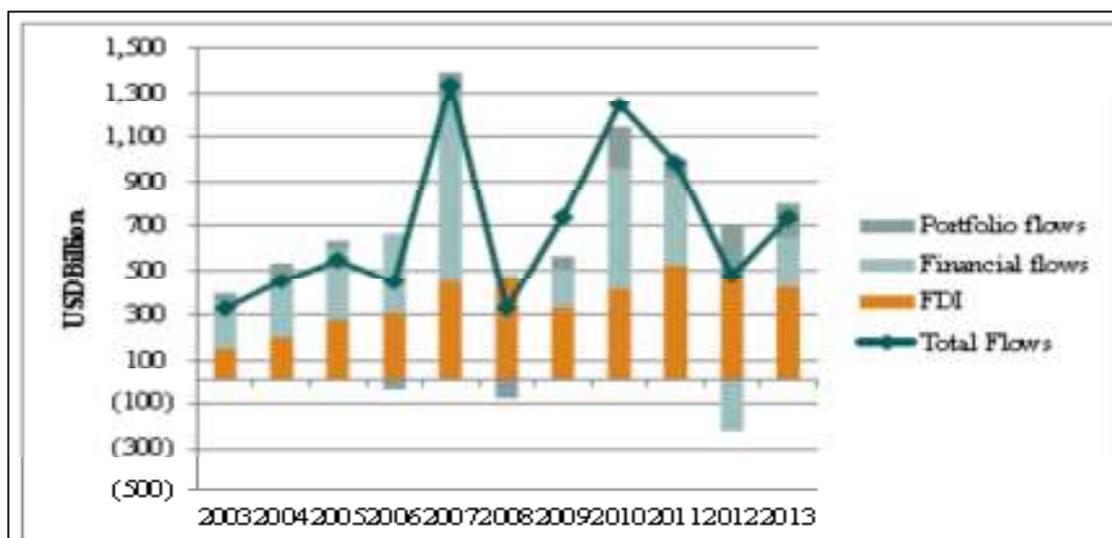
Development and investment in human resources and FDI individually affect growth, and at the same time, they support each other with complementary effects. In general, development of human resources increases FDI by making the investment climate more attractive for foreign investors. Developed human resources can be seen through the high level of skills of the labor force or through indirect effects such as increased social and political stability, and the level of health (Inglehart, Ronald 2015). On the other hand, FDI contributes to the development of human resources through multinational companies (international companies)

that assure education and training, bring new skills, information, and technology in the host country. Such interconnection leads to complementary effects that create an upright cycle of development of human resources and FDI. In this cycle, the host country attracts an increasing level of foreign investments. International companies that achieve a high level of added value while increasing the level of skills of the workforce, and thus attract new investments. Intensive investment in human resources is not enough for the country to continuously benefit from foreign investment. Other pre-conditions which are essential for maximizing the benefits are:

- A clear policy on the business environment and attractive investment climate;
- Coordination between formal education, training system, and development;
- Cooperation of all interested partners to develop human as government agencies for promoting foreign investments, multinational companies, and educational institutions;
- Identification of international companies that will contribute the most to human resources and technology transfer.

Foreign direct investments in developing countries and globalization have become intense after the Second World War. The international movement of capital is the transfer of real and financial assets between entities of different countries, with countertransference deferred for a given period, and to achieve economic and political interests of the participants in this transfer (Robert B. Warren 1937).

**Figure 11: Net Private Capital Flows towards Developing Countries (2003-2013)**



Source: World Economic Outlook, IMF

The economy of a country provides sufficient inflow of capital from various public and private sources. In the last three decades, a significant number of developing countries and in transition have recognized the importance of foreign investments as the main source of financial capital inflow in the economy. In the world and total international developments for many years after the Second World War State, inflows of capital had precedence in all forms of international capital movements. For a period of ten years, as shown in Chart 16, the structure of capital inflows is considerably altered in developing countries. In addition to significant nominal growth, foreign investment after 1993 took over as the main form of capital inflows, while inflows from the capital market to a great extent declined. A special feature of FDI at the beginning of the 90's of the last century is a significant expansion of investment activities in developing countries. Factors that make those countries attractive for foreign investment were rapid economic growth, especially in Southeast Asia and Latin America, and privatization programs open to foreign investors and liberalizing FDI regime.

**Table 26. Net financial flows to developing countries and economies in transition, 2005–2014.**

Billions of dollars	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<b>Developing countries</b>										
Net private capital flows	155.7	251.4	386.6	153	440.6	534.7	468.9	175	327.7	171.9
Net direct investment	246.4	241.6	342.9	364.9	267.7	352	455.2	412.9	448	400.3
Net portfolio investment	-55.7	-121.8	-19.6	-61.2	8.2	91.5	57.9	78.6	27.7	73.7
Other net investment	-35	131.6	63.3	-150.7	164.8	91.2	-44.2	-316.6	-147.9	-302.1
Net official flows	-66	-263.8	-96.6	-132.3	53.8	49.3	-70.6	-21	25.5	1.8
Total net flows	89.7	-12.4	290	20.7	494.4	584	398.3	154	353.2	173.7
Change in reserves	-547.3	-670.7	-1056	-741	-711.7	-884.9	-754.9	-484.2	-631.3	-589.3
<b>Africa</b>										
Net private capital flows	26	109	11.2	52.1	30.2	-1.2	20.9	60.8	-24.2	23.3
Net direct investment	29.4	25.8	40.8	54.5	47.4	34.8	41.8	35	40	41
Net portfolio investment	1.7	6.9	-2.9	-42.4	-16.4	-0.3	-11.7	3.5	8.9	-0.1
Other net investment	-5.1	76.3	-26.7	40	-0.8	-35.7	-9.3	22.3	-73.1	-17.6
Net official flows	-19.6	-143.2	11.7	-37.9	23.1	22.1	10.3	-0.6	91.7	31.5
Total net flows	6.4	-34.2	22.9	14.2	53.3	20.9	31.2	60.2	67.5	54.8
Change in reserves	-63.7	-75.7	-85.8	-75.9	3.3	-22	-29.1	-31.3	9.5	23.1
<b>East and South Asia</b>										
Net private capital flows	65	56	154.1	-28.4	340.5	370	321.3	-12.9	253.7	108.3
Net direct investment	128.6	139.9	162.9	155.7	99.6	196.8	264.6	218.2	234.2	207.1
Net portfolio investment	-36.5	-138.9	-45.5	-38.3	28.9	23	29.7	-9.1	-79	-39.3
Other net investment	-27.2	55	36.7	-145.8	212	150.3	27	-222	98.5	-59.5
Net official flows	5.2	-2.1	-42.5	-9.9	9.3	11.4	-49.2	25.2	-2.5	46.9
Total net flows	70.2	53.9	111.6	-38.4	349.8	381.4	272.1	12.4	251.2	155.3
Change in reserves	-344.7	-433	-675.2	-490.9	-667.8	-685.2	-505.3	-219.6	-512.6	-524.8
<b>Western Asia</b>										
Net private capital flows	25.1	36.1	112.4	56.9	34.4	49.1	-54.8	-5	-37	-49.6
Net direct investment	32.1	44	46.9	56.7	51.8	35.7	23.1	29.1	24.4	18.3
Net portfolio investment	-5.2	-0.8	-4.9	15.7	-5.8	5.6	-23.4	55.5	42.1	49.5
Other net investment	-1.8	-7.1	70.4	-15.5	-11.6	7.7	-54.5	-89.6	-103.4	-117.4
Net official flows	-21	-72.6	-69.6	-89.1	-21	-38.8	-55.7	-102.4	-120.4	-141.5
Total net flows	4.1	-36.5	42.8	-32.2	13.4	10.3	-110.5	-107.3	-157.4	-191.1
Change in reserves	-98.5	-107.7	-166.1	-133	7.2	-88.2	-110.2	-174.3	-121.8	-76.7
<b>Latin America and the</b>										
Net private capital flows	39.6	50.3	109	72.4	35.5	116.8	181.5	132.1	135.3	89.9
Net direct investment	56.3	31.9	92.4	98	68.9	84.6	125.6	130.6	149.4	133.9
Net portfolio investment	-15.7	11	33.8	3.8	1.5	63.2	63.3	28.7	55.8	63.6
Other net investment	-1	7.4	-17.2	-29.5	-34.8	-31.1	-7.3	-27.2	-69.9	-107.6
Net official flows	-30.6	-45.9	3.8	4.6	42.4	54.6	23.9	56.7	56.7	64.9
Total net flows	8.9	4.4	112.8	77	77.9	171.4	205.5	188.8	192	154.7
Change in reserves	-40.4	-54.4	-129	-41.3	-54.5	-89.6	-110.2	-58.9	-6.4	-10.9
<b>Economies in transition</b>										
Net private capital flows	36.7	68	140.5	-91.2	-43.2	3	-42.1	-12.4	29.5	-80.6
Net direct investment	11.5	28.4	34.7	55.4	22	12.9	21	30.5	8.7	4.6
Net portfolio investment	7.4	5	8.4	-22.3	-1	12.2	-8.5	-5.9	1.8	-10.9
Other net investment	17.7	34.6	97.4	-124.3	-64.2	-22	-54.6	-36.9	19	-74.3
Net official flows	-22.1	-31.7	-4.6	-18.3	40.5	-16.1	-18.4	-2.9	-44.2	-8.6
Total net flows	14.7	36.3	135.9	-109.6	-2.7	-13	-60.5	-15.3	-14.7	-89.2
Change in reserves	-79.4	-134.6	-170.6	29.5	-10.6	-51.6	-26.6	-25.2	23.4	52.6

Source: Based on IMF World Economic Outlook database, October 2014.

Table 26 presents some indicators of FDI trends. In the last decade there was a strong and increasing trend in international capital movements toward the developing countries, with net private capital flows to developing countries increasing more than three times from \$155.7 billion in 2005 to \$327.7 billion in 2013. Foreign direct investment has presented the largest

increase over the last decade, increasing in net terms from \$246.4 billion in 2005 to \$448 billion in 2013 and showed a greater stability. In developing countries the outward FDI has also increased significantly during this period, reaching \$553 billion, or 39 percent of total outward FDI in 2013. FDI to developing countries, though, has been focused on a small number of countries and sectors, largely in Asia and Latin America. Though the last decade, the flows in countries of Africa have increased, reaching an average of \$40 billion in the post-crisis years, but they remain limited compared to the volume of flows to East and South Asia or Latin America and the Caribbean. Also, Greenfield FDI in developing countries has fallen by more than 50 percent since the crisis, signaling a potential decline of the impact of FDI on the real economy and substantial development. Although the value of announced Greenfield projects in LDCs increased by 9 percent in 2013, it remains significantly below historical levels.

## **5.2. The development of human resources and attracting foreign direct investments**

One of the characteristics of rich developed countries is the availability of a workforce that has a qualitative human capital. The question is whether such human capital is the key driver of economic prosperity or result of development. Studies that observed long-term trends in education and economic growth in the last century have shown that development of human resources and economic development go gradually (Godo & Soto, 2001 Hayami, and Cohen). Some of the developing countries in the last decade(s) of the last century used similar trends in the development of human resources and economic growth. A characteristic of these countries is that they have achieved great economic benefits by attracting foreign investment, especially multinational companies, and thus mobilize funds from foreign investments provided in fast economic growth. It may be a question whether developing countries or transitional countries attract foreign investment. The graph shows the importance percentage. The investment climate includes the availability and quality of production factors, the size of the market, the cost of logistics, and numerous social and political factors that affect the job done with minimal risk, as confirmed by experiences of countries that have in the past successfully attracted significant FDI. A key element in the choice of location for the investment of multinational companies (International Organizations) was the level of human capital, especially when it comes to those International Organizations that achieve a high level of added value. In recent years, the influence of factors of human capital has become even greater, because production is becoming more and more based on skills of workers in

the production of high-tech and service industries. International Organizations plan their investments seeking employees with a high level of knowledge and skills in engineering, technology, organizational skills, and business administration. Two questions that are concealed in the evaluation of the impact of human resources on economic development by attracting FDI are the following:

- Is the human capital essential to attract all kinds of FDI?
- What is the necessary level of human capital for attracting FDI?

Both issues are difficult to answer because in recent decades there has been a significant change in the form of FDI in the world market. The best ways to come to answer is the analysis of other authors and take examples from peer countries that have gone through a transition phase in where today is Kosovo.

### **5.3. Is human capital prerequisite for all kinds of FDI?**

As we have seen in previous chapters, literature dealing with the academic approach to the analysis of FDI assumes that human capital is one of the key factors for attracting FDIs (Anyanwu, John C.2012, Markusen 1999, Dunning 1998, Lucas 1990). The academic researches on process of examination in identifying the determinants of FDIs in developing countries are very rare. The main reason for the existence of such a small number of studies relies on the fact that it is hard to construct quality indicators and indicators of human capital, and the available statistical indicators which are recorded as an investment in human resources as a separate category. The actual research can be divided in two main groups. The first group analyzed the period of years 1960-1980, and the second after the year 1980. The earliest group of papers published by the Root and Ahmed (1979), Schneider and Frey (1985), Hanson (1996) and Narula (1996) comes to crucial conclusions that in developing countries, which were covered by their studies, the influence of elements of human capital like literacy, the percentage enrolled in school, the availability of technical and professional workers, have no statistically significant impact on FDIs. Such a conclusion may be consistent with the fact that these works observed the period 1960-1980 when foreign investment in developing countries concentrated on winning the market, safeguarding natural resources, and most of the cheap labor. According to Dunning (2002), in that period the availability of highly educated people did not have a great importance in the operations of foreign investors. The second group of researches that analyze more countries. Noorbakhsh and others (2001), UNCTAD (2002), and Nunnenkamp and Spatz (2002) used statistical indicators in the period after 1980. In this work, it is revealed that the level of human capital

and the level of investments in human resources have a significant impact and a positive effect on attracting FDI and that these effects become even more significant over time. The basic difference in their research in the first set of authors, in addition to econometric precision, is that they use more recent indicators on investments that bring greater added value. The fact is that most of the International Organizations that have invested their capital in developing countries after 1980 were much more oriented towards efficiency and a highly educated workforce. In UNCTAD's work it has been proven the correlation between elements of human capital as a percentage of students and the level of students in science and engineering with the level of FDI in 140 developed and developing countries. Evolution of foreign investment, which was originally after World War II, sought markets in which they can realize profits based on cheap labor and natural resources, and greater emphasis on technology developed and processes based on knowledge have positioned human capital as a determinant of foreign investors, particularly those observing for a high level of efficiency. This is consistent with the mode of development of Southeastern Asian countries, which before joining FDIs had no program of development of industrial skills. Also, cases of Singapore, South Korea or Africa are mostly searched for natural resources and expanding markets, where there was a persistent stagnation in the growth of human capital. Although not confirmed on a large number of works, secondary education is the minimum level of education that is essential for attracting FDI that brings a high level of added value and requires high efficiency. In most studies that have been conducted, human capital is viewed through the levels of secondary or higher education. Broadman and Sun (1997) and Coughlin and Segev (2000) confirmed that in China at the beginning of the 1990s, the level of adult education was one of the key determinants of FDIs in China on the center of a regional analysis of the level of education. Since the beginning of this century, a number of international organizations have initiated research related to FDI and investment climate of the host country, such as the exploration of the world of business environment and exploration of foreign direct investment financed by the World Bank. Studies have contained questions concerning the motivation of investors in choosing the country for investment, where the results showed that the quality of human resources is an important factor that influences the decision-making of this kind. The potential for employment with 39% of the technical and administrative staff with 38% and workers with high-level skills with 32% proved to be critical factors in choosing the destination for investment. It can be concluded that the answer to the question whether human capital is essential to attract all kinds of FDI, is that human capital is an important determinant of FDIs, especially for those that require

high efficiency and a skilled workforce as one of the inputs in business, while the investments that are the result of the existence of favorable natural resources or cheap labor have far less significance.

#### **5.4. What is the level of human capital necessary for attracting FDI?**

If we confirm the importance of human resources as a factor in attracting foreign investment, then this leads to the question what kind of human resources developing countries have used in an attempt to attract these investments. In this section, the author will analyze the significance of policies of formal education as a prerequisite for ensuring a high level of FDIs while the question of training and development becomes much more important in the next stage, where they are already providing some level of initial investment, which will be discussed in the next chapter. Primary education is the starting point of any policy of human resource development. Without the supplied general education population, the host country not only runs the risk of attracting FDI only generating low value added, but also decreases the possibility of securing entry into the group of developed country. The experience of developing countries shows that significant investment in primary education has an enormous impact on the volume of attracted FDIs. Probably the most famous of all policy initiatives is to expand access to primary education program "Education for all", in a joint operation conducted by governments and non-governmental organizations with the aim to improve education. The initial initiative to launch this program was set at the World Conference on Education which was held in Thailand in 1990 with the participation of UNESCO, UNICEF, UNDP, the World Bank, as well as representatives of 155 governments and 150 NGOs. This initiative had a noble impact on the increase in grants for elementary education, and also encouraged governments of developing countries to improve the level of education. A good example is Mexico where compulsory education was extended from basic to extensive education in 1993. Introducing this step, the government for the period of seven years reduced the number of illiterates from 40% to 12%, and the average number years of schooling, which in 1980 amounted to 9 years, increased to almost eight years in 2000 (Cohen and Soto, 2001). Another example is Brazil's, where the program "Education for All" included in the school system so that the result was that the percentage enrolled in school with 86% in 1990 increased to 97% in 1999. Some countries, such as Singapore, have invested significant resources in raising the quality of education as well as the expansion of the coverage of education. In development stage in the 1960s, Singapore has initiated a scheme called "standardized educational system," which intended to deliver essential level of

knowledge in mathematics, science and English. In other countries were executed national strategies for expansion, including secondary and higher education. Ireland and South Korea are examples of countries that have managed to increase the scope of the policy. In Ireland, the changed system of financing secondary education in 1967, made education free for all, and subsequently introduced higher education. In South Korea, which is already a high level of coverage of higher education, has problems of securing personnel required for the industry especially in the field of technology. After identifying the problem and confirming that small the number of students enrolled in that field, South Korea changed the system of qualifications provided by graduates and technological sciences and obtained the status of professionals such as lawyers, doctors, or other similar (UNCTAD 1994). Singapore's investment promotion agency (SIA) has launched an initiative that the education system in the country is reorganizing to meet the needs to the real economy (Miyamoto 2008). The beginning of the implementation of the program was 1997 and it was named "world-class university program," with the objective to promote the educational institutions in Singapore and to enable educational courses that will meet the needs of the market. Expected objective of this program was to ensure a satisfactory level of education and research and development that will meet the needs of the economy. This example shows that even though Singapore began the process of transition more than 40 years ago, it still needs to implement strategies for improving human resources in order to ensure the maintenance of competitive advantages on the world market, in particular through the further attraction of foreign investments. Ireland agency for promotion of investments and the Irish Development Agency (IDA) also had a great influence on the formation of an educational policy that is synchronized with the needs of the economy. In 1997, Ireland formed the "Expert group for future needs in skills," in order to identify the need for skills and qualifications in the various economic sectors and proposed action for human resource development (EGFSN, 2008). In addition, Ireland's IPA introduced strategy "Education, training and development," which included programs in Research in Higher Education with the aim to promote research and development and innovation capacity of the economy (IDA, 2009). Moreover, the European Union has made a strategy called "minimum platform learning," which defines the knowledge and competence that are necessary for the future labor market (Carneiro 2002). This strategy is included in the analysis of necessary skills such as communication, information technology, the ability of personal study, as well as other personal and social skills. It is expected for this platform to include the analysis of minimum skills that will be required in the future labor market, a market that is rapidly turning into technological and personnel development. The experience

of other countries in attracting foreign investments leads to two important conclusions. First, the policy of human resource development must be based on its primary education system. Without a clear policy on basic education, the education system will continuously create an uneducated workforce that will be a bad signal to foreign investors. Basic education in primary and secondary schools establishes a sound foundation for the improvement of human capital in higher education, which has become very popular with foreign investors as a precondition for attracting capital. Secondly, and most importantly, policy development of human resources must be managed in accordance with the demands of the economy. Previous experiences show that the participation of the economy and foreign educational institutions that have close ties to the high-tech industry can be effective. The experience of countries such as Singapore or Ireland shows that educational strategies that are proposed via Agency for Investment Promotion provide the reform policy for human resource development, which is in line with the needs of the economy. Finally, it can be said that empirical studies show that human capital is critical for attracting FDIs and that host countries must provide at least primary education for all adults to present a country as potentially interesting for foreign investors. In order to ensure effective policy formulation for the development of human resources, it is necessary to establish cooperation of all concerned parties, namely the government, the economy, and the agency for the promotion of investments.

### **5.5. The creation of human capital**

Through technology transfer by foreign investors, foreign investors and multinational companies are still willing to allocate their assets in such an environment where there is already a formed human capital of educated and skilled workers. In the earlier chapter, we clarified the role of host countries in attracting FDIs through attempts to develop an attractive business climate supported by a clear strategy for reform human resources development. In this section, more attention will be paid to the role of host countries that should be played in mobilizing received foreign investors to engage in further strengthening and development of human resources, or in the training process, which becomes important after completing formal education. Again, in many types of research it has been confirmed that in addition to attracting foreign investors, the country is essential to ensure a basic level education for all citizens, as beginning of the process of transfer, acceptance, and dissemination of foreign technology. South Korea and Taiwan are the best example in the implementation of this practice, since they started attracting foreign capital only after they have developed highly trained human resources (Xu, 2000). In addition to foreign trade, foreign investors are the

only channel by which foreign technology is transferred in a developing country or transition country. Therefore, foreign investors training programs are the right choice for the start of training employees in an economy. Foreign investors are not only financially able to provide training, but they are also able to provide innovative forms of training that include information technology, organizational skills, and management, to which host country usually has very limited access. There are different types of training that can be implemented in any economy. About this topic already has been argued a lot in the previous part, but we can briefly summarize the basic forms of formal and informal training. When talking about the training of employees, it is generally accepted that there is a low level of investment in training (Batra and Tan 2002 OECD 2003, OECD 2004). A study of the world business environment WBES (2003) confirms that, on average 60% of all companies in East Asia and Latin America implemented some level of training. Data vary in different countries with the highest percentage of over 70% in China, Singapore, and the Philippines, while the lowest of 30% in Malaysia. Despite evidence that productivity increases as a result of additional training for 30-70% (Batra 2003), especially in small and medium enterprises (World Bank 2003), still there is a low level training practices worldwide. It is necessary to clarify the reasons that have led to low levels of investment in training. The empirical research in developing countries of East Asia and Latin America has analyzed reasons why firms make the low level of investments in training of employees. Employees were offered a list of seven reasons, i.e. market failure affecting the low level of investment, including (Investment Climate, Capabilities, and Firm Performance: Evidence from the World Business Environment Survey 2004):

- The organization uses out-of-date technology;
- Informal training is enough;
- Lack of funds for carrying out training;
- High turnover of staff make training very expensive;
- Absence of know-how techniques and possibilities of training;
- In the recruitments process employs more trained staff from other companies;
- The organization is skeptical regarding the usefulness of training (Batra, 2003);

The results of a study in East Asian firms have shown most significant factor which leads to low level of investment in training are the organization use outdated technology with 40%, that informal training is sufficient to 30% and a significant level of staff turnover from 33%. In Latin America, the results are somewhat different. This is the first place where the reasons

that the organization employs more trained workers with 44%, while the obsolescence of technology and informal training just below the 30% and 33% (Batra, 2003). It can be determined that in those countries that have gone through a period of transition at the end of the last century, there are clear reasons for the unsatisfactory training level. It also turned out to be that large companies situation are much better, as the opportunity cost for many employees is lower than in smaller firms and they are more willing to take risks. Other studies have shown that the effects of the size of the company are very important for the level of training especially in countries such as Mexico, Thailand, Indonesia, and Malaysia (Zeufack, 1999; Tan and Lopez-Acevedo, 2003; Miyamoto and Todo 2003). Also, it was shown that despite the impact of the size of the company, a major impact on the level of training has ownership structure. Numerous studies have shown that companies in which the majority of ownership is in hands of foreign investors and International Organizations, there is a greater volume of investment in training (Tan and Lopez-Acevedo, 2003 Miyamoto and Todo, 2003; Gershenberg, 1987; Ritchie, 2001). Foreign investors in most cases have fewer problems in providing the necessary funds for training through loans, because they have easier access to foreign capital and also they have much easier access to information on techniques and organization of training on a global level. It is necessary to point out that foreign investors when taking domestic firms frequently take account of the level of education completed by the employees, choosing those companies that have a higher percentage of university graduates. The main goal for this is that the effect of increasing the productivity of educated employees is much higher, and thus the companies with a greater share of highly educated employees are more likely to provide training (Tan and Lopez-Acevedo). In studies conducted by Ritchie (2001), Tan and Batra (1995), and the World Bank (1997), it is confirmed that the level of training of employees is much higher for employees who are better educated. Training is the main source of development of human resources and naturally this is the high interest of investors. Also, in many cases, foreign investors are interested to involve themselves in support of the formal education system of country. One of the best examples of large foreign investors who have invested in education is Intel. They have invested significant resources in the creation of curricula, provision of teaching equipment, infrastructure, and technical support in almost all countries where they have their own production facilities, such as Argentina, Brazil, China, South Korea, India, Russia, Poland, Ireland, and many others (Intel, 2009). For example, in China, Intel gave its support to the development of higher education through the creation of an effective curriculum and research. In cooperation with the Chinese Academy, Intel has conducted joint research

projects that have enabled the development of technology and have provided scholarships for the best students. A similar example of large foreign investors participating in the development of education in Indonesia is Toyota. In cooperation with the Foundation ASTRA, Toyota created a joint foundation with ASTRA, whose purpose was the development of human resources through education, research, and development (Toyota Astra, 2009). The question that naturally arises is that what are the reasons that foreign investors support formal education? One possible answer is that these companies can benefit while being able to hire graduates of educational institutions that they support. As explained in on previous parts, there is much higher return on investment in education which is conducted in the younger age. Similarly, we can say that it is much more efficient to invest in education in formal educational institutions than in training of the established workforce. The best indicators for this service are multinational companies in Europe and the US, such as Harvard Business School, INSEAD in France, or Stockholm School of Economics, which have their offices in a number of developing countries. As noted in the previous chapter, Singapore is one of the countries that first decided to attract such educational institutions in their country. Transfer of technology through human resources development activities of foreign investors and International Organizations have proved to be vital for developing countries and transition economies, as their local capacities (companies, organization) proved to be a poor source of such processes for reasons of market failure. Activities of International Organizations are important as they provide advanced transfer of skills and technologies to local companies, which otherwise would not have been able to import. Knowledge spillovers are considered as one of the most important channels through which country can make technology transfer. Shedding can be achieved in four ways:

- Vertical connection;
- Horizontal connection;
- Trade employees;
- Independence of employees.

Vertical connection is one of the most common ways of technology transfer by foreign firms in the host country. Vertical knowledge spillovers as knowledge spillovers between two firms of different stream (supplier and producer) via supply chain and can occur between two firms located in the same region. There are sufficient examples of this type of connection. One example is Mexico in the 1980s, where the Mexican auto industry had a rapid growth after the arrival of General Motors and other car producers. In a few years, more than 300

domestic auto parts suppliers were included in the cooperation with these companies. Knowledge spillovers are performed through the interaction of local and foreign firms in training, in production and quality control at the weekly meetings and through technical support (Lim, 2001). A horizontal connection is achieved when domestic companies operating in the same economic sector as foreign investors, where foreign investors carry out their investments in infrastructure, technical support, or design a strategy for the introduction of advanced technologies and skills. For example, in Malaysia, the government cooperated with foreign investors in a number of meetings that were organized with the aim of developing strategies and form a development center. Such a development center is directly above of foreign investors that provide training on production techniques, management skills, or other types of training. Experience of staff is also a very common way of knowledge spillovers. This occurs when workers who have been trained by a foreign company in the country set out to look for a new job. They try to sell their newly acquired knowledge and skills, as well as the experience gained by working with foreign investors. Independence of employees is a process that happens when foreign investors plan to conduct training of employees, which eventually give them support by becoming independent in their work. An example of such knowledge spillovers is a program that is offered by Siemens for young workers in the three-year period, where they worked as a low-paid workforce, but after that period could have half of their working time performed outside the company, either with other employers or running their companies (Siemens India, WEB). The spill-over of knowledge actors are not only foreign investors and International Organizations. Borenzstein and others (1998), and Blostr and others (1994) provide examples where the host country adopts a strategy to increase the capacity for receiving new knowledge and skills. By reducing the gap in technology, foreign investors and domestic companies experience an increase in the level of knowledge spill-overs. Regardless of whether the strategy worked out at the state level or the level of local organizations, what these two authors in their works show is that the organization quality of training by the host country facilitates knowledge spillovers that foreign investors bring with them when entering the country.

#### **5.6. Strategy for the development of human resources as a basis for the promotion of training and knowledge spill-overs**

Without strategic and targeted orientation of the government of the host country, there is a little possibility to reduce the gap in the level of technological achievement between foreign investors and domestic companies. This means that the precondition for the technological

advances must be carried out in parallel with raising the level of skills of employees in local companies. However, despite understanding the need for the creation of such a strategic approach to technology transfer, problems occur in the absence of financial resources for the provision of training. Even in the case that the government provides sufficient funds to support the financing of training, it is not possible to satisfy market demand for a large number of qualified and skilled workers. It is, therefore, necessary to ensure the participation of all interested party from the public and private sectors to enable the knowledge that foreign investors bring with them and it is available for other local companies. Measures taken by the developing countries to overcome a low level of investment in training and human resources development can be grouped into three categories:

- Measures to increase the availability of information;
- Measures to reduce the risk of employee turnover;
- Measures to reduce the effects of lack of funds.

In a large number of companies in developing countries and transitional economies, there is not enough information on the benefits that can be achieved by investing in human resources. As already mentioned in the survey of WBES, one of the reasons that are given for the low volume of investment in training is that in organizations there is not enough knowledge about techniques and training opportunities. Many companies are skeptical of such benefits regarding investment in particular, because only a small number of studies show the positive effects of investment in the training available to the general public. For this intention, it is necessary to create a strategy that would aim to disseminate information about the value of such investments. Some countries such as Mexico or Malaysia have embraced this approach to solving the problem of the lack of quality information. In Malaysia in 1993, it was established a fund for human resource development (HRDF). This fund was established by representatives of the private sector and governmental representatives, with the main objective of disseminating the information through training workshops for needs analysis and counseling offices to assist in the development of training schemes (World Bank, 1997). Mexico approached in a different way and had established a program for the necessary quality and modernization (CIMO) in 1998 with the mission to provide subsidized training to SMEs. In a short time, the program included over 23,000 companies and/with 10.000 employees. During the program, it was realized a large dissemination campaign with all of its important components, through workshops in which they explained the basic benefits of involvement in the program and given technical assistance in the introduction of training

schemes (World Bank, 1997). A World Bank study has confirmed that the existence of CIMO to a significant extent increases the participation of workers in training programs. Measures to reduce the risk of staff turnover and a lack of financial resources, many governments have tried to solve by introducing tax incentives. Financial support provided by the states can be divided into four categories:

- Guarantees for expenditure on training;
- Reimbursement of expenditure on training;
- Tax exemptions for salaries;
- Tax exemptions on profits.

In the case of guarantees for expenditure on training, the state has approved to firms an easier access to affordable credit lines for the amount of funds invested in training. This approach has been used in Singapore and Argentina. Returning issued in alphabetic training means that the state firms back a certain portion of the funds invested in the training of employees. This type of aid has been used in Korea, Malaysia, South Africa, and Chile. Tax exemptions are a model that has been used by France, Turkey, and the Netherlands. It is clear that if the government accepts the existence of a low level of investment in training, there are various modes that can be used to give support to companies to increase that level. The first part is with mutual benefit for the individual and society as a whole benefits by increasing the level of human capital. In this regard, it is clear that the state should assume the role of initiator of initiatives to address this kind of problem. OECD (2002) scripted a program called "Instructions for international companies" which was signed by 30 Member States and seven non-members. It is recommended that all International Organizations need to support the process of capacity building of human resources in the host country, to facilitate the transfer of innovative capacity, and promote training. It also recommended the formation of human capital by creating employment opportunities and facilitating training opportunities for employees, through the development of science and technology to meet the needs of local markets, and hiring local employees in the sectors of science and technology with the provision of training in order to improve financial indicators. Although this manual is not binding on the signatory countries, companies and governments are actively involved in the promotion of the program and effective implementation in the market. In order to guarantee that there are adequate offer skills that are needed in the economy, it is essential that the government incorporate the private sector in education and training as active participants.

Considering the above-mentioned, the role of human resources as a basis for attracting FDIs strategic targets in Kosovo labor market and workers in Kosovo are still slow to adapt to the economic situation that is changing. Therefore, the present concern is about the supply of educated, skilled, and experienced personnel in the overall market.

The demand for qualified staff is increasing faster than supply. There is an increased competition among companies in the recruitment of experienced and qualified people that is insufficient in the market such as finance directors, financial analysts and controllers, internal auditors, experts in the departments of human resources, IT, and marketing experts. As a result, stronger pressure is put on companies to retain high-quality employees. Companies are responding proactively are offering personal/professional development and incentives. For example, developing packages in wages and benefits are based on the results, instead of a traditional rigid system of payments related to years of service. The educational system and the way of thinking of people will inevitably be changed. Previously, employees were accustomed to a lifetime and secure employment in the same company. In such circumstances education and training are not a priority for either the employee or the employer. In addition, labor in Kosovo has never been particularly mobile. Today, new entrants in the labor market are more willing to go to other locations. This position improves their employment opportunities and career development. This is resulting in the risk of "brain drain" as many young people wish to leave the country and work abroad. There is an overloaded bureaucracy and state universities provide incomplete knowledge. The number of private universities has increased, but few of them offer different curricula compared to the public university. As a consequence, the market finds foreign universities more attractive for hiring. The education system is still too rigid and fails to provide the education needed for new developments in the market. Although university education has improved regarding the number of students graduating, there is still a need for more innovative and more flexible ways of teaching, in order to respond to changing demands of the modern labor market. To deal with these shortcomings of higher education institutions, the European Union has established supportive various programs, including Tempus, Cards, and many others, but it takes several years for the effects of such aid to become evident. Private colleges and other educational institutions are still in the development stage and only move to work in the field of training, but have not yet managed to reach the level of international standards. In any case, they cannot and should not take responsibility for the education system of Kosovo, which still has to rely on state universities. Kosovo labor market is increasing, but the pace of positive change is slow. The

number of new international companies that have emerged in the market has increased (World Bank Group in Kosovo, 2015). The greater presence of multinational companies has led to the emergence of a new form of professionalism that creates new skills among employees. The unemployment rate is slowly decreasing, and the government seeks to support the labor market various actions that encourage employment. In addition, in the market appeared a larger number of consultants in human resources and recruiting firms to help people finding the appropriate expertise, as well as offering services such as organization development and human resources. Labor demand and the number of qualified staff are still at odds as there is no sufficient supply of labor to cover the growing needs. If we look at the numerical data on unemployment and seeing a large percentage of people with lower education, we note that retraining is also necessary. One of the priorities should be to attract emigration with appropriate expertise (those working abroad and who have acquired key qualifications and knowledge of the business in global companies) to return to Kosovo. Such people often ask the company in top management, instead of bringing foreigners. For the human capital, i.e. the labor force, often said to represent the comparative advantage of Kosovo when it comes to attracting foreign investment. In general, we agree with this assessment. However, it is necessary to point out that, with a relatively small investment, this comparative advantage could substantially increase the quality of the human capital. Knowledge and skills will be in accordance with the dynamic changes in the business and in terms of the legal framework with which companies are facing when it comes to employment. With changes in labor law, Kosovo would become comparable to most other markets in Europe, which would increase competitiveness. Funding is provided in the first phase of the transition is not used for the improvement of human capital in Kosovo, but we must not forget that there are many other possibilities involving more actively existing foreign investors, specifically attracting new FDI, especially pre-accession of funds of the EU, which Kosovo still uses only in marginal amounts (The European Union Office in Kosovo, 2016). Yet, we should not forget that the main macroeconomic risk facing the economy of Kosovo in the coming years suddenly and significantly reduce the inflow of foreign capital and the emergence of the balance of payments crisis, and for that it is necessary to access the set strategy. Kosovo's economy for several years achieved high and growing deficit in the current balance of payments, which covers the foreign investments and loans (World Bank Group in Kosovo, 2015). In such circumstances, a sudden and significant reduction in foreign capital inflows driven mechanism of balance of payments crisis can lead to undermining macroeconomic stability (inflation, etc.), and probably a decrease in the level

of economic activities (UNDP 2015). Sustainable economic development of Kosovo in the coming period will continue to be highly dependent on the inflow of foreign funds. Therefore, the expected gradual reduction of the inflow of funds from privatization requires the creation of an enabling environment to increase Greenfield investments, especially those that achieve a higher level of added value. In this sense, it is necessary to speed up the process of harmonizing our legislation with the EU, in order to increase the legal certainty of business and investment. It is a need to simplify the legislation and to allow the increase of competitiveness by reducing administrative barriers to business. The necessary steps taken are based on the experiences of three countries analyzed (Singapore, Ireland, and Costa Rica), and which include the following:

- Establishing regular contacts with Ministry of Education, Investment Promotion Agency, as well universities, with the intention of creating good education plans and programs that could be adapted and aligned with the needs of the labor market;
- Providing a forum for human resource professionals who seek to improve their professional and personal development, which would ensure active involvement of HR professionals in the economy;
- Programs, networks, and support services, which enable foreign companies to make meaningful contribution to the complex and dynamic world of human capital, must be the basis for the new strategy to attract FDI;
- Joint active involvement of all stakeholders, in order to attract highly skilled and educated workforce that is currently abroad to return to Kosovo;
- Establishing a licensing system for HR professionals. This system should be developed by independent expert organizations and supported by the relevant ministries;
- The introduction of a system for training management and HR professionals to a greater extent than it is today;

### **5.7. Analysis of human resources in the investment process of foreign investors**

Investment process usually begins with a preliminary financial analysis of business firms that are potentially for sale. The job is usually awarded to brokers or financial advisers who analyze the financial indicators of the past few years. The question of credibility and objectivity of advisers has become a matter of debate in 2001 (Dinello, Natalia E and Squire, Lyn, 2005). In the debate insisting that the necessary additional analytic techniques will enable acquiring objectives of the organization. Such techniques are necessary to analyze the

human capital that is related to financial performance. Analytical techniques used today are completely dependent on the analysis of financial data that allow making model, which subsequently are utilized for the assessment of future income. Also, larger models use the past performance indicators to predict future events, instead of using resources, among which there are data on human resources. One of the first models created is the index of human capital - HCI by Watson Wyatt (Pfau, Bruce and Kay, Ira and Nowack, Kenneth M and Ghorpade, Jai, 2002). HCI has emerged as a result of the research practices of human resources in 70 organizations in America and Europe. In the comparative analysis of the data series in 1999 and 2001, the author tried to establish a direction in which there is a correlation. It turned out that there is a much higher correlation between HCI indicators of the 1999 financial results in 2001 than vice-versa, which supports the assertion that the practice of quality human resources in the company delivers good financial results before the good financial results lead to improving the practice of human resources in the organization. In his analysis, Wyatt explained that 47% growth in the market value of the analyzed companies in the intangible component of human resources, namely the system of rewards and responsibilities 16%, collegial and flexible workplace 9%, excellent employment and retention of employees 7.9%, integrity and communication 7.1%, and focused HR technology 6%. The study showed that comparing five-year revenues of companies are coming to the conclusion that those companies that had low levels of HCI index achieved an average 21% return on investment, companies with an average index of HCI have achieved 39% return, while companies with high HCI achieved 64% return. This analysis supports the statement that it is necessary to include elements of human capital in the analysis of financial indicators of the company, or return to the fundamental concept. However, most organizations do not have an effective system of monitoring components of the intangible capital of the company. One of the efforts to solve this problem is presented in research of Royal and O'Donnell, (2000) in which the index created compares the market value of firms with a series of factors which are named index value creation, and included eight intangible factors among which are the quality of governance and the quality of employees. The fundamental concept of this analysis was created in 1934, in which the organization is analyzed as a process which creates its value. This approach has been replaced in the seventies of the last century with portfolio theory, and later in the 1980s with the popular CAPM - Capital Asset Pricing Model (Ross, 1976, Mitchell, 2001). One of the effects of these changes is that the advisers' assessment of firms have begun to rely on their own model, which relies heavily on mathematical models of assessment of income, rather than a broader analysis of the organization and the environment

in which it operates. The value of shares is viewed solely through the lens of risk and return on investment, or beta factor shows the volatility compared to the same sector of the market. Such mathematical estimations fully eliminate the factor accepted as the basis for the theory of systemic analysis of the organization, which observes firm in the wider context of the environment, as well as internal and external connections (Royal, Carol and O'Donnell, Loretta, 2005). According to this theory, this is the most complex system to react to the environment, adapt to and often becomes even more complex during its development. For this reason, it is essential to expand the analytical approach based solely on mathematical analysis and other factors that may affect the financial performance indicators. In order to avoid this for companies that are knowledge-based, advisors should understand the value of the intellectual capital of the company in order to be able to do the right assessment of future income. Intellectual capital is owned by employees and thus is employed owners of the factors of production, not the company whose owners are in possession of other factors of production (Peet, Richard and Hartwick, Elaine, 2015). According to Stacey (Royal, Carol and O'Donnell, Loretta, 2005), intellectual capital can be divided into two main categories, human capital and intangible assets. Together they can be measured by valid quantitative methods. This provides the index of intellectual capital, which not only includes hours spent in training, or the number of patents made, but also the extent of utilization of the capacity of these companies in the business process. Such approach is used for other statistical indicators of company's performance in the previous period to calculate an accurate indicator of potential business in the future. Qualitative analysis of human capital includes a broad range of analysis techniques in companies. It includes interviews with managers and employees, focus groups, historical analysis, individual observations, and research on other documented sources. It is clear that today's advisors are not able or willing to deal with such a detailed analytical process, which would be expensive both for them and investors.

In the context of Kosovo the process of privatization was attempting to make a model which would cover all of these techniques, but in practice it turned out that such an analysis had never been performed. The assessment of companies in the privatization process proved to be generally inefficient approach and was based solely on an analysis of financial data and mathematical models. All the relevant institutions in Kosovo mentioned earlier cited the advantages of Kosovo, and they mentioned the qualified workforce when assessing the value of the companies that were sold. In the next stage of privatization of the state-owned enterprises, it is necessary to include an analysis of human resources and human capital, and

thus to ensure the arrival of foreign investors who will be able to take benefit of this resource in the best possible way and continue to develop and facilitate the shedding of their knowledge and skills in the business environment in Kosovo.

### **5.8. Chapter Conclusion**

In this chapter the author has provided a review of various theories which explain FDI. The review has identified a considerable number of potential determinants of inward FDI and it has shown that human capital is not taken into account by most of these theories. Furthermore, a few studies that recognize human capital do not provide arguments why it may attract FDI. The result of human capital investment on FDI has been borne with conflicting conclusions with some scholars concluding that there is a positive relationship between human capital investment and FDI, while others do not see this correlation as significant. Having found no clear and explicit rationale(s) for a relationship between human capital and inward FDI in FDI theory, the chapter sought to explore these through an analysis of the role of human capital in economic growth theory. Accordingly, three mechanisms through which human capital could affect inward FDI were identified are productivity enhancement, facilitation of technology adoption, and facilitation of innovation. Finally, it was argued that there may be reverse causation in this relationship, an issue which should be treated with caution in the empirical analyses conducted in the rest of this research.

The theory discussed in this chapter, however, does not yet provide a suitable theoretical framework for analyzing FDI in transition economies.

## **Chapter 6: Foreign direct investments post-conflict Kosovo**

### **6.1. FDI and economic development**

Economic development is vital to every country and especially for countries in the aftermath of armed conflict once immediate reconstruction needs have been addressed. Development assistance only cannot transform damaged economies of countries, and foreign direct investment (FDI) can be a valuable instrument to regenerate industries, restructure infrastructures, and gradually eliminate the need for aid. Although the causal link between FDI and economic development is the subject of disagreement among scholars, with some proposing that the relationship goes in the opposite direction, it is generally assumed that certain types of FDI can bring benefits if they are managed carefully as part of a comprehensive investment strategy. In fact, what matters the most, as the United Nations Policy Brief on the Role of Foreign Investment in post-conflict countries highlights, is the quality and form of FDI rather than quantity. The task of developing countries, and mainly those coming out of years of conflict, cannot be left only to market forces, FDI can only be acceptable if it was valuable and makes a real contribution to the host economy, regarding job-creation and spill-over of knowledge and/or technology. Policies on FDI must be balanced regarding the demands with the acknowledgment that developing countries are competing to attract investment. The potential investors will logically consider the incentives available to various destinations, opportunities, and the legal regime and decide on investments. The investment system is vital not only for attracting new investments, but also it can also encourage the existing investors in increasing levels of investment. In addition, the investment system can offer protection and privileges to diasporas in the process of rebuilding of their country (Nicholas Turner, Obijiofor Aginam and Vesselin Popovski, 2008).

### **6.2. Landscape of Foreign Investment in Kosovo**

At the end of the conflict, many foreign firms acting within the framework provided by foreign aid agencies and international or European institutions entered Kosovo to rebuild the vital infrastructure. Being involved in the reconstruction was seen as an opportunity to set up a foothold in the country and the region. However, most firms had no clear long-term strategy and were essentially involved in one-shot projects through tenders held by the EU. A central stake during the reconstruction period for the local administration is to set up a clear long-term strategy to attract foreign investors willing to commit in the long run. Defining priorities then set a basis for dynamic future economic development by creating growth mechanisms.

The transition from the period of reconstruction to a period of economic development saw a reshuffling of cards regarding foreign presence. New sectors such as banking and telecommunication developed and some foreign firms saw their presence diminish despite previous strong involvement.

Kosovo is very rich in mineral deposits, but its potential has been left unused for different reasons. During the Yugoslavian rule, the mining sector was a key segment for the growth of the economy of Kosovo. The capacities of the mines have suffered due to management neglect during the 1990s, as well as war damage (World-Bank-Kosovo, 2016). Agricultural land has been underutilized also, despite the favorable soil and weather conditions. Agriculture has traditionally been an important economic factor in Kosovo, participating with around 30% of total GDP. Transition process, under-investment, and war led to a sharp decline in the sector (Topxhiu, Rahmije Mustafa and Krasniqi, Florentina Xhelili, 2011). Private enterprise development started during 1990's when the first elements of entrepreneurship in Kosovo began to emerge. In practice, these elements did not develop because of the favorable business environment, but as a response to several political developments in ex-Yugoslavia, especially the political movement of the 1990's when Kosovo Albanians declared their independence. At that time, most of the populations that were employed in state industries or agriculture were expelled from their working places by the Yugoslavian regime in Kosovo. Therefore, people had to find a way out of these circumstances and began to open small retail grocery stores, craft stores, and cultivation of agricultural products. After the war, almost everything started from zero. Countries that experience prolonged periods of conflict and wars face much contradiction need immediately to improve basic infrastructure, governmental capacity, lack of public revenues, and investor interest to provide those services (Schwartz, Jordan and Hahn, Shelly and Bannon, Ian, 2004). Even though donors have provided considerable aid for reconstruction and rehabilitation, Kosovo is still struggling to absorb assistance in a constructive manner due to a wide range of capacity constraints. "Initially, the GDP growth figures were in double digits during 2000–2001, and this was mainly the result of the massive donor-funded reconstruction effort, but during the following years, despite continued donor financing and remittances, only a moderate growth can be seen" (Topxhiu, Rahmije Mustafa and Krasniqi, Florentina Xhelili, 2011).

### 6.2.1. The importance of historical ties in determining foreign presence

In the new landscape, German, Switzerland, Austrian, and Slovenian investors that had already been very active have seized a large part existing business opportunities through very active national Chambers of Commerce and governmental agencies. In the first eight years since its declaration of independence (2008-2016), most FDI that Kosovo attracted came from Germany, Switzerland, and Turkey. Other notable investors were Austria, Slovenia, and the United Kingdom. Germany is the biggest investor in Kosovo. Turkish firms have also taken advantage of historical ties and with the help provided by the Turkish Chamber of Commerce is established a strong presence of Turkish businesses in Kosovo. Nevertheless, most companies present in Kosovo are medium sized companies. Large multinationals have little interest in such a small market, and small companies do not have the international capacities to overcome the barriers to entry.

**Table 18. Foreign direct investments in Kosovo by countries (net)**

		2008	2009	2010	2011	2012	2013	2014	2015	Increase/decrease 2014-2015
1	DE	44	75.2	91.5	66.6	49.5	21.7	29.4	45.3	54%
2	CH	32.1	22.7	35.1	30.9	43.8	41.7	38.2	72.9	91%
3	TR	23.8	14.5	4.9	34.7	65.6	88.6	20	57.8	189%
4	AT	51.3	15.5	21.1	19.6	0.4	10.7	30.3	33.5	11%
5	GB	36.6	6.2	38.9	80.1	14.3	10.7	-39.5	26.6	-167%
6	AL	21.9	23.3	20.3	11.2	4.7	19.3	20.4	40.7	100%
7	SI	44.3	50.8	34	16.2	9.3	7	-9.4	5.6	160%
8	US	4.8	11.8	12.6	14.3	10.8	12.7	14.7	24.9	69%
9	IT	0.1	6	6.6	1.7	4.4	8.7	3.3	5.7	72%
10	BG	2.8	...	0	3.4	8.1	5.6	14.5	1.6	-89%
11	FR	3.5	6	3.8	0.2	6.3	3.8	3.3	3.2	-2%
12	NO	0.1	2.5	3.3	2.5	2.9	4.7	5.9	2.9	-52%
13	MK	2	1.5	1.8	5.8	1.2	4.6	3.2	0.5	-85%
14	LU	6	8.3	0.4	0.5	0.8	2.3	1.2	0.1	-88%
15	AE	0.1	0.7	8.7	6.5	0.8	-0.8	1.3	1.4	8%
16	RS	5.5	0.6	0.4	0.4	0.4	5.7	2.4	0.8	-66%
17	NL	25.9	23.1	17.2	4.7	-25.6	-0.1	-7.8	-24.1	208%
18	MT	0.6	...	0.9	0.2	4.3	3.1	0.1	0	-85%
19	HR	0.7	0.7	1.8	2.9	0.4	1.3	1.1	0.1	-86%
20	CA	0.2	0.3	0.8	0.5	1.2	1.2	0.9	1.1	21%
21	KW	0.1	0.5	1.6	0.2	0.7	2	0.5	0	-94%
22	GR	0	0	5.9	0.4	0.3	-0.4	-0.6	-0.2	-75%
23	CZ	0.2	0.4	0	1.3	0.3	0.2	0.4	1.3	268%
24	BA	0.7	0.5	0.8	0.1	0	0.2	0.3	0.8	197%
25	CY	0.3	0.3	0	1	0.3	0.3	0.3	0.1	-65%
26	SK	0.2	0.1	0	0	...	0.2	0.1	0.1	-20%
27	EG	0.1	0.1	...	...	0.1	...	0.1	0	-31%
28	ES	0.1	0.1	0.1	...	0.2	0.2	0.1	-0.8	-650%
28	Other	63.5	61.9	23.9	55.8	78.6	23.6	25.2	16.6	-34%

Source: CBK Monthly Statistics / 2016

Foreign Direct Investments (FDI) in Kosovo reached a value of euro 324.4 million compared to the value of euro 151.2 million in 2014.

### **6.2.2. Privatization Program**

The Kosovo government has been gradually privatizing the assets of SOE (state-owned enterprises) starting since the 2000s. The PAK (Privatization Agency of Kosovo), is an independent agency, with the task of to handle the funds of Kosovo's SOE assets. As of 2015, PAK has sold around 300 SOE and created a trust fund of around EUR 600 million. Foreign investors are free to participate and follow Kosovo's public procurement laws. However, bidding processes have been criticized in the media as non-transparent and illegal. Kosovo's power supply and distribution was privatized in 2012 and has been in 2013 to Turkish investors Çalik/ Limak consortiums. With significant changes during the ten years, the government issued a tender power supply company "Kosovo C," in 2014. The American company has bid and won the tender and now is under evaluation. Another important project is giving under the concession for the construction ski and tourism Resort in Brezovica, which is expected to be finalized in 2016. Kosovo government of a much needed source of steady long-term revenue to address short-term liquidity needs (IMF C. R., 2015). As a result, this potentially hinders the development of an attractive business environment as the government seeks other sources of revenue, possibly through higher taxes. Other observers argue that these assets have been sold off at a price much below their real value and denounce the opacity of the procedure.

### **6.2.3. Restrictions upon Foreign Investment**

The majority of capital flows in the country are linked to the Kosovo diaspora that sends remittances to their relatives. Most of these inflows are affected by building houses and catering to everyday needs rather than directed towards productive investment (Kosovo Human Development Report 2014). Domestic investment has remained mainly in the construction industry. However, most businesses that are set up by locals are small-scaled. According to the European Commission Liaison Office in Kosovo, these businesses represent a high risk of going bankrupt. The specific measures undertaken are not helping them. For this reason, the Commission has engaged in several programs to promote SMEs via financing or providing access to expert counseling (Kosovo, 2016). Kosovo's laws do not differentiate domestic from foreign investors. The government actively promotes foreign investment and supports the expansion of the private sector. However, the lack of a single governmental organization empowered and responsible for organizing and coordinating all FDI opportunities is an obstacle to some projects. The Kosovo economy continues to shift from

socialism system of governing to capitalism, and yet public distrust of the private sector remains.

#### **6.2.4. The legislation system on FDI**

The legislation system in Kosovo has three segments which operate at the same time. This includes laws passed by the former Yugoslavia through 1989, regulations issued by the UMIK, and law issued after the independence of Kosovo. With the international assistance, Kosovo government has been moving legal structure that it is in line with the EU standards. Legislative framework, weak law enforcement, and the need for additional legal reform hinder economic growth and investment. Addressing these challenges international community especially U.S. government and the EU provide support in the enhancing Kosovo's judiciary. Licensed private enforcement agents began supporting enforcement of contract dispute decisions in 2014 and have experienced considerable achievement in executing collections on non-performing loans. All main sectors of the Kosovo economy are open to foreign investment. The Kosovo Assembly and UNMIK have approved business legislation that explicitly tries to attract foreign investment. With the Kosovo law, foreign companies that have activity in Kosovo have same privileges as local except in some particular product (trading of military goods, the foreign firm can have maximum 49 percent ownership). In 2011, the government took additional actions to open Kosovo economy for FDI through the passage of the Law on Public-Private Partnership (PPP). This law is allows FDI transactions to be structured and more flexible. The KA passed the bill on FDI in 2013, which has improved further the legal infrastructure and has corrected inconsistencies that had unduly discouraged foreign investment. KIPA (Kosovo's Investment and Promotion Agency) has been created for promoting Kosovo to foreign investors. Nevertheless, KIPA is only partially due to expected revisions to Kosovo's investment policy.

#### **6.2.5. Limits on Foreign Control**

In general, Kosovo laws do not restrict funding, acquisition, and sale of interests in enterprises and by private entities. Under existing laws, foreign companies operating in Kosovo are granted the same rights as local businesses apart from in the production and selling of military related-good. Foreign investors can have a private ownership right, and they are not subject to approval by the government.

#### **6.2.6. FDI process of approving, screening and reviewing**

Kosovo laws, in general, do not require from foreign investor to be screened, reviewed, or approved. However, the absence of processes and procedures in the process of attracting and

securing FDI, creates possibilities for abuse and corruption, and creates opportunities for the politicization of FDI activities. Law on Competition with the objective of limiting unfair competition was adopted in 2010 and amended in 2014. The authority was established in 2008 and containing of four members and a chairperson who are elected by the Kosovo Assembly, and this authority is in charge of implementing Law on Consumer Protection and Competition and other similar laws.

### **6.3. Current Economic Situation**

The Republic of Kosovo is a developing country and the business environment is vibrant and growing, but still far behind other Balkan countries. Kosovo business structure is not stable, and the government does not promote business and entrepreneurship. However, there are some remarkable initiatives sponsored by the government to promote exports. Managing small enterprises is a challenging task, particularly knowing the fact that the access to finance is limited and mainly depends on the owner's capital, while domestic and foreign banks support a limited number of SMEs. In general, the development of economic environments, the management of small and medium enterprises is a very attractive task, but in business environments like Kosovo, managing small and medium businesses is a real challenge.

### **6.4. Development Framework General and Perspectives**

Geographical position, access and free trade in the region, potential for EU export growth, and the largest Kosovo underutilized resources (labor, land, and minerals) can be used to attract foreign investments in agriculture, mining, and labor-intensive manufacturing. However, given the deteriorating economic outlook in Europe and slowing global economy, economic growth in Kosovo is expected to be moderate (World Bank Report). According to the European Commission's 2014 Progress Report, Kosovo's private sector appears to be small and incapable to advance in efficiency improvements brought from economies of scale. SMEs that have less than 250 employees account for more than 97% of entire employment in Kosovo. Retail and wholesale trade continue to be the leading sectors, which have a share of 30.3% of all new enterprises, followed by the real estate and service sector with about 20%. The great informal sector powered by weaknesses in law enforcement and taxation policies continues to delay fair competition and to damage the business environment. This situation also delays developments in productivity by limiting entrepreneur's access to finance, technology, and in the market. Generally, Kosovo's private sector remains undersized and underdeveloped. The great informal economy, limit possibilities for accessing the finance

which is very much needed and also this is the impacting cost of finance, which represents major challenges. Decreasing the informal economy remains an important challenge.

#### **6.4.1. Financial Sector Developments**

By the end of 1999, there were no working banks in Kosovo. The approval of the first bank was given to Micro Enterprise Bank of Kosovo (MEB Kosovo), with the shareholders EBRD and IFC, and which started to operate in January 2000. The operations of financial institutions in Kosovo are regulated by law and regulations, the contents of which largely harmonized with the principles and the standards established and accepted in the international context. The banking sector of Kosovo represents the vast majority of the financial system. Thanks to the implementation of international standards, Kosovo has created the appropriate conditions for the establishment of a modern and stable banking sector. Kosovo formal capital is underdeveloped, while the insurance market, after several years since the beginning of the reform, more than doubled its total balance sheet. Despite the low participation of life insurance in the total financial system, it has achieved a significant growth. The banking system of Kosovo shows potential for growth more than other financial sectors. Stability of financial sector contributes to the function of protecting the interests of users of financial services through supervision of financial institutions by the Central Bank of Kosovo through the system of deposit insurance, which further strengthens confidence to the extent of entire financial system, and the function of the credit registry, which provides information on financial indebtedness of potential clients. There are nine (9) banks that are active in the banking system in Kosovo as of today, which represent 72.6 percent of the total assets in the financial sector. Their products and services consist of bank accounts, loans, bank cards, bank guarantees and letters of credit, e-banking, domestic and international payments, etc. Access to these services is enabled through 305 branches and sub-branches, 493 ATMs, POS-9039 and 113,171 e-banking accounts. (CBK quarter report 2015). Bank activity is mainly dominated by loans, and depending on the type of loan type the term may be up to 15 years. 67.7 percent of total loans are loans to companies. Major parts of these loans are issued to commercial segment (corporate loans 53.2 percent) while distribution to the industrial sector loans (energy, construction including mines and production,) create 23.8 % of total loans to the commercial sector. Agriculture and farming represent 3.9% of total lending in Kosovo. The loans to households participate with 30.8 percent of total loans (CBK). The structure of liabilities side of banks is dominated by deposits which count for 80% of the total assets of the banking sector. The ownership structure of commercial banks in Kosovo has a different

structure. Eight of them are foreign capital banks and two partially domestic capitals. There are 3,638 personnel working at the commercial banks employees (Kosovo Banking Association 2015). In 2015, the number and the distribution of financial institutions in Kosovo almost the same as in the previous year remained. Specifically, the total number of credit institutions was 84 and 10 containing the commercial banks, 13 insurance companies, two pension funds, 41 financial auxiliaries, and 18 microfinance institutions (CBK, <http://bqk-kos.org/>, 2015).

#### **6.4.2. Structure of employment**

Limited access to jobs is not the only problem in the labor market. The common challenges remain with respect to existing places of work. Informal employment is a key feature of the labor market in Kosovo (Gerxhaliu, 2016), although there is a lack of information and analysis on the overall size and characteristics of informal employment. While labor force survey does not share information on informal employment, some estimates can be calculated by comparing the estimated number of workers from the SFP Union with the number of workers registered for the purpose of income tax as reported Ministry of Economics and Finance. Based on this estimate, about 50 percent of all employees in Kosovo were in the informal sector in 2015. The ILO's survey called "from school to work" confirms similar rates for new workers (KAS, 2016). The degree of informality is even more distinct if it is determined according to whether companies have complied with the payment of pension contributions and taxes, as 67 percent of young workers are not enrolled in the social insurance system. To be employed in the informal sector is often the only opportunity to secure a job in an economy with high unemployment. Widespread informal employment may have a number of consequences for the economy and society. Informal employment does not give workers protection and rights at work, and lowers the labor standards in general. High level of informal employment may have an adverse impact because it reduces tax revenues governmental fiscal. Although informal worksites represent an important feature of the labor market in Kosovo, there were no proper researches on this topic. The labor market in Kosovo is characterized by a relatively high level of temporary, part-time, and self-employment (KAS, 2016). Temporary employees as a percentage of a total number of employees are decreasing, but still remain at the level of 51.5%. The corresponding part-time workers are around 17%, although this share is much higher in females than in male (28% and 13% respectively). The survey of the transition from school to work carried out by the ILO shows that about 72 percent of all young workers under temporary/part-time reported that this is

because they cannot find a permanent job/with full time (V. Corbanese, G.Rosas, 2007). Self-employment continues to contribute about 21% of overall employment level and is an alternative to paid work when the latter is difficult to achieve. It should be noted that many workers engaged in low-paying jobs and productivity do not earn enough to escape poverty. World Bank in its Poverty Assessment reports that Kosovo poor make up 35 percent of those living below the poverty limit. (World Bank Group in Kosovo, 2015). The employees, workers, and self-employed in agricultural households (farmers living from working the land) have the highest incidence of poverty. The high rate of poverty among the unemployed and substantial part of the working poor shows the need to promote better access to jobs and a higher quality of work is the essential path to reduce poverty.

### **6.4.3. Human resources development**

Getting a clear human development picture of Kosovo is difficult. Kosovo's unique status and challenges of its post-conflict administration have made reliable data difficult to source. Unfortunately, the range of data available suggests that Kosovors have the most challenging human development context in Europe. Kosovo ranks 87th in the world, (UNDP -HDI-human-development index), which leaves it behind all the rest of Europe. The people of Kosovo will, on average have a shorter life expectancy, less expected years of schooling, and a poorer standard of living than all of their European counterparts. The HDI is a complete instrument existing to assess the capacity of an administration to increase choices and capabilities of all its interested party equally. This measures the state of the human experience in three fundamental categories: A long and healthy life; Access to knowledge; and Living standard. Taking a closer look at Kosovo's society reveals deep fractions along three divides: 1) Between the rich and the poor; 2) Between different ethnic groups; and 3) Between the genders, particularly affecting the young population. Inequality is the common theme running through these fractions, and it is reflected throughout their economic, socio-political, and gender dimensions. Kosovo's leaders are aware of the challenges they face, they recognize that private sector as a human development tool, and have linked their vision for the future to the European Union (EU) 2020 strategy for sustainable and inclusive growth. The strategy is a description of the three fundamental elements of sustainable development which are economic development, social development, and the environment. Kosovo, like many other low-income countries with modest education and literacy rates, perceives growth through a considerable factor in resolving socio-economic problems. Though, there are many obstacles to overcome. Kosovo before 1999 was administered by a highly centralized,

ideologically socialist state system that owned all the dominant means of production and private enterprise were represented on a small scale. There were no regulations and socially responsible private enterprises for small family businesses or Kosovo's major industrial assets. Even though from 1999 there were many efforts in the direction of a transition to a market economy, the public sector still dominates in Kosovo's labor market. Today, over a decade after the conflict, the private sector is more than ever viewed as a rescue for Kosovo's aspirations and a principal segment of its development vision.

#### **6.4.4. Business Climate in Kosovo, Doing Business –World Bank**

The improvement of business climate including financial aspects, regulatory, legal, and institutional, has a positive impact on the overall development of private sector. This impacts the development of the private sector, which affects the improvement of the socio-economic welfare of the country. It performs efficiently at different levels of production, creates conditions for innovative solutions to technical and operational barriers, encourages technological innovation, and transfer of knowledge. The private sector was essential for achieving significant development around the world. This sector constitutes the largest GDP in many developing countries. It is also responsible about 90 percent of jobs in the world (World Bank, 2012), and carries the heaviest weight in the achievement of the first Millennium Development Goals (MDG) of halving the number of people living on less than \$ 1 a day by 2015 (CIDA, 2003). In addition, in many countries, the private sector generates substantial income taxes to provide health services, education, and other public services. Put differently, private sector represents the main source of economic growth, creating jobs, reducing poverty, and increasing revenues for the government in many developed and developing countries. In the path of transition to a market economy, Kosovo constantly faced obstacles of various natures, reflected in the business environment and, as a result, have prevented the development of the private sector in the country. Despite some recent reforms, Kosovo still ranks 66th out 189<sup>1</sup> countries in the Doing Business Report of the World Bank 2015, worse than all neighboring countries except Albania. Macedonia, for example, ranks 12th or 54 positions higher than Kosovo. Moreover, Kosovo's businesses operate in an environment of unfair competition, corruption, non-functioning judicial system, and other harmful factors. This unfavorable business climate has been a burden for businesses. Considering the status of economic development in Kosovo, Austrian Chamber of Economy has made an assessment of the climate business by a Quantitative Online Survey. The results

were as expected. Half of the respondents rated the current economic situation in Kosovo as a poor one and a third planned for 2016 to have an improvement. (Huruglica, 2016).

Country's financial figures used in this chapter are taken from the World Bank's report 'Doing business' 2015. According to the WB (World Bank report Doing Business 2015), Kosovo has improved its business and investment climate in general. Kosovo moved to place 66<sup>th</sup> due to a number of ongoing legal and administrative reforms. The best country in the region is Macedonia, which is ranked, 12<sup>th</sup>, followed by Montenegro (46) and Kosovo (66), while Bosnia and Herzegovina are at the 79<sup>th</sup> place has the lowest ranked country. Compared to last year's report, Macedonia has made progress in two places, for improving procedures and processes and when awarding permits for construction, protection of minority shareholders and ease tax payments. Kosovo shifted from 64<sup>th</sup> place to 66 due to lacking in procedures for obtaining enforcing contracts get in the construction permits, registering property, and resolving insolvency. The largest decrease compared to 2016 ranking was recorded in Albania, which according to the World Bank report, fell from 62<sup>nd</sup> to 97<sup>th</sup> place.

**Table 17. Doing Business in Kosovo**

Topics	Kosovo			Albania			Macedonia			Serbia			Bosnia and Hezegovina			Montenegro		
	DB 2016 Rank	DB 2015 Rank	Change in Rank	DB 2016 Rank	DB 2015 Rank	Change in Rank	DB 2016 Rank	DB 2015 Rank	Change in Rank	DB 2016 Rank	DB 2015 Rank	Change in Rank	DB 2016 Rank	DB 2015 Rank	Change in Rank	DB 2016 Rank	DB 2015 Rank	Change in Rank
Starting a Business	47	40	7	58	54	4	2	2	0	65	62	3	175	165	10	59	55	4
Dealing with Construction Permits	136	137	-1	189	122	67	10	10	0	139	178	-39	171	170	1	91	102	-11
Getting Electricity	124	118	6	162	159	3	45	43	2	63	61	2	119	131	-12	163	162	1
Registering Property	32	31	1	107	104	3	50	50	0	73	72	1	97	95	2	79	77	2
Getting Credit	28	24	4	42	36	6	42	36	6	59	52	7	42	36	6	7	6	1
Protecting Minority Investo	57	54	3	8	18	-10	14	18	-4	81	81	0	66	64	2	36	33	3
Paying Taxes	67	64	3	142	130	12	7	7	0	143	165	-22	154	151	3	64	97	-33
Trading Across Borders	71	70	1	37	37	0	26	26	0	23	23	0	28	28	0	42	42	0
Enforcing Contracts	48	46	2	96	96	0	26	25	1	73	73	0	66	67	-1	43	43	0
Resolving insolvency	163	163	0	42	40	2	37	34	3	50	49	1	38	35	3	36	33	3
<b>DOING BUSINESS 2016 RANK</b>	66	64	2	97	62	35	12	14	-2	59	68	-9	79	82	-3	46	47	-1

Source World Bank 2015

#### 6.4.5. Legislation

Since 1999, Kosovo's established judicial system has been fully compliant with the EU legislation. Kosovo has installed international financial reporting standards. The legislation documents in Kosovo are available also in English.

#### **6.4.6. Informal sector and small and medium enterprises**

The informal economy prevents open competition and increases operating costs of enterprises in the formal sector. Informal labor contracts and systematic evasion of social security contributions weaken employee protection and reduce their social benefits. It has a negative influence on the fiscal budget and in the complete infrastructure of society. The approximate size of the informal economy ranges from 39%-50% of the GDP (Government Programme for Prevention of the Informal Economy in Kosovo 2010-2012). Expanding the number of small and medium enterprises in the formal sector is one of the biggest challenges of the small and medium enterprises' strategy (Government Program for Prevention of the Informal Economy 2012). The informal economy weakens the trust between small and medium enterprises and the financial institutions, reduces SME access to credit, and the ability to make use of formal mechanisms for dispute resolution.

#### **6.4.7. Customs and Taxes**

Currently, the majority of Kosovo's taxes are collected at the border. If the production industry is able to develop at later stages, tax collection could be expanded and shifted internally by legal and private individuals, and that would be of vital importance to encourage imports of goods and raw materials for production purposes. If this does not happen, it is likely to discourage both domestic and foreign investors regarding production. Clearly, it would be premature to abolish duties which would have a devastating impact on the income and in the position of the government, but Kosovo depends heavily on its competitiveness and its ability to grow and attract manufacturers. Some existing policies speak out against this tax category for intermediate goods and raw materials.

#### **6.4.8. Institutional support**

Institutional support does not appear to be coordinated with well-defined policies for business development. Kosovo government has planned a series of initiatives, but there is no information whether they will be implemented. The SME Support Agency has been created with the main purpose to take the leading role in supervising SME strategy. These agencies are the following: Investment Promotion Agency of Kosovo (IPAK), the Kosovo Business Registration Agency (KBRA), and the Agency for Standardization. Kosovo Investment and Enterprise Support Agency (KIESA) is the prime governmental institution, which supports foreign investments in Kosovo. "KIESA provides a broad variety of provision programs to assist international businesses achieve their relocation objectives, and the Agency is also charged with the promotion of exports," Kosovo Chamber of Commerce is established in

1962, and it is the representative of business community interest. Kosovo Chamber of Commerce is a non-profit and independent organization with no political affiliation. KCC is organized and works with the objective of improving the market economy, entrepreneurship, and triggering competition between its members. Kosovo Chamber of Commerce members operate in different areas of the economy, including construction, banking and insurance technology, telecommunications, metal processing, wood processing, food and beverage processing, etc. (OEK, 2012).

### **6.5. Declaration of independence and economic perspective**

The economic policies have been volatile in the eight years of independence of Kosovo. Kosovo is in a period of fiscal expansion subjected to increased economic growth and budget revenues. At the same time, these external imbalances and economic vulnerabilities have increased. Since 2008, the fiscal consolidation has made steps in response to existing financial constraints. The government has improved progressive reforms the economy of the regulatory framework for businesses. There is a general unanimity in society on following market-oriented policies. At the same time, informal business practices and corruption are still a challenge, and economic development remains the primary target in this context, while the rule of law still needs to be strengthened. Kosovo is an economy, which uses Euro currency, and it was relatively isolated from the global economic crisis, due to its limited participation in the world economy. Bank lending is financed from domestic sources in the form of deposits, and the sector remains well capitalized and profitable.

Financial resources are an important factor for the development of enterprises in Kosovo, which in return will affect the country's economic growth. However, funding is likely to facilitate the creation of new businesses or expanding current capacities of enterprises in Kosovo. This statement comes from the fact that interest rates of commercial banks, which are the major source of financing of companies, are categorized as high and as additional liquidity for the company. From the research done in Kosovo industry, shows that the majority of companies that have invested in Kosovo (75.8%) have used their capital and 20.7% had used bank loans from banks operating in Kosovo (Ministry of Trade and Industry& Riinvest, 2010). Other sources of funding are proportionally less and include loans from banks operating abroad participating by 0.5%, non-governmental organizations, donors, or to refuse the return of those funds by 0.9%, and loans from friends and family with 0.7%. Moreover, from the same survey, the results show that the majority of companies that have

received bank loans (81%) reported that credit conditions are unfavorable. In this context, the majority of the companies (74.2%) indicated that the annual interest rate is 10-15%, and 14% of companies reported that they paid higher interest rates. Only about 11% of businesses have received loans with interest rates below 11%. These data show solid financial conditions that are presented in the perceived barriers to such commercial enterprises as well (Ministry of Trade and Industry & Riinvest, 2010).

The economy offers very limited employment opportunities. External deficits are very high, and economic activities are mainly in the service industry. Kosovo is heavily relying on remittances and there is a trend of decline on remittances in a direct or indirect support. (CBK, Monthly Statistics Bulletin, 2016). At the contrary, from the regional economies Kosovo's average economic growth of 3.5 percent during 2011–14 is favorable but has remained slightly below the global average (IMF, 2015). Development is expected to continue for around 2.5-3.0% in 2016, mainly driven by domestic demand and steady increase in government consumption and investment. Exports have also increased but still the coverage level is low, covering about one-third of imports. The production is extremely underdeveloped. Agriculture contributes only about 17% of the value in the economy (USAID-Kosovo, 2014-2018). Production is limited and concentrated in the extraction of raw materials, which also dominate the export of goods. Data on employment is scarce and often unreliable. Employment and activity levels are at the low level. It is considered that only about a quarter of the population has a working place and out of eight only one woman is employed (World Bank 2014). Unemployment is estimated around 45%, and it is expressed particularly among young people - more than 70% of them are without a job (KAS, 2014). Approximately 80% of the unemployed are out of work for more than one year, profound structural challenges freely. It has relatively high growth in the last three years, but employment lagging behind and not enough jobs are being created to reduce the labor market.

**Table 13: Key indicators of the labor market (%)**

Key indicators of the labor market (%)	Male	Female	Total
The participation rate in the workforce	61.8	21.4	41.6
The inactivity rate	38.2	78.6	58.4
Employment to population ratio (employment rate)	41.3	12.5	26.9
The unemployment rate	33.1	41.6	35.3
The unemployment rate among young people (15-24 years)	56.2	71.7	61
The percentage of young people NEET youth population (15-24 years)	26.6	34	30.2
The percentage of unstable employment to total employment	26.7	18.9	24.9

Source: Kosovo Agency of Statistics: Survey results of labor power 2014 in Kosovo

Moreover, economic structure relies heavily on sectors for low-skilled workers. Most of the workers are unskilled, meaning possible restrictions for companies trying to develop high technological capacities. Large remittance inflows have significant effects on the labor market because they increase the expectation on wage, which in return reduces the work incentives. On the survey conducted by the agency for statistics in Kosovo on Labor Force Survey 2014, the result shows that the employment rate has shown a slight increase between 2012 and 2013 but then fell back to a certain extent in 2014. The Labor Force Survey data show that the percentage of people employed part-time fell from 11.1% in 2013 to 7.7% in 2014. Self-employment (as a percentage of employees) has increased slightly over the past two years. Also, the percentage of employees in unstable jobs (people who are self-employed and have no employees and those who work without pay in a family business) increased by 23.6% in 2013 to 24.9% in 2014. Production, trade, education, and construction continue to employ almost half of employed people. The unemployment rate decreased slightly from 30.9% to 30.0% between 2012 and 2013 but increased to 35.3% in 2014. However, between 2013 and 2014 the percentage of discouraged persons has fallen from 12.1% to 10.7%. The inactivity rate also declined slightly between the two years. This may suggest that individuals, who have been inactive, have started looking for work (and so would be classified as unemployed). There has been a slight change in labor force participation between 2013 and 2014, increasing from 40.5% to 41.6%. The participation of female in the labor force and employment has remained unchanged between 2013 and 2014. Youth unemployment rose again in 2014, from 55.9% to 61.0%. Also, there was an increase in long-term unemployment in more than 12 months, from 68.9% in 2013 to 73.8% in 2014. The percentage neither of young people who do not know they are employed nor in education or training (respondents aged 15-24 years, who are neither employed nor in education or training) fell from 35.3% in 2013 to 30.2% in 2014.

### **6.5.1. Transition to a market-based economy**

Over the past few years Kosovo's economy has shown progress in transitioning to a market-based system and maintaining macroeconomic stability, but it is still highly dependent on the international community and the diaspora for financial and technical assistance. GDP is estimated at around \$5.4 billion and the total population is 1.8 million (ASK 2015). Remittances from the diaspora, located mainly in Germany and Switzerland, are estimated to account for about 15 percent of GDP (Trading Economics, 2016), and donor-financed activities and aid for another 15 percent. Kosovo's citizens are the poorest in Europe with an average annual per capita income of only EUR 3084 (Government of the Republic of Kosovo, 2016). Unemployment, around 45 percent of the population, is a significant problem that encourages outward migration and black market activity (Government of the Republic of Kosovo, 2016). Despite substantial development subsidies Kosovo was the poorest province of the former Yugoslavia.

In 2016, economic growth remains moderately stable. Growth reached 3.6 percent in 2015 and is estimated to remain at the same level in 2016. (World Bank, <http://www.worldbank.org/en/news/speech/2014/06/03/remarks-jan-peter-olters-regional-environment-center-baker-tilly-kosovo-conference>, 2016). Kosovo is rich in natural resources. Minerals and metals including lead, lignite, zinc, aluminum nickel, chrome, magnesium, and a wide variety of construction materials once shaped the backbone of industry, but output has declined because of ageing equipment and insufficient investment. (World Bank, <http://www.worldbank.org/en/news/speech/2014/06/03/remarks-jan-peter-olters-regional-environment-center-baker-tilly-kosovo-conference>, 2016). A limited and unreliable electricity supply due to technical and financial problems is a major impediment to economic development. Most economic development since 1999 has taken place in the trade, retail, and construction (Global Investments & Business Center, 2016).

Banking supervision and conservative lending of commercial banks have been critical in maintaining financial stability. Domestic deposit funds and banks observe an informal 80% threshold for the loans to deposit ratio. Financial sector under the agreement with the IMF has created the provision of emergency liquidity by establishing a special reserve fund. High and continuous external imbalances represent a specific challenge for the country's economy. The current account deficit increased from 5.7% in 2013 to 7.7% of GDP in 2015, while the trade deficits have over 40% of GDP and even expanded lately (CCEQ 1-2015). They are funded only partly offset by surpluses in trade in services and the income account. Current transfers,

both declined to the government and the private sector, but remain significant and finance about half of the deficit in trade in goods.

Kosovo remains the poorest economy in Europe, with a per capita income estimated at USD 3785 on 2015 (Global Investments & Business Center, 2016). The economy remains delicate and poverty remains a challenge. Even before the conflict of 1999, Kosovo underwent total isolation and no investment, and the war resulted in heavy damaged infrastructure, no agricultural or industrial production, and no active financial sector. Since 1999, significant financial and technical assistance from the EU (€2.4 billion in total) and other donors has helped to achieve substantial progress in economic reconstruction and institution-building, much of this being channeled through EAR (European Union Office in Kosovo, 2016).

After an initial post-conflict acceleration in 2000, economic development has been slowed in line with declining of donor resources. Sixteen years after the conflict, Kosovo's economy is still significantly depends on remittances and external assistances which are contributing with more 11% to GDP (Trading Economics, 2016). According to the National Strategy of the Republic of Kosovo, the main defined economic sectors are agriculture, mining, energy, transport, telecommunication, and environment.

Fiscal instability and the limited ability to borrow externally have also been factors in creating the difficulties in social segment protection, alongside the effects of war, gender issues, ethnicity, and other demographic factors. The poverty remains high in Kosovo, although the Kosovo Development Strategy considered as major goal to achieve.

With an employment rate of 42% in 2014 (23% for women and 77% for men, ASK 2016) Kosovo remains behind EU Member States. This result reveals extremely high unemployment levels and underdeveloped labor market in general. In 2006, out of 323,508 (Kosovo Agency of Statistics 2015) employed Kosovars, 75,000 were employed in the public sector and 248,000 in the private sector. It is estimated that in the private sector only half of employment is reported, the rest is being informal employment. The majority of all employees are temporary, self- employed workers, or part-time. The private sector consists by low capital, small-scale enterprises, with restricted capacities or motivation for investment in human capita and engagement of new technologies (Kosovo Agency of Statistics, 2016). Manufacturing, trade, education, and construction employed almost half of employed in 2014. The trade sector employed 14.4%, manufacturing 13.8%, education 11.9%, and construction employed 10.9% of all the employed in Kosovo (Kosovo Agency

of Statistics, 2016).

Education and healthcare were the two largest employers of women (employing almost 40% of employee women). Manufacturing, trade, and construction are the most common employment sectors for men (Kosovo Agency of Statistics, 2016).

Kosovo is the country with the youngest population in Europe. Almost two-thirds of Kosovo's population is of working age (15-64 years). The working age population is expected to grow rapidly over the next decade. Estimates indicate that about 40% of young people aged 15–19 and 69% of young people aged 20–24 are active in the Kosovo labor market (Kosovo Agency of Statistics, 2016). However, young people in Kosovo find it difficult to find jobs. According to estimates from the Labor Force Survey (LFS), unemployment among individuals aged 15–24 was 71% in 2014, while the same rate for females amounted to around 70%. Moreover, about half of all unemployed youth are long-term unemployed. The LFS finds that about 43% of all unemployed youth have been searching for a job for more than one year and 19.4% between six months and a year (Kosovo Agency of Statistics, 2016).

Transformation into a market economy inevitably includes the founding of a labor market, with employers and employees contracting privately in every aspect of employment, work duration, and compensation. Founding a labor market will require policy reform, as well as new institutions to ensure that the market runs normally. Labor market policy during the transition period should have the following goals:

- Support the efficient allocation of labor;
- Contribute to the improvement of macroeconomic indicators;
- Efficient productive employment.

### **6.5.2. The employment policies**

Since the end of war in Kosovo employment has remained a major and challenging issue in the policy agenda of Kosovo government, because there is an increased understanding that only economic growth alone will not automatically generate employment if it is not followed by consistent policies and strategies aimed at achieving this end. The Kosovo government supported this view and, in partnership with its international, has developed a number of strategies and action plans:

- Action Plan of the Economic Vision of Kosovo 2011-2014;

- Kosovo strategy for youth 2013-2017;
- Kosovo: 2014-2018 country development cooperation strategy;
- Kosovo youth strategy and action plan 201 –2012;
- Kosovo Youth Employment Action Plan, a mid-term policy framework (2007–2010);
- IPA Multi-Annual Indicative Programme Document 2007–2009;
- Resource allocation to Kosovo for IPA 2008;
- The Kosovo Youth Action Plan and Policy 2007–2010;
- Kosovo Employment Strategy 2008–2013;
- A national Strategy for Entrepreneurship Education and Training 2007–2010.

In recent years, Kosovo government with the help of international donors has made a number of analyses related to employment and unemployment issues in Kosovo. All of them highlight the fact that Kosovo is facing significant labor market challenges compared to regional countries but also to EU standards. All government agencies agree that employment among young people needs to be considered as a primary goal for employment policies in Kosovo and needs an immediate action.

Creating a high employment rate and decreasing poverty requires a detailed strategy which needs to be followed by a combination of reforms in various areas considered vital in job creation. In Kosovo, similarly with other countries in the region, the basis of creation of new employment has been the private sector in general, and self-employment in particular. Comparing with other regional countries the regulatory regime is quite favorable, since taxes, custom duties, taxes, labor costs, and social protection are one of the lowest. Nevertheless, labor law is still very basic and delivers only limited treatment of areas regulated in most countries. Inadequate labor law enforcement and unfavorable unemployment protection help to stimulate employment but create high performance of employment deficits and are counterproductive to the growth. Consequently, policy alternatives must take into account creating environment for enterprise development and reduction of the informal economy, stronger employment protection, and formalization.

### **6.5.3. Informal Employment**

A survey conducted by Riinvest and UNDP in 2011 confirmed that firms based in Kosovo consider unfair competition and informality as the major barriers in a list of 22 other problems.

These findings suggested that informality in Kosovo represent a serious problem and continuously increasing, therefore, it needs an immediate action plan to in order to solve it (UNDP & Riinvest, 2011).

This study tackles two types of informality, labor informality and tax evasion.

Survey results show that on average 37 percent of the total employed workforce has not legally declared employment protection, on job security, health and safety, and opportunities to develop professionally for those working in the informal economy are likely to be minimal.

Another factor which is affecting the work quality is that only 28% employed had a permanent contract for their main job while 72% had temporary contracts (Kosovo Agency of Statistics, 2016).

According to the same the survey, business managers and owners believe that on average the businesses in their industry report about 65.6 percent of their sales, meaning 34.4 percent is evaded. Roughly 37.3 percent of respondents claim that there is high or very high chance of getting caught evading taxes. The remaining 62.7 percent of respondents believe that they can easily get away if they decide to cheat.

There are only estimates and no objective data regarding the size of informal economy as an important component of Kosovo's economy. The estimates of the ILO and the World Bank indicate that over half of total employment in Kosovo is in the informal economy. Informality among young and adult workers is even more pronounced if measured according to compliance with statutory provisions on social security. Informal economy is most wide spread in the construction, forestry, trade, services, tourism, transportation, and agricultural sectors (European Commission, 2015).

### **6.5.4. Employee and unemployed protection**

The access to employment services in Kosovo is possible to all registered jobseekers, though the registration is obligatory only for social assistance. The current legislation does not foresee any kind unemployment benefits meaning that the social safety is based only on

pension scheme system and social assistance. Since 2001, the public employment service has provided the employment counseling and career guidance, together with job labor market training, but beside of some initial efforts they remain very ineffective.

Fulfilling its main functions for public employment service is very difficult due to the lack of resources, and ineffective administrative ability in contributing to the difficulties faced by the public employment service. They are unable to provide correct information on the labor market and job search assistance or to address inequality in employment. The ratio of placements to total registered unemployed was 1.8% in 2014, implying that in Kosovo there were around 13 registered unemployed per one job placement mediated by PES or around 7% unemployed registered at PES were supported to find appropriate placement in the labour market (Ministry of labour and socialwelfare, 2014).

The total number of participants in vocational training barely reached 3,000 in 2007 (i.e. 0.9%) (Ministry of labour and socialwelfare, 2014). Employment subventions and labor-intensive public works remain unproductive because of the weak capacities of the public administration to coordinate it. There is also a lack of harmonization between employment services and social assistance, which is leading to weak targeting of active labor market measures.

There are two key bases of statistics of the labor market in Kosovo, Survey of Labor (LFS) conducted annually by the Statistical Office of Kosovo (SOK) since 2001 and the registration data of the Public Employment Service (PES). The available data have some limitations. Firstly, the absence of a recent census asks questions about the reliability of extraction of samples of less than two percent, which are used in SFP. Secondly, SFP typically is made in the last quarters of the year, so it cannot adequately capture the seasonal employment during summer. Thirdly, the register of the unemployed swell of Public Employment Service that is the number of people who are not actively looking for work, or who are working in the informal economy, while there are many unemployed who are not registered with the Public Employment Service. Labor market conditions remain challenging. Key indicators such as the rate of labor force participation and employment rates are low by international standards while the unemployment rate is very high.

**Table 21. Number of employees in state administration by years 2003-2014**

Sector	Year											
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
General services	8.45	9.32	9.12	8.91	8.10	8.02	8.42	10.62	14.95	13.03	13.82	13.81
Public Order and Security	13.29	15.37	16.10	17.61	17.44	17.46	16.38	16.84	17.11	14.61	14.65	15.03
Education	31.86	32.13	31.63	32.13	32.29	32.75	32.70	33.34	29.68	34.21	34.41	34.60
Health	13.69	13.64	13.24	13.27	13.22	13.16	13.47	13.47	12.47	13.52	14.10	14.35
Economy	1.35	1.53	1.51	1.06	1.27	1320.00	1.31	1.28	1.31	1.29	1.32	1343.00
Recreation and culture	431.00	478.00	487.00	454.00	321.00	316.00	313.00	258.00	743.00	1.03	1.03	1.02
Housing issues	1.12	1.26	1.73	1.61	1.50	1.46	1.11	1.09	1.52	1.12	1.13	1.11
Environment	231.00	282.00	265.00	239.00	216.00	220.00	231.00	272.00	277.00	378.00	363.00	367.00
<b>Total</b>	<b>70.42</b>	<b>74.01</b>	<b>74.08</b>	<b>75.28</b>	<b>74.37</b>	<b>74.70</b>	<b>73.93</b>	<b>77.16</b>	<b>78.07</b>	<b>79.18</b>	<b>80.82</b>	<b>81.62</b>

Source: Statistical Yearbook of the Republic of Kosovo 2015

According to the survey of labor force (LFS) published recently, in 2015 the rate of participation in the labor force, defined as the share of employed and unemployed in the total number of population of age to work (15 -64 years) was 46.8%, the rate which is the lowest in the region. Low participation rates in the workforce are mainly due to the disproportionately young population, loss of the motivation of workers, and the low participation of women in the labor market.

**Table 22. Employment rate by years 2001- 2014**

Year	Male	Female	Total
2001	31,1	8,1	19,6
2002	39,4	8,8	23,8
2003	42,8	8,3	25,3
2004	46,4	9,9	27,7
2005	45,8	11,7	28,5
2006	46,1	11,8	28,7
2007	40,1	12,7	26,2
2008	37,7	10,5	24,1
2009	39,7	12,5	26,1
2010	-	-	-
2011	-	-	-
2012	39,9	10,7	25,5
2013	44,0	12,9	28,4
2014 <sup>1)</sup>	41,3	12,5	26,9

Source: Statistical Yearbook of the Republic of Kosovo 2015

Limited access to jobs is a major concern and performance of job creation has lagged behind forecasts. In the years 2001-2014, the employment growth was very slow despite annual economic growth accelerated to an estimated rate of 4%<sup>ii</sup> and remains very low compared to other countries in the region. The employment rate for women is also very low at around 13 percent, while in the jobs seekers list we can see that almost 50% of them are females.

**Table 23. Registered job seekers by gender and qualification 2008-2014**

Level of skills	Jobseekers 2008		Jobseekers 2009		Jobseekers 2010		Jobseekers 2011		Jobseekers 2012		Jobseekers 2013		Jobseekers 2014	
	Number	%												
No qualification	200.97	59,8	203.76	60,1	200.71	59,9	195.39	60,1	148.75	204,8	153.72	57,3	156.88	57,2
Half qualified	13.70	4,1	13.36	3,9	12.59	3,8	11.83	3,6	8.88	12,2	8.93	3,3	8.95	3,3
Qualified	29.03	8,6	28.85	8,5	28.35	8,5	27.21	8,4	22.39	5924,1	22.56	8,4	22.79	8,3
Secondary education	87.09	25,9	87.68	25,9	87.87	26,2	84.60	26,0	72.62	100,0	75.23	28,1	77.31	28,2
Secondary not tertiary	2.21	0,7	2.18	0,6	2.16	0,6	2.00	0,6	1.65	2,3	1.68	0,6	1.72	0,6
University	2.95	0,9	3.06	0,9	3.58	1,1	4.22	1,3	5.05	7,0	5.99	2,2	6.84	2,5
Total	335.94	100.00	338.90	100.00	335.26	100.00	325.26	100.00	259.34	100.00	268.10	100.00	274.49	100.00
Female	158.12	47,07	161.02	47,51	160.86	48,0	157.92	48,6	119.37	46,0	124.37	46,4	127.92	46,6

Source: Statistical Yearbook of the Republic of Kosovo 2015

**Table 24. Employment rate by economic activity 2001 - 2014**

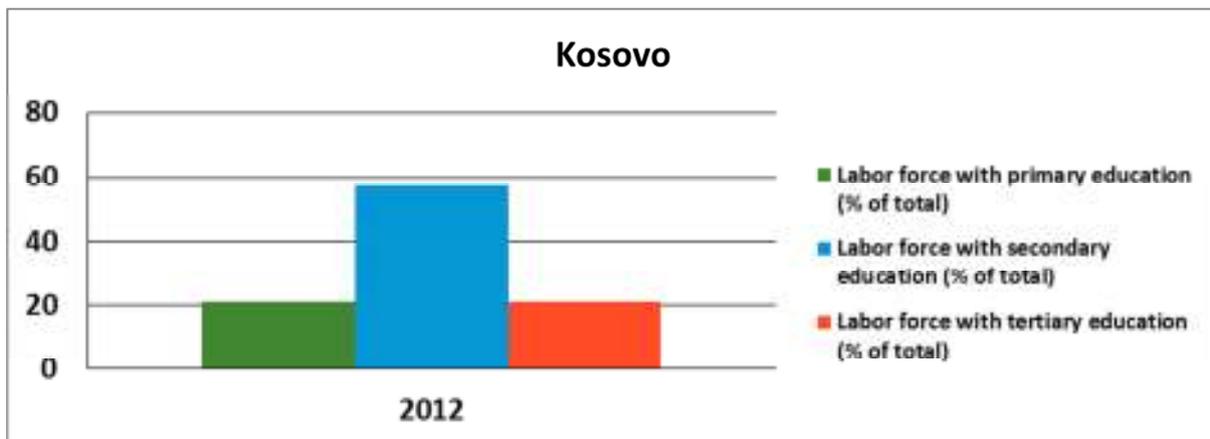
Economic activity (NACE)	2005			2006			2007			2008		
	Male	Female	Total									
Agriculture	18,4	20,5	18,8	21,9	19,6	21,4	13,1	19,3	14,6	9,3	3,2	8,0
Mining	2,0	0,1	1,6	1,7	0,6	1,5	1,2	0,2	1,0	1,7	0,9	1,5
Production	10,6	5,8	9,6	7,9	5,1	7,3	12,7	3,3	10,4	10,1	3,9	8,7
Energy	3,8	1,1	3,2	4,3	1,0	3,6	3,3	0,7	2,7	6,2	1,6	5,2
Construction	9,8	0,6	7,9	10,1	0,3	8,1	8,7	0,3	6,6	10,8	0,6	8,6
Trade	14,1	12,8	13,8	16,3	16,4	16,4	17,5	15,1	16,9	17,4	15,9	17,1
Hotels	3,8	2,3	3,5	3,3	0,7	2,8	4,9	1,0	3,9	5,1	2,1	4,5
Transport	4,7	2,4	4,2	4,2	1,5	3,7	5,4	1,8	4,5	5,9	4,3	5,6
Finances	1,0	1,5	1,1	1,2	2,4	1,4	1,0	1,5	1,1	1,4	3,1	1,8
Business	2,6	1,5	2,4	2,1	2,4	2,1	1,4	1,2	1,4	2,4	3,3	2,6
Public Administration	8,4	7,5	8,2	8,0	6,9	7,8	9,7	9,2	9,6	9,6	10,0	9,7
Education	8,5	19,4	10,8	9,9	18,5	11,7	9,4	20,2	12,1	10,6	24,4	13,6
Health	2,6	15,2	5,2	2,6	16,1	5,4	3,9	16,5	7,0	3,2	18,4	6,5
Other	9,7	9,5	9,7	6,6	8,5	7,0	7,8	9,7	8,3	6,2	8,3	6,7

Source: Statistical Yearbook of the Republic of Kosovo 2015

The structure of employment report for 2015 shows us that the service sector is the largest provider of jobs in Kosovo, with about 71% of total jobs. In the service sector, trade, and

education sub-sectors represent the largest (respectively, 17.1% and 13.6%). Agriculture comprises about 8.0% of the total number jobs. Compared to 2005, trade, education, and other services have recorded an increase in jobs, while agriculture and construction reported a decline. The transition from agriculture to services confirms the trend that has been experienced in other developing countries and those in transition. There is a positive correlation between employment and educational attainment. LFS 2007 reports that 74.7% of individuals with higher education were employed compared with only 32.7% of those with secondary education. The big difference between the employment rates of these groups can be attributed to the lack of an acceptable system of qualifications, which forces employers to seek university education as a substitute for professional qualifications. As mentioned above, the unemployment rate in Kosovo is high. LFS data from 2014 indicate that about 43.6 percent of the workforce is unemployed. The unemployment rate in Kosovo is almost twice as higher than the average unemployment rate in the Western Balkans.

**Figure 9. Education statistics, World Bank, December 2015**



Source: World Bank 2015

Unemployment is particularly high among young people, women, and those with low education. Young Kosovors are twice more likely to be unemployed than adults and have a long period of transition from school to work<sup>iii</sup>. Despite the relatively low rate of participation of women, the unemployment rate for women is 11.6 percentage points higher than the workforce as a whole. Those with low levels of education are more likely to be unemployed. Nearly 55% of the unemployed are less educated than the middle school level. Another issue of concern is the duration of unemployment. Nearly 85% of the unemployed in 2007 had been out of work for more than a year. Furthermore, 81.7% of the unemployed (and 97.6% of the unemployed in the 15-24 age groups) have no work experience, which emphasizes the

importance of the first contact in the labor market or work experience to gain sustainable workplace. High unemployment is the main factor of prevailing poverty in Kosovo. According to the Poverty Assessment for Kosovo (2007), approximately 45% of the population consumes below the lower poverty line, and one-third of the poor are estimated to be in extreme poverty, which means that they are unable to meet minimum daily nurturing. However, poverty in Kosovo is relatively shallow, so that job growth would have a substantial impact on reducing the incidence of poverty and would set the country on a path of economic growth. Although there is no full compliance between unemployment and poverty,<sup>iv</sup> the risk of poverty is much higher for the unemployed. A comparison of the incidence of poverty among the employed and unemployed shows that the latter has 20 percent higher risk of becoming poor than the first. The probability of becoming poor is significantly higher if the person is unemployed compared to whether the individual is working.

#### **6.5.5. Policy development and policy implementation**

Kosovo has great degree of centralization of government institution both in development of policies and in its implementation. Having in mind the importance of the employment policies which cover a number of different policy areas (such as social policy, training policies, economic development, and education), and for the successful development and implementation of the social policies, first Kosovo needs a good synchronization between differed department and ministries in planning, implementing, evaluating and monitoring. Kosovo has made some progress in creating several inter-ministerial working groups<sup>v</sup>

Nevertheless, the development of partnership and social dialogue on education and training issues is predominantly at low levels. Trade unions are not very involved in negotiations on human resource development issues. The employers' associations are mostly undertaken by the Kosovo Chamber of Commerce. The policy implementation relies on responsibility of the Public Employment Services and Ministry of Labor. Having in mind administrative capacity of both institutions, their yield remains very poor.

The measurement performed by the government of Kosovo in aiming at reducing unemployment remains very modest in their objective on responding effectively to unemployment reducing. In conclusion, there is a lack of tools and procedures in process to monitoring and evaluating the policies and implementation and measurements. The reform of labor market is crucial for Kosovo. Institutional capacity needs to be in line with the

objective with regard to the development of employment policy, which should gradually be in line with European strategies on employment.

#### **6.5.6. Strategic policies in Education**

There are a numerous strategic documents in Kosovo, yet the crucial features of a rational and wide-ranging lifelong learning strategy approach are absent. Kosovo government has identified that development of human capital through education is the most urgent segment for education, economy, and energy. The political commitment finds tangible expression in the sector strategies, such as the Strategy for the Development of Higher Education in Kosovo, Action Plan of the Economic Vision of Kosovo 2011-2014, Kosovo strategy for youth 2013-2017, Kosovo: 2014-2018 country development cooperation strategy Kosovo youth strategy and action plan 2010 – 2012 Kosovo Youth Employment Action Plan, a mid-term policy framework (2007–2010), IPA Multi-Annual Indicative Programme Document 2007–2009 resource allocation to Kosovo for IPA 2008, The Kosovo Youth Action Plan and Policy 2007–201 Kosovo Employment Strategy, 2008–2013, and national Strategy for Entrepreneurship Education and Training 2007–2010.

None of these strategic activities in the operating plans have been implemented as forecasted. This is not only due to weak planning but also due to the low capacities in programming and implementation. Additionally, these strategies do not contain continuing education. Although lifetime learning is main subject in all strategies, vocational education, pre-school education, and the technology are not addressed adequately. Education outside of the school system has little reference. The Kosovo authorities, together with international partners, are in the process of revising all the strategic documents. This revision will enable the Kosovo authorities to depart towards a general strategic document in relation of lifelong learning as a predominant concept covering all aspects and levels (formal, non- formal, informal pre-school, primary, and secondary, tertiary) of education and training.

#### **6.5.7. Secondary and higher school enrolment**

The first higher education school in Kosovo was established in 1959 (Ministry of Education). Currently, Kosovo has 7 public universities, 25 private colleges, altogether offering 418 different study programs, with slightly over 100,000 students currently enrolled (Rexhaj, Xhavit and Pupovci, Dukagjin, 2015).

Actual inclusion of group age 20-24 is 62.7%, which is the same as EU average (Eurostat 2013). Lecturing is delivered in four languages: Albanian, Bosnian, Turkish, and English.

The University of Prishtina in 2001 has accepted the Declaration of Bologna, and this is one of the first universities in Europe to start with the reforms called the EHEA<sup>vi</sup>. Beside the changes that have happened in the system of education, in practice still there are immense discrepancies between the labor market and educational system. The government of Kosovo realized the role of human resources in attracting investments, but there are still unsolved transitional problems in Kosovo.

Kosovo educational system foresees nine years of obligatory basic (primary and lower secondary) education, accompanied by three to four years of non-compulsory upper secondary education. The government also supports non-obligatory preschools which are offered to children from ages one to six and tertiary education at the University of Pristina and several private colleges. Since 1999, the education has witnessed a significant reform especially:

- Dropping the entry age to 6 instead of 7 years;
- The introduction of Bologna reform;
- The introduction of nine years duration of compulsory school instead of eight;
- Expansion on curricula;
- Upgraded acceptance rates on several school levels.

The absence of accurate statistics in general, for the school-age population, means that correct statistics on the enrolment rate are also absent. One assumption is that Kosovo's enrolment ratios are below by regional countries, particularly at the secondary and tertiary levels. Gross enrolment rates in pre-university education (primary, lower secondary and upper secondary) in 2014 were quite satisfactory, albeit not universal. Enrolment rates in upper secondary education have improved significantly in recent years compared to a rather low 2011 baseline in comparative terms. MEST still remains to address participation of all social groups and people with special needs. Enrolment rates in preprimary education have remained stable at around 70 percent.

Around half of the youngsters leave school and only 1 out of three youngsters finish the education system with qualifications (Kita, 2008). An estimated 10% drop out of obligatory education and 25% do not finish secondary education (Kita, 2008). Widespread poverty also transforms into poor education outcomes. In theory, education is free for all, but the financial burden to pay for schoolbooks, food, and transport rests entirely on families. Some 25 % of youngsters drop out of school for economic reasons.

Kosovo's education system will require a major reform which needs to be in line the current system of Kosovo's new open political system and market economy. Although the government recognizes that there must be fundamental reform of the system, it also understands that such changes can only be achieved in the medium term. This is because the education system touches almost everyone's life with important and far-reaching consequences. In a more open society, changes in national education policy are difficult to introduce without extensive public discussion. Currently, the Kosovo public is aware that changes are necessary.

In the sector of education, two of most important policies, the Kosovo Education Strategic Plan (KESP) 2011-2016 and New Kosovo Curriculum Framework (KCF), have a focus on skills. The KESP sets the vision for the education sector up until 2016 and covers all the levels of education from preschool to the higher education level. Attention was shown also to the adult education, non-formal education, and teacher training. The skills relevant to the labor market are linked particularly to vocational and higher education. By 2014, vocational education and training curricula are foreseen to be in line with the needs of the labor market. Labor market driven research and scientific work is additionally planned for higher education.(Strategy for Development of Higher Education in Kosovo 2015).

#### **6.5.8. Government expenditures in education**

Higher education is one of the most notable segments of modern society. It creates an environment in which individuals can achieve their intellectual and creative potentials. Through high-level training in various disciplines, it provides people with necessary knowledge, ability, and values to cover for some social necessities. Through learning processes, higher education provides society with capability for innovation, adjustment, and progress (Strategy of Kosovo for higher education development 2005-2015) among the most important indicators which represent education. Financing includes the participation of educational expenditure in gross domestic product and the participation of educational spending in the total public expenditure of the country. According to the recent World Bank's Public Expenditure Review, education is the largest sole program of government spending, accounting for about 16 percent of the total. Government spending on education in Kosovo is relatively low compared to regional standards. Claims on the budget come from a different of sectors. As shown in Table 25, education was the largest single program of government expenditure in 2008, accounting for 16% of the total. Between 2007 and 2010 spending on education, health, police, and social protection all increased by about one third.

**Table 25. Sectoral Composition of public Expenditure**

	2007	2008	2009	2010
<b>Education</b>	127	167	177.1	169.5
<b>Transportation</b>	37.7	166.8	116	130.8
<b>Other central</b>	64.6	101.2	141.2	112.4
<b>Police</b>	83.9	95.7	102.6	110.8
<b>Health *</b>	74	88.4	113.4	102.9
<b>Other municipal</b>	61.4	87	116	129
<b>Pensions</b>	67	80.5	89.4	100.7
<b>MEF/MPA/KTC</b>	102.7	72.7	150.2	93.2
<b>Social</b>				
<b>Protection</b>	56.1	69.3	69.5	72.9
<b>KEK subsidies</b>	11.5	42.8	47.1	44.5
<b>Justice</b>	26.3	29.7	36.4	36.5
<b>PM/Assembly</b>	11.4	13.9	17.8	21.1
<b>Total</b>	<b>723.4</b>	<b>1015</b>	<b>1176.7</b>	<b>1124.3</b>

Source: World Bank - Kosovo Public Expenditure Review 2011

Kosovo expenditure on primary education is moderately low if we compare to regional countries. The spending in primary education as a percentage of GDP is about 1.32%, which is in line with regional countries, and is located above the average (1.22%). Nevertheless the results suggests that Kosovo must increase investments in educational and in its youngest population, which represent the major resource for strengthening the economic growth and development, and create opportunity for Kosovo to reduce its high levels of unemployment.

#### **6.5.9. The strategy of economic development of Kosovo**

Economic activity in Kosovo started to recover after a slow growth in 2014. The year 2014 was characterized by developments which brought up a general risk adverse of economic agents in the investments. The data for the first half of 2015 show signs of an accelerated pace of economic growth. Since data on national income for the first semester of 2015 are missing, the valuation of economic activity is based on the tendency of several indicators that impacted on the trend of economic growth. Import of goods grew by 4% during this period. Data on the structure of imports show an increase of 5.4% of importing investment goods, of which the main goods are those used in the construction sector. Specifically, the import of

construction materials contributed with 1.3 percentage points to the growth of import of investment goods, in general, representing 57% of imports for these goods. Imports of goods used for investment represent around 30% of total imports. A more accelerated pace of investments during the first half of 2015 is supported by the level and structure of FDIs. FDIs were over four times higher than the same period of 2014, which translated into value, represents 130 million more. FDIs during this period were concentrated in construction and immovable property, while there was a significant increase in the financial services and energy (Central Bank of Kosovo).

**Table 19. Kosovo: Selected Economic Indicators**

	2010	2011	2012	2013	2014	2015	2016	2017
							Forecast	
Population,	1775	1799	1816	1821	1838	1855	1872	1890
Gross domestic product, EUR mn, nom.	4402	4815	5059	5327	5600	5900	6100	6500
annual change in % (real)	3.3	4.4	2.8	3.4	4.5	3.6	2.9	3.8
GDP/capita (EUR at exchange rate)	2500	2700	2800	2900	3000	.	.	.
GDP/capita (EUR at PPP)	5900	6200	6500	6700	6900	.	.	.
Consumption of households, EUR mn, nom.	3768	4142	4458	4652	4900	.	.	.
Annual change in % (real)	3.5	3.5	2.9	2	4.5	.	.	.
Gross fixed capital form. EUR mn, nom.	1301	1476	1317	1323	1300	.	.	.
Annual change in % (real)	11	8.1	-13.6	-0.2	0	.	.	.
Gross industrial production						1	1.5	3
annual change in % (real)	1.8	-5.7	-3.3	0	10	5	6	8
Gross agricultural production								
annual change in % (real)	1.4	0.2	9.9	2	6	4	5	6
Construction output								
annual change in % (real)	-9.7	18	3	0.6	3	5	4	5
Unemployment rate in %, average	45.1	44.8	30.9	30	30	29	29	28
Reg. unemployed persons, the end of period	335	325	260	268	274	.	.	.
Average monthly net wages, EUR	286	348	354	356	416	.	.	.
annual change in % (real, net)	12.3	13.4	-0.8	-1.2	16.4	10	0	2
Consumer prices, % p.a.	3.5	7.3	2.5	1.8	0.4	1	1	2
Producer prices in industry, % p.a.	4.7	5.7	1.7	2.5	-0.6	.	.	.
General governm. budget, nat.def., % of GDP								
Revenues	25.9	27.2	27.3	35	35	36	37	37
Expenditures	27.7	28.3	28.6	37	37	37	37	38
Deficit (-) / surplus (+)	-1.8	-1.1	-1.2	-2	-2	-1	0	-1
Public debt, nat.def., % of GDP	5.9	5.3	8.1	8.9	10.7	11.2	10.8	11.1
Central bank policy rate, % p.a., end of period	14.3	13.9	12.9	11.1	10	.	.	.
Current account, EUR mn	-516	-658	-380	-339	-400	-450	-550	-500
Current account, % of GDP	-11.7	-13.7	-7.5	-6.4	-7.1	-7.6	-9	-7.7
Exports of goods, BOP, EUR mn	299	317	282	291	320	.	.	.
annual change in %	73.5	5.8	-10.9	3.4	9.8	3.1	6.1	11.4
Imports of goods, BOP, EUR mn	2041	2364	2332	2287	2380	.	.	.
annual change in %	12.2	15.8	-1.3	-1.9	4.1	3.8	4	5.8
Exports of services, BOP, EUR mn	574	625	641	633	700	.	.	.
annual change in %	10.1	8.9	2.5	-1.3	10.7	4.3	5.5	10.4
Imports of services, BOP, EUR mn	398	369	317	320	330	.	.	.
annual change in %	35.5	-7.3	-14	1	3	3	2.9	11.4
FDI inflow (liabilities), EUR mn	369	384	229	280	170	.	.	.
FDI inflow (assets), EUR mn	37	5	16	30	20	200	300	400
Gross reserves of NB excl. gold, EUR mn	634	575	840	799	850	.	.	.
Gross external debt, EUR mn	1361	1428	1517	1596	1736	.	.	.
Gross external debt, % of GDP	30.9	29.7	30	30	31	.	.	.
Purchasing power parity EUR/EUR	0.417	0.435	0.428	0.438	0.439	.	.	.

Source: National statistics and IMF.

One of the major elements that do not have a positive tendency to increase is employment, which on average has stagnated.

**Table 20. Country comparison of key labor statistics**

	Labor Force Participation Rate		Employment to Population ratio		Unemployment Rate	
	2013	2014	2013	2014	2013	2014
Country	2013	2014	2013	2014	2013	2014
Albania	40.5	41.6	28.4	26.9	30	35.3
Bosna and Hercegovina	59.9	61.5	50.2	50.5	16.1	17.9
Kosovo	57.2	N/A	40.6	N/A	29	N/A
Macedonia	62.2	48.9	49.2	39.7	21	18.9
Montenegro	58.9	42.6	47.4	34.9	19.6	18
Kosovo	43.6	43.7	31.6	31.7	27.5	27.5

Source: SOK (2014)

From the today's perspective, it is not difficult to conclude that globalization has caused a new distribution of economic power in the world, including in our immediate environment. As part of the expansion of globalization, most countries in Central and Eastern Europe began the transformation of their economies back in the 90's of the last century. Kosovo was delayed ten years with the beginning of the transition, and the transformation of Kosovo's economy began only in 2000. In the long term speaking, the greatest effects are manifested on the main development resource - the human factor. In this section, we will analyze indicators of Kosovo's economy and will define all factors that have impacts on human resources. Dynamic economic growth is impossible without a structural change, the pace of which will mostly depend on two main factors:

- Increased investments and
- Educational reforms.

In general, sustainable economic development of our country should enable long-term economic growth which will be based on the excessive use of natural resources, or unacceptable environmental consequences would into question its sustainability, as well as the economic prospects of the future generations. This means that the development of

Kosovo's economy in the direction of sustainability can only be seen on the basis of achieving economic growth, first of all, on the basis of factors such as knowledge, information, people, education, and quality of connections between people and institutions. Investments in general represent a keyword for the structural transition problems of Kosovo's economy. Only investments (new investments) could create competitive products and sustainable economic growth based on creating new jobs. In parallel, without educational reform, it is impossible to fight with structural problems, create competitiveness, and reduce unemployment.

#### **6.6. Chapter Conclusion -Summary of the major problems and challenges HRD of Kosovo**

The forthcoming major challenge for Kosovo is to increase the importance of human capital improvement in the general policy program for socioeconomic development and make sure a good functioning education system that outfits to the needs of population of Kosovo. For the near future, there is need that government is committed in implementation of extensive consensus regarding the direction of education policies, availability of sufficient resources through the mobilization of public and private donor.

The reform on education must address shortages of the education and training system through the whole system.

The development of economy historically was connected within the concept of agrarian society which were based primarily on the dominant participation of natural factors and physical labor, and during the expansion of industrial society, both in production and in merchant activity, the most important factor of production was real and financial capital (money, material handling equipment, energy) due to technological developments. During the twentieth century "industrial society," IT-society" or the so-called "weightless economy" was dominated by intangible factors (Frank Webster 1995). The key factor of production has become a whole set of intangible factors such as knowledge, information, and skills, resulting in a growing economic impact of having a greater market value. The economic impact is not only visible in the services sector, but also modern agriculture and industry are increasingly dependent on research and use of information. Technological development has led to the fact that the share of physical labor, and even the material technology, as well as natural and financial resources are gradually losing significance. In a society whose economy is founded on knowledge, as the main comparative advantage of production becomes a whole string of intangible factors such as knowledge, information, skills, and work culture that generates an

increasing economic performance and gains an increasing market value, knowledge and information have not been confined to the service sector. In fact, modern industry and agriculture are increasingly dependent on research or the use of information and knowledge in defining the product, as well as commodity and financial markets (Global Forum on Agriculture 2010). The twentieth century is now the valid shape of development concept of sustainable development which is based on the new growth theory, in which the center of applied knowledge is complex, scientific, and technological development. Key determinants of growth and development of a country economy has become the speed of innovation and the ability to create an economy that turns theoretical knowledge into inventions and new technologies. A key factor of national wealth is the capacity to generate new ideas, innovation, and knowledge that can be subsumed under the creation and disposal of human capital. How knowledge can be more or less economically efficient to be in the knowledge-based economy requires not school, textbook knowledge but the ability to solve problems, to generate and implement innovations, and to cooperate with others. Within the majority of economically relevant international organizations and developed countries in economic terms knowledge economy and knowledge society have become popular, so the studies that indicate their significance and make the national strategy for promoting the knowledge-based economy. Kosovo started to work on the National Strategy, which analyzes the strengths and opportunities as well as weaknesses and threats for sustainable development by 2017 (RS Government, 2008). The draft of the National Environmental Protection Programme has already adopted a sectorial strategy. The prospect of achieving sustainable development of the Republic of Kosovo in the introduction, adaptation and application of the principles prevailing in the European Union, and in increasing the competitiveness of which is based on knowledge, innovation, and entrepreneurship. The strategy defined five essential national priorities of the Republic of Kosovo for sustainable development by 2017. All five elements can be seen as objectives to be fulfilled in order to allow Kosovo to progress on the "Doing Business" and thus provide easier access to foreign investment. They also set goals for each of the priorities where it can be seen that a large number of them is a challenge for human resources in Kosovo, and in this regard should be made significant steps in improving human resources through intensive investment in education and development. National priorities and some of the goals of the strategy are as follows:

- Membership in the EU on the development of a market economy able to face the pressure of competition within the EU;

- The development of a competitive market economy and balanced economic growth, improvement of conditions for attracting FDIs;
- The development and education of people, increasing employment, and social inclusion of reducing the outflow of professionals by creating better-working conditions;
- The promotion of adaptability of workers and achieving greater labor market flexibility;
- The investment in knowledge and skills of people through quality, efficient, applicable education, and continuous training of members of all social groups on the principles of equal opportunities;
- Development of infrastructure and balanced regional development;
- Improvement and protection of natural resources.

The strategy is made and analyzed in the Republic of Kosovo, and it contained the strengths, weaknesses, opportunities, and threats for sustainable development in the future. Among advantages, there are the potential skilled labor force, private sector growth, and the existence of expertise and financial support from the diaspora. Weaknesses that are seen in Kosovo are slow privatization process, an insufficient number of Greenfield investments, a continuation of the “brain drain,” a very low rate of spending on education and science as a percentage of GDP, and the adverse socio-economic situation of young people. Chances noticed in the strategy include the completion of the privatization process, increasing public-private partnerships, while threatening to the economy are unemployment, poverty, debt, slow economic growth, unfavorable demographic trends, and the possible lack of political will to implement legal reforms.

While analyzing the sustainable development strategy of Kosovo for the period until 2017, it is shown that Kosovo has decided to continue its path towards integration into the world economic trends, mostly relying on the economy that will be based on knowledge. It is clear that such an economy requires a high level of accumulated human capital. Since, in technological terms, Kosovo is still largely lagging behind the developed countries, it is clear that the only way to go in raising the level of knowledge is attracting foreign investors who would be willing, in addition to realizing short-term profits, to transfer their skills in Kosovo and to enable the entire economy towards a more rapid progress in catching with the developed countries. Knowledge society and knowledge-based economy do not imply rigid, factual, school, and textbook knowledge, but a set of skills, abilities and interest

(competencies) that create innovation, solve problems, cooperate with others, and working for the common interest. In this respect, it is essential to take into account different types of knowledge. The knowledge can be more or less economically efficient, depending on how it set up the relationship of knowledge being a public good and expertise being a private good. To take advantage of the concept of the knowledge economy at the national level, it is not enough just to realize the effects of the market valuation of new production factors and spontaneous restructuring of the economy towards sectors with the largest share of knowledge. For the realization of this concept, by the experience of the most advanced economies of the world in this regard, the most important are the following factors (GoK 2008):

- Modern education and continuous improvement;
- Funding for research and development, especially investments in modern industry;
- Appropriate scientific, technological, and cultural policy of the company;
- Appropriate management of economic change in line with changes in the world and the environment;
- Sectors of high technology and the definition of incentives to attract foreign investment in these sectors;
- The choice of macroeconomic policy, system, and structural economic solutions;
- Electronic communication, mass use of computers, and other modern technical means;
- The level of protection of property rights, especially intellectual property;
- Social responsibility of business enterprises.

The system of sustainable development implies educated people who learn fast, are innovative, and creative. The analysis of our educational system comes to be unsustainable, given that it is inefficient and does not produce high-quality results at most of levels of education. The result of such a system is at the low level of education, outdated program, lack of standards for quality assurance of education, a significant outflow of trained staff. There is a lack of advanced skills necessary in the educational process both for the teachers and the students (pupils), and therefore, do not provide students with intellectual skills necessary for self-regulated learning, critical thinking, problem-solving, opportunities for relevant intellectual activities of students, nor foster research and innovation. The benefits of early education in Kosovo are not used, in general, a large part of the population remains uninvolved in the educational system, and those who get to study them often abandoned

studies or rarely end within a reasonable time. The current Kosovo economy functions still remain unfavorable, considering economic structure, given natural and technology resources, which are relatively scarce. The part limitation comes from the relatively weak natural, technological, and financial base. The Republic of Kosovo, with its 1.8 million inhabitants<sup>vii</sup> and a gross domestic product of just over 5 billion euros (CBK 2015) is not a country of the significant market or major economic potential at the global or European level. Results of primary education in the Republic of Kosovo, measured by PISA (2006) surveyed the linguistic, mathematical, and scientific literacy and the results are far below the European average. The relationship between general and vocational education in secondary schools is very unfavorable to the detriment of the general, whose participation should increase with 26%, at least, 40 % ( Mihail Arandarenko & Will Bartlett 2012). Many secondary school students failed to appear later in the labor market. Thus, every 13th generation of young people (on average) comes from the school system without qualifications. The higher education system in the Republic of Kosovo is relatively a large number of young people who are studying or have passed through a certain stage when they were students. However, it is a small percentage of those completing their studies within a time limit that may be considered useful and acceptable for society with 8-10% of total enrollment (World Bank 2013). According to Education Statistics (World Bank, <https://knoema.com> , 2015) the number of students repeating the first year is close to 30%. Despite these bad indicators, says it all that with the application of appropriate strategies concerning the economic and other aspects of the development of Kosovo could significantly improve the relatively poor position in relation to the reference countries in transition, especially compared to those from Southeastern Europe. The progress in the next phase of development of the Kosovo society, state, and economy should not be short-lived and with unpredictable consequences. It is needed to provide conditions for the sustainable development of the economy based on knowledge which will lead to an increase in the group of the main economic indicators such as GDP growth, employment, foreign trade, competitiveness and exports, investments and standards of the population. In order to establish a viable system and method of education for XXI century, the Republic of Kosovo shall, with strict rationalization of the use of public funds and reform the ways of their use, increase investment in education to at least 6% of GDP as much as the standard in Europe, increase the overall literacy of the population, reduce the proportion of people without occupations, and harmonize the educational system with the needs of the labor market and reform on the one hand, and the needs of future generations based on new technology and method of communication with the other. It is

necessary to change the system of financing and equalization of public and private education system, modernize curricula, introduce quality assurance system, create modern staff who will work in education, establish a social partnership for education, and implement the process of licensing, certification, and accreditation. The existing education system must be improved as soon as possible. It is necessary to motivate and support all stakeholders to work towards the development of education for sustainable development and the integration of content on sustainable development in the formal educational system, through all relevant subjects, as well as through informal forms of education. To achieve the wanted results, it is necessary to meet certain requirements:

- Formulating a strategic agenda for lifelong learning as a principal concept covering formal and non-formal at all levels of education and training with cost prioritized activities;
- Improving the basic education quality ensuring better learning results for all children with different socioeconomic backgrounds;
- Providing favorable conditions for economic, financial, institutional, and technical support to the reform process of education for sustainable development;
- Work to promote the concept and practice of sustainable development and sustainable system of education through formal and informal learning;
- Adequate training of teachers at all levels of education for sustainable development;
- Systematic work on the development of research in the field of education;
- Continuous improvement of cooperation in educational reform at the national, regional, and international level.

Finally, the sustainable development strategy in this segment requires a new system of education that must ensure the incorporation of knowledge from all related sectors with particular emphasis on the use of that knowledge. It must strengthen basic and applied knowledge as a precondition for adopting the labor market to ensure access to quality education for all, to strengthen early childhood education, to develop a system of continuing education for the environment, and to achieve broad skills of educated people by changes in the technological and economic environment.

## **Chapter 7: Methodology of collection and analysis of primary data**

### **7.1. Introduction**

This chapter starts by defining and justifying the choice of methodology and research approach of the researcher. The chapter continues by discussing the rationale behind the research design and research question. It is also discussed the population, sampling, credibility, usefulness, and strategies for data collection and analyses.

### **7.2. Research methodology**

Kosovo Chamber of Commerce within the "Foreign Investment Club" has conducted a research based on foreign direct investment in Kosovo. Namely, the aim of this study was that through surveying companies which are the major investors in the country, to understand the real situation of the investment environment in Kosovo, and to identify segments and dimensions in which Kosovo has to do more in order to attract foreign direct investments.

Moreover, the researcher was part of the study as an interested third party since the beginning and has contributed actively during all phases of the study (see annex 1).

This research is designed and conducted under the responsibility of KCC and supported by the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), and also approved in advance from the board of "Foreign Investors' Club".

For study purpose, we surveyed 28 investing companies in the country. Companies are selected from lists provided by the Investment Promotion Agency (IPAK) and other lists provided by accredited Chambers of Commerce in Kosovo. The participation on the survey was voluntary, since the quality of the results depends on the willingness of entrepreneur to participate in the interview.

The results presented in the following document are data collected on field through "face to face" method of surveying, given that it is proved to be a relevant method for data collection. Data were collected in late June and early July 2013 (in the whole territory of Kosovo).

Multiple choice questions allow evaluation or judgment regarding doing business environment in Kosovo and the points of view of the investors. Responses are worded as follows: "problematic", "neutral", "favorable", or "powerful factor".

This survey collects information from owners and managers of companies investing in Kosovo regarding their assessments of the environment of doing business in Kosovo,

barriers, evaluating capacity of our local workforce, and their preference to invest again in Kosovo.

### **7.3. Research design and rationale**

The main design issue behind the research design is how the author answers the research question. The importance of research question cannot be overemphasized. In general, this research is designed to discuss and analyze the impact of human capital in attracting FDI in Kosovo, and will investigate the investment climate as seen by foreign investors.

The process followed in drafting the questionnaire and data collection is described in the following subsections.

### **7.4. Question base testing**

Based on the literature review carried out in previous chapters and in consultation with the different experts in different industries, research partners, and mentor it was decided to compile a questionnaire which contains a section for collecting demographic and sections dedicated to issues related business climate. The questionnaire contains closed and open-ended question and the total number of attributes for which the information in them is 38.

In designing the questionnaire is used Likert scale with 4 units and each individual is asked to assess the importance of attributes by selecting a point scale that the best present individual assessment. Scale units are worded as follows: "problematic", "neutral", "favorable", or "powerful factor".

Clear instructions for completing the questionnaire are formulated in a special section and respondents were instructed before completing questionnaire, ensuring their equal treatment and anonymity.

The draft questionnaire was pre-tested to ensure that the language used is understandable and simple, no allusions or ambiguous questions, the questions are listed correctly, so that logical fluency and instructions were clear.

They have the opportunity and knowledge to answer the questions. In formatting the questionnaire there were also issues addressed in the pilot test.

Sample testing was conducted on a sample of 3 FDI companies. Testing took place during the conference organized by ECK, where the researcher was granted access to targeted respondents. The researcher conducted face-to-face meeting with FDI companies and institutional representatives (mainly the shareholder, CEO). In the final formulation there was

also consultation with questionnaire design experts and statistical analysis experts. The time required to respond to the questionnaire was slightly higher than 30 minutes.

In this phase, the question base was administered solely by the respondent, meaning that the respondents filled the questioners by themselves. The researcher had only the supportive role in case where clarification on question was needed. The completed draft of the questionnaire, along with the feedback provided, were useful to reshape the question base, reformulate some questions thereby finalizing the questionnaire, and starting real data collection.

After piloting, some of the survey questions were reformulated to avoid ambiguity.

In this part, the findings of the research will be presented, discussed, analyzed, and interpreted.

As a qualitative study, a descriptive approach has been used in order to present findings and to identify patterns and themes.

The next stage of research **involves examination of the categories identified to determine how the FDI are correlated to human resources.**

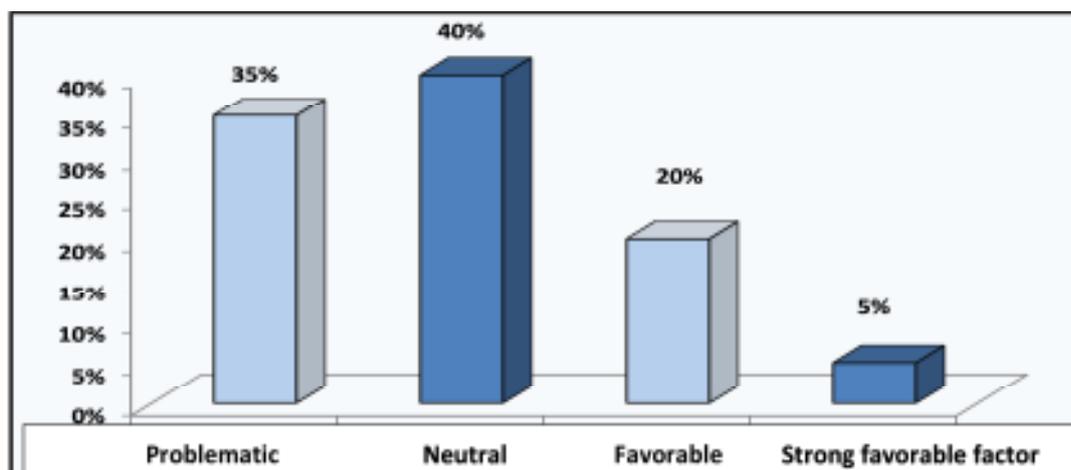
## 7.5. Data Presentation

### Factors that affected investments

#### Political Stability

Findings show that Kosovo political stability has been noticeably challenging for decisions on investments (35%), 40 percent of companies have declared of not being influenced by political stability and only 20 percent said it has been among the favorable factors for investment.

Figure 10. How has political stability affected your investment decision?

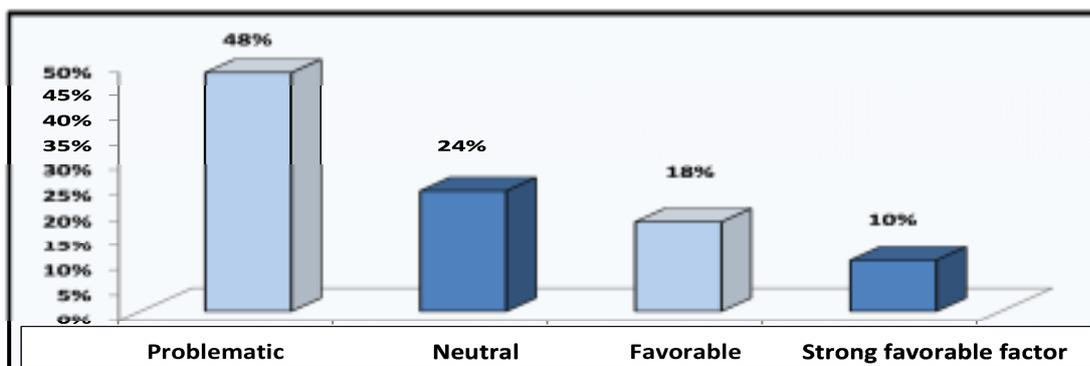


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

#### Economic Stability

About economic stability, the situation changes considerably, and about half of interviewed investors said that economic stability is enormously problematic for investing in country, 19 percent of them evaluated to be favorable, and 10 percent evaluated being a solid factor for investment in Kosovo.

Figure 12. How has economic stability affected your investment decision?

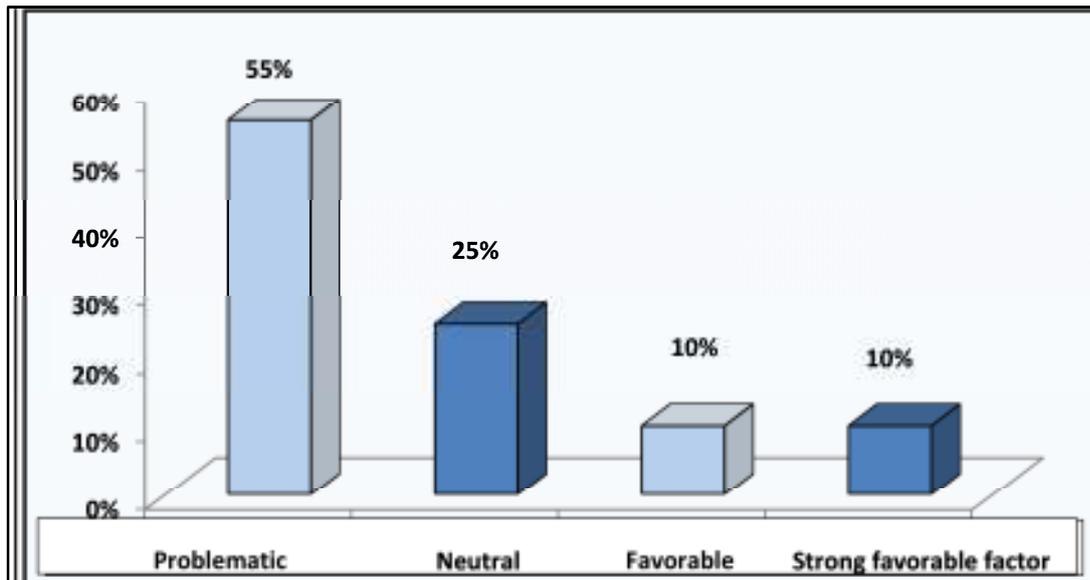


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### Stability and clarity of the legislation in force

Figure 16 shows that more than 55 percent of the investing companies, which have been interviewed, considered that current legislation clarity and stability to be problematic, 25 percent of them have assessed it as neutral, while the remaining part of 10 percent considered as a strong and encouraging factor to invest in our country.

Figure 13. How has stability and clarity of the legislation in force affected your investment decision?

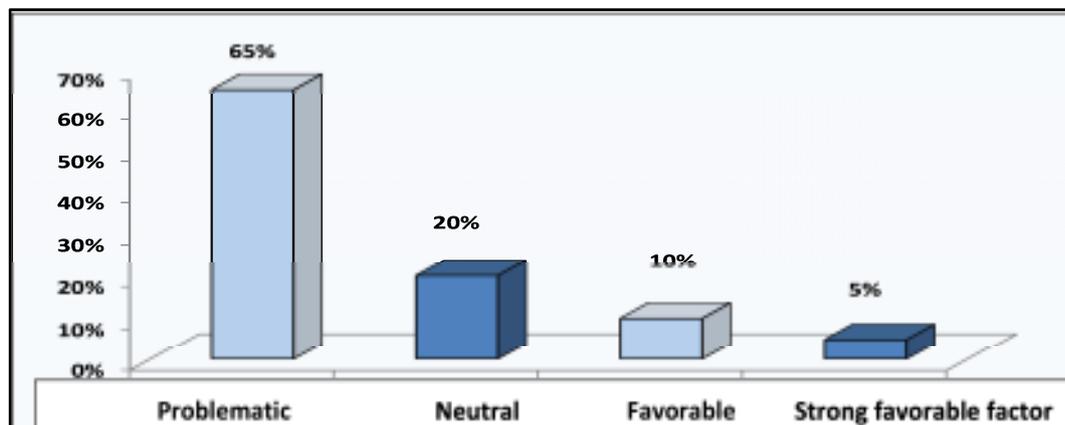


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### Degrees of protection of investments by the current law

Investors that have invested in Kosovo consider that protection of investors existing in the current law is very problematic, and at the same time, 65 percent consider it very difficult. Furthermore, a more concerning issue is the fact that only five percent of respondents consider the law being a favorable factor in investing in Kosovo.

**Figure 14. How has degree protection of investments by the current law affected your investment decision?**

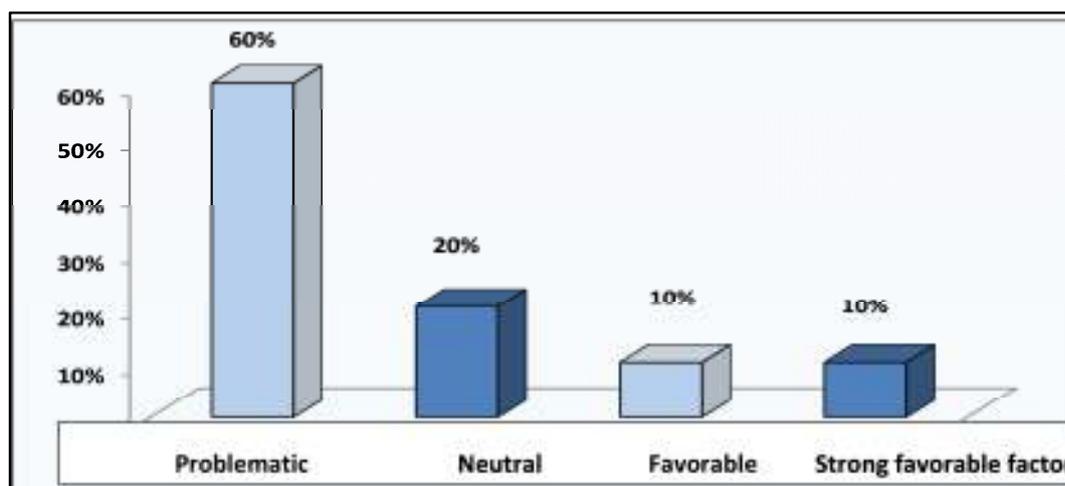


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### **Attractiveness of investments legislation**

Around 60 percent of investors interviewed evaluate the legislation as unfavorable, and while distributed equally in percentage those who evaluate being positive and very positive and factor, respectively ten per cent.

**Figure 15. How has the investment attractiveness of the legislation affected in your investment decision**

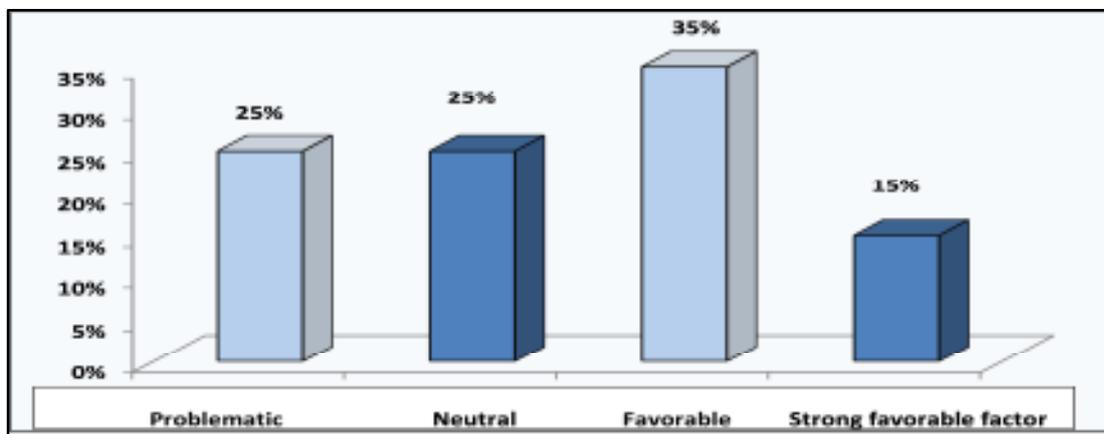


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### The ease of procedures for obtaining licenses/other certificates

From the report presented below, we recognize that in general the simplicity of procedures for obtaining licenses is a helpful element in attracting investment, correspondingly 35 percent of companies specified that this component is positive; when we add 15 percent of the companies who have evaluated as a very positive than in total, half of the investors consider the simplicity of procedures for obtaining licenses as a very positive element. The equivalent percentage is dispersed between those who estimated being difficult and neutral and regarding their influence on investments in Kosovo, correspondingly 25 percent.

Figure 15. How has the ease of procedures for obtaining licenses for investment affected your decision to invest?



Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### Results of impacts in investments

From the results below it can be concluded that business partners are decisive factors for a decision on investing in Kosovo, while less appropriate support is estimated to be provided by the institutions regarding the necessary information.

**Table 27. Factors that influenced decision to invest**

	N	Mean
Availability of investment incentives (tax and customs)	20	2.55
Availability of free trade regime (CEFTA, Japan, Norway)	21	2.62
Availability of free trade preferences offered by EU countries	20	2.7
Presence of business partners	19	3.37
The degree of current infrastructure (in the sector I have invested)	20	3.1
Support provided by relevant institution with necessary information	19	2.37
Valid N	17	

\* "1-problematic", "2-neutral", "3-favorable" or "4-strong favorable factor

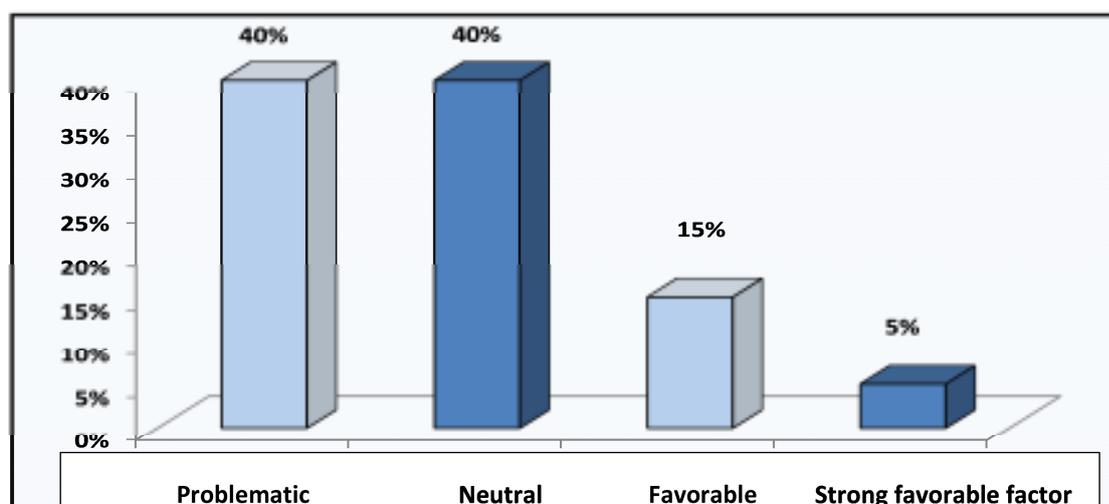
Source: Kosovo Chamber of Commerce - Findings on investment environment in Kosovo

## Results of customs and tax regime

### Attractiveness of customs legislation

Concerning customs legislation, the situation is estimated to be almost the same as for tax legislation. Nearly 43 percent of companies consider investing to be problematic and unfavorable in Kosovo in the context of customs legislation. Only 14 percent of the companies estimate the customs legislation to be “investment-friendly” and 10 percent of them estimate as strong and supportive investment factor.

**Figure16. How has tax legislation affected your investment decision?**



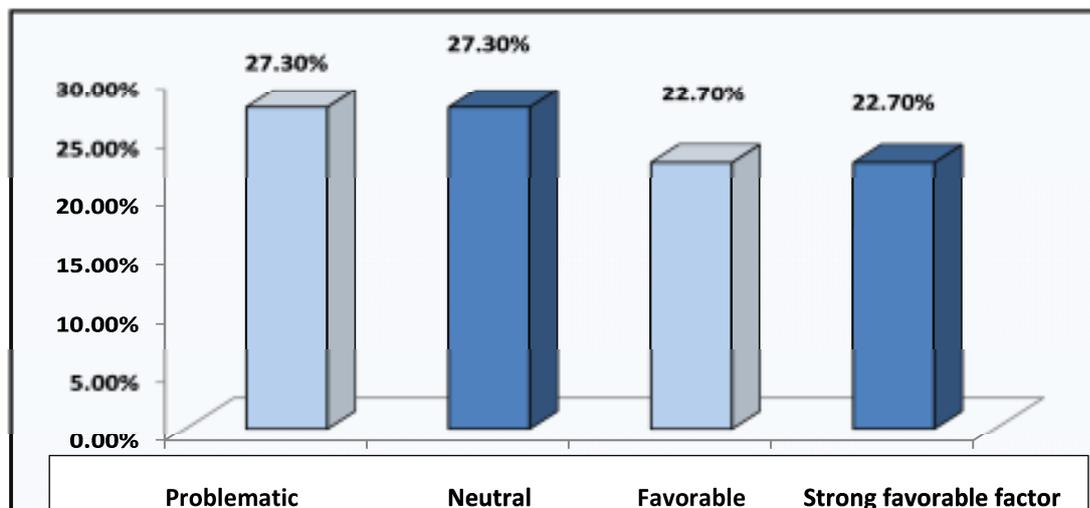
Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

## Results of the labor force

### Availability of skilled workforce in Kosovo

As for the availability of skilled labor force in Kosovo, interviewed investors distributed in equal, respectively around 27 percent said that finding skilled labor force is problematic the same percentage of those companies that started being not affected by this component. Very satisfactory rates of about 45.4 percent of them consider that Kosovo's workforce is skilled and is a strong factor in attracting investment.

Figure 17. How has availability of skilled workforce in Kosovo affected your investment decision?

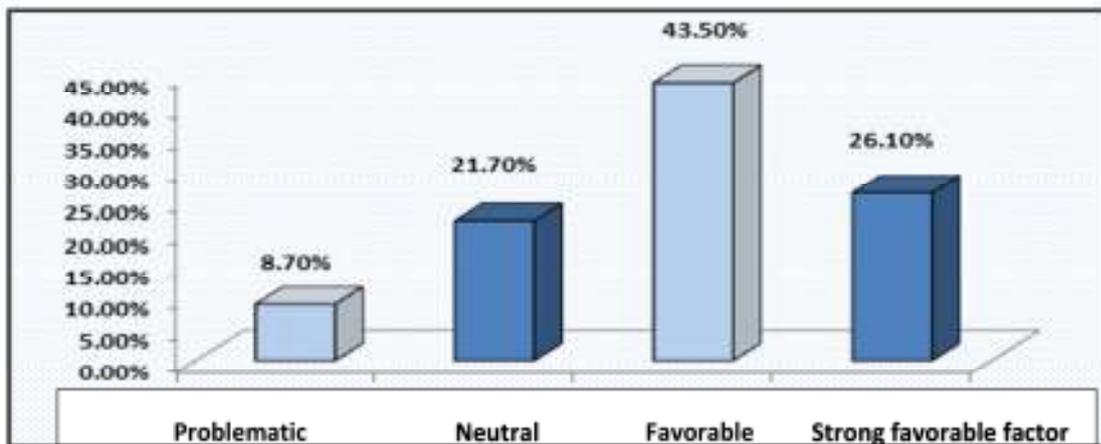


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### Cost of labor

The following graph estimates the labor cost in Kosovo. For nearly 70 percent of companies investing in the country is favorable regarding labor cost only about nine percent declared to be problematic.

Figure 18. How has cost of labor affected your investment decision?

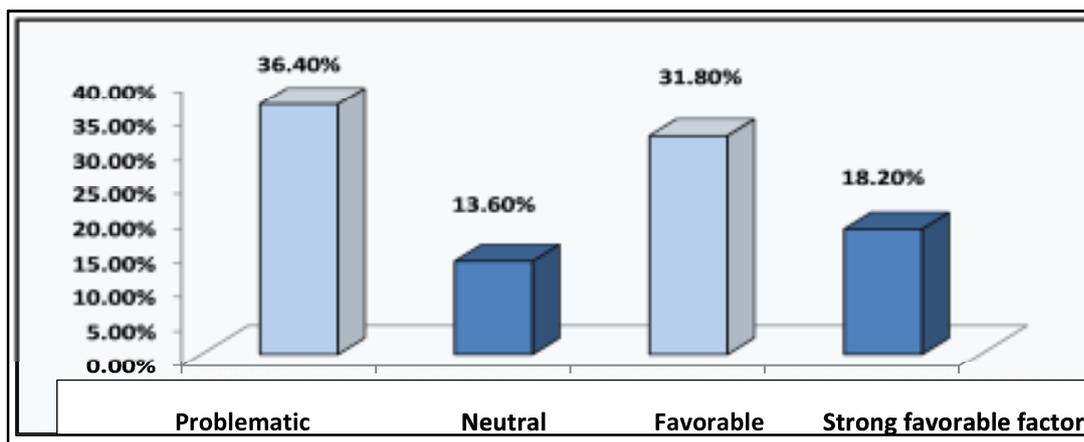


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### Presence of technical experts (highly qualified) within the field

For almost 36 percent of the investment companies finding technical specialists in the relevant field has been problematic. The situation described below reflects an excellent situation for about 50 percent of those who stated that the presence of experts in the field is favorable and a powerful factor. However, it remains challenging to consider the percentage of those who evaluated the situation as problematic.

Figure 19. How has the presence of technical experts (highly qualified) affected your investment decision?

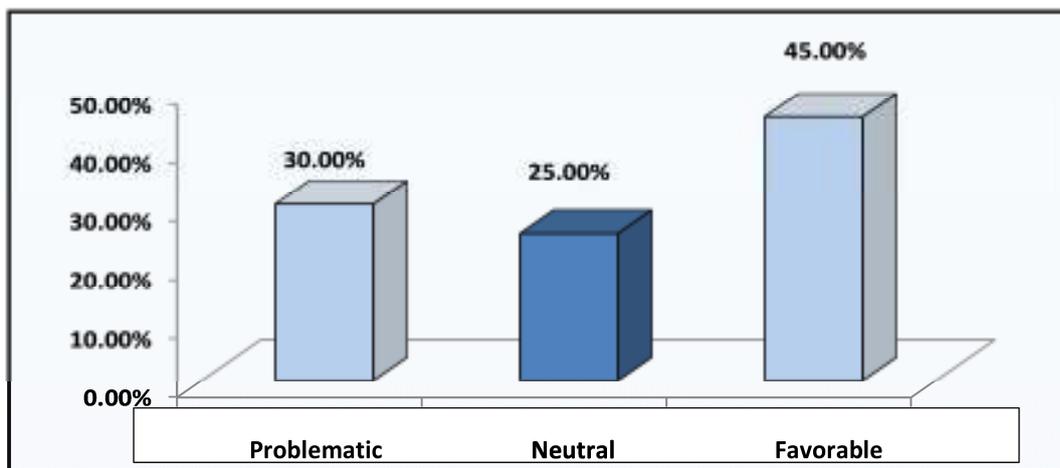


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### Level and correlation of qualification with business needs

We have positive figures in the case of qualification level of people with business needs. About 45 percent of investors estimate the correlation to be a favorable degree of training to the needs of business people, about 30 percent stated to be problematic, and the rest said to be neutral regarding this issue.

**Figure 20. How has level and correlation of qualification with business needs affected your investment decision?**



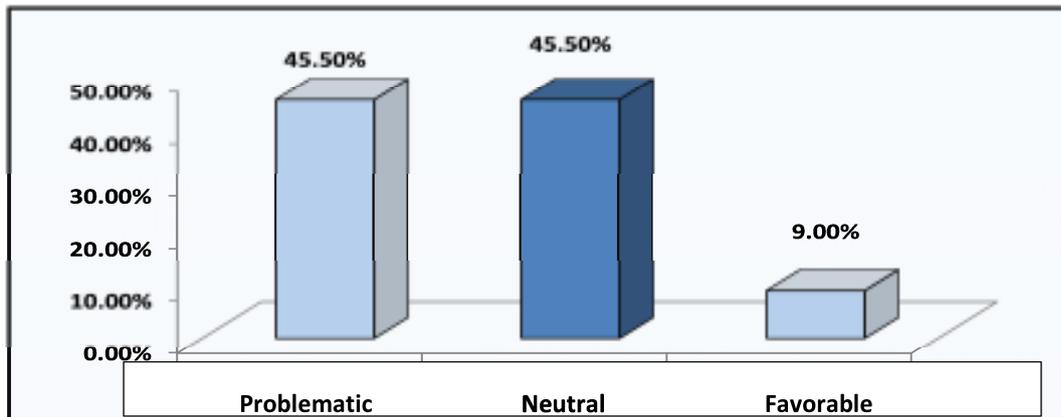
Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### The results of survey: Is Kosovo attractive to foreign investors

#### Availability of a normative/legal basis regarding foreign investments.

The findings presented in Figure 21 show that overall investment companies are of the opinion that there are no legal and favorable normative/legal bases in Kosovo for investments. Divided into equal percentage are businesses that reported the situation to be problematic and neutral, with 45.5 percent respectively. Only about 9 percent stated the availability of normative and legal base being favorable.

**Figure 21. How availability of a normative/ legal basis regarding foreign investments affected your investment decision ?**

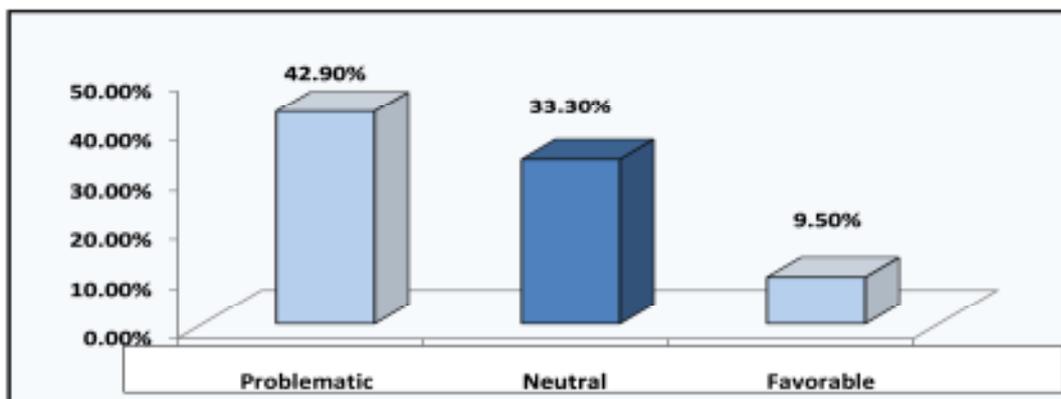


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### **Investment attractiveness of Kosovo compared to neighboring countries**

In accordance with the answers related to investment attractiveness of Kosovo compared to neighboring countries, unfavorable figures show up. About 43 percent of them consider being problematic the attractiveness of our investment compared with the region, from remaining 33.3 percent estimated being neutral and only 14.3 percent estimate being a strong factor (Figure 22).

**Figure 22. How has investment attractiveness of Kosovo compared to neighboring countries affected your investment decision?**

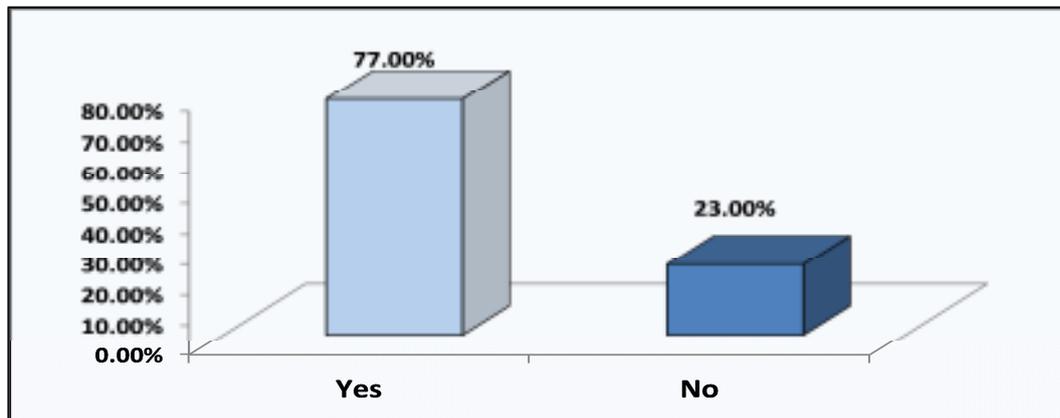


Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

### Would your company consider investing in Kosovo again?

Most of the companies interviewed, 77 percent consider Kosovo as a country where they will invest in the future. However, the percentage of the companies that will not consider under any circumstances is as well very higher and is a concerning issue for about 23 percent. So, Kosovo needs to do more to keep current investment companies in Kosovo.

Figure 23. Would your company consider investing in Kosovo again?



Source: Authors adapting the results of survey conducted by Kosovo Chamber of Commerce

#### 7.5.1. Major findings of the survey

Amongst the key findings from this research is that nearly 77 percent of investors are willing to invest again in our country, whereas about 23 percent stated that they do not prefer and will not invest any more in Kosovo. As we have seen in figure 17, the availability of skilled labor force in Kosovo is paramount. Around 27 percent said that finding skilled labor force is problematic (the same percentage of those companies that started being not affected), but this component still represent a serious concern further almost 36 percent of the investment companies finding technical specialists in the relevant field has been problematic. Remains a challenge for Kosovo government and related agencies to do more regarding attracting new investments, or at least keep the existing ones, even though the outcome is considered being favorable, and current investors rank Kosovo as a favorable country for investment. On the other hand, asked what are the other obstacles to invest in Kosovo, investors have argued also the problems with high interest rates, VAT on raw materials, economic and political stability and infrastructure, procedures for obtaining building permits, not a very clear legal framework, and investment protection are considered being important factors that are unfavorable to invest in Kosovo.

### **7.5.2. Does human capital affect FDI in European developing economies?**

The initial idea of this dissertation that possible determinant of FDI's are not only determinants of economic nature, but as we have seen there are also other factors that have impacts in attracting FDI inflows. As we have seen in previous chapters academic studies realized that social capital is a factor, which is considered by foreign enterprises before investment decisions. Whenever we are discussing human capital in the economy, we have in mind its extended definition, which is including discussion on human capital features, political rights, and freedoms cultural values, religion beliefs, and economic freedom of individualities. It is considered (as we have seen in previous chapters) that human capital could be an important factor in attracting foreign direct investment which undertake this kind of investment and they are looking for quality workforce skills (Druska 2001; Talpos & Enache, 2010; Dunning, 1988; Lucas, 1990; and Zhang and Markusen, 1999). Cultural values also have a role in foreign investment decisions, since the enterprises are looking for environments with similar cultural tradition when deciding regarding the location for a foreign direct investment. The political environment in host country could also be a determinant of FDI. Political uncertainty, both domestic and international, discourages the foreign investors in the investing in the country which face these problems (Andrea Colli 2015). The level freedom of economic environment in host countries is expected to influence FDI inflow. Freedom of economic environment includes various forms of the Political Risk Index (Andrea Colli 2015), Corruption Index published by Transparency International, Competitiveness Index, Gastil Democracy Index (Freedom of the Press 2016), Law and Finance (Rafael La Porta 1998), and Good Capitalist Governance Index (Altman, Morris 2013).

From the variety of different components that are considered and have influence on the inflow of foreign direct investment in a country, the author has decided to narrow empirical paper only to human capital related factors. In the process of testing the hypothesis “Human capital influences in FDI”, the author chose a sample that consists of European Union new member states. The selected countries share common characteristics and historical background. As a dependent variable, the author has used foreign direct investment inflows as a percentage of GDP, and as independent variables were used numerous measures of human capital like school enrolment, primary (gross), gender parity index (GPI), school enrolment, primary and secondary (gross), gender parity index (GPI), school enrolment,

tertiary (gross), gender parity index (GPI), current education expenditure, primary (% of total expenditure in primary public institutions), current education expenditure, secondary (% of total expenditure in secondary public institutions), current education expenditure, tertiary (% of total expenditure in tertiary public institutions), current education expenditure, total (% of total expenditure in public institutions), government expenditure per student, primary (% of GDP per capita), expenditure on primary as % of government expenditure on education (%), government expenditure per student, secondary (% of GDP per capita), expenditure on secondary as % of government expenditure on education (%), government expenditure per tertiary student as % of GDP per capita (%), expenditure on tertiary as % of government expenditure on education (%), expenditure on education as % of total government expenditure (%), government expenditure on education, total (% of GDP), labor force with primary education (% of total), labor force with secondary education (% of total), and labor force with tertiary education (% of total). The author chose only these independent variables, because the intention is to focus only in some possible determinants which are the quality elements of the workforce.

On the topic of the econometric methods used, author managed the data by combining time series and data corresponding to different countries. The author proposes the following simple regressive model:

$$Y_{it} = \alpha + \beta_{it} \times X_{it} + E_{it}$$

where:

- $Y_{it}$  is the dependent variable;
- $\alpha$  is the free coefficient;
- $\beta_{it}$  are the independent variables coefficients;
- $X_{it}$  are the independent variables;
- $E_{it}$  is a random variable;
- $i$  is the number used to run the regression;
- $t$  is time period.

The author used data from all these countries from the World Bank reports for the period from 2000 to 2013. The SPSS obtained results were presented in Table 1 and 2.

**Table 1. The combined form of findings**

<b>Descriptive Statistics</b>			
	Mean	Std. Deviation	N
School enrollment, primary (gross), gender parity index (GPI)	.9884	.0089	119
School enrollment, primary and secondary (gross), gender parity index (GPI)	.9979	.0151	119
School enrollment, tertiary (gross), gender parity index (GPI)	1.4121	.1891	120
Current education expenditure, primary (% of total expenditure in primary public institutions)	91.9424	4.2000	87
Current education expenditure, secondary (% of total expenditure in secondary public institutions)	92.3910	3.5365	85
Current education expenditure, tertiary (% of total expenditure in tertiary public institutions)	88.6976	5.4514	102
Current education expenditure, total (% of total expenditure in public institutions)	91.2348	3.1845	100
Government expenditure per student, primary (% of GDP per capita)	19.7881	5.6531	95
Expenditure on primary as % of government expenditure on education (%)	21.2155	5.6852	94
Government expenditure per student, secondary (% of GDP per capita)	21.4787	4.4136	94
Expenditure on secondary as % of government expenditure on education (%)	42.8485	5.4045	93
Government expenditure per tertiary student as % of GDP per capita (%)	22.6417	4.5950	112
Expenditure on tertiary as % of government expenditure on education (%)	20.7193	3.0364	111
Expenditure on education as % of total government expenditure (%)	10.5213	3.0870	111
Government expenditure on education, total (% of GDP)	6.0323	4.1679	111
Labor force with primary education (% of total)	18.3642	14.3429	120
Labor force with secondary education (% of total)	61.3625	14.2151	120
Labor force with tertiary education (% of total)	20.3102	6.6896	108
Foreign direct investment, net inflows (% of GDP)	47.3983	20.6470	120

**Source: Author's measurements using SPSS.**

**Table 2. Correlation Analyses**

	Pearson Correlation	Sig. (2-tailed)	Sum of Squares and Cross-products	Covariance	N
	<b>Foreign direct investment, net inflows (% of GDP)</b>				
School enrollment, primary (gross), gender parity index (GPI)	.213*	.020	4.614	.039	119
School enrollment, primary and secondary (gross), gender parity index (GPI)	-.097	.294	-3.579	-.030	119
School enrollment, tertiary (gross), gender parity index (GPI)	.127	.168	58.873	.495	120
Current education expenditure, primary (% of total expenditure in primary public institutions)	-.028	.797	-193.649	-2.252	87
Current education expenditure, secondary (% of total expenditure in secondary public institutions)	-.048	.666	-272.375	-3.243	85
Current education expenditure, tertiary (% of total expenditure in tertiary public institutions)	-.161	.107	-1705.157	-16.883	102
Current education expenditure, total (% of total expenditure in public institutions)	-.054	.591	-329.997	-3.333	100
Government expenditure per student, primary (% of GDP per capita)	.042	.687	457.216	4.864	95
Expenditure on primary as % of government expenditure on education (%)	-.113	.279	-1217.336	-13.090	94
Government expenditure per student, secondary (% of GDP per capita)	.226*	.028	1909.247	20.530	94
Expenditure on secondary as % of government expenditure on education (%)	-.142	.175	-1441.134	-15.665	93
Government expenditure per tertiary student as % of GDP per capita (%)	-.065	.498	-689.600	-6.213	112
Expenditure on tertiary as % of government expenditure on education (%)	-.012	.904	-79.914	-.726	111
Expenditure on education as % of total government expenditure (%)	-.278**	.003	-1956.129	-17.783	111
Government expenditure on education, total (% of GDP)	.160	.093	1525.076	13.864	111
Labor force with primary education (% of total)	.114	.215	4020.813	33.788	120
Labor force with secondary education (% of total)	-.252**	.005	-8807.817	-74.015	120
Labor force with tertiary education (% of total)	.528**	.000	6866.335	64.171	108

**Source: Author's measurements using SPSS.**

From the results we can see that the labor forces with secondary education accomplishment are negatively correlated with the foreign direct investment inflows and it does not seem to be a theoretical rationale for secondary education being less important to foreign investors, but this finding could be partly explained by fact that secondary education attainment may actually measure different phenomena in different countries, because of the differences in education systems concerning the length of secondary education or the mix of general vocational education. Other specifics that we can see in Eastern European countries is that foreign direct investment are correlated positively with the percentage of people that have tertiary education and expenditure on education as % of total government expenditure. This

situation may well be explained if we consider that at the beginning of the transition period, Eastern European countries have increased the quality of human capital. It seems that international investors took into account this situation and favored these countries for their FDI, ensuring all the human capital requirements for the more efficient technological transfer. It is obvious that at a 5% significance level, only five out of eighteen independent variables have an adequate statistical relevance.

## **7.6. Chapter Conclusion**

In this chapter were presented the findings of the research.

From the results we can see, as expected, with particular system panel data methodology which was used in testing the statistical significance of human capital variables as determinant of FDI inflows for several measures of human capital, are positively correlated to FDI inflows at a tolerable statistical significance level.

School enrolment and human development are important determinants of FDI inflows so that FDI inflows are positively correlated with human capital among the example of Eastern European countries. Hence, the investment on education and other human capital elements are of the greatest significance in enabling and creating environment for foreign direct investments. Reaching high level of educational is vital to a country's ability to both attract FDI and to increase the human capital spill-overs from foreign enterprises' presence.

Finally, the empirical results indicate that human capital is important for attracting FDI inflows, and host countries need qualitative education system for their population to show that their country has a sound investment climate to potential multinational enterprises.

Consistent with the results of the meta-regression, in order to support the hypothesis that human capital positively affect the level of FDI (European transition economies), the author has analyzed an interpreted qualitative study with a descriptive approach to the research on investments in Kosovo which has gathered information from owners and managers of companies that have invested in Kosovo regarding their opinion on barriers in doing business, tax and customs regime, the country's labor force (based on the needs of the companies that invested in our country), and attractiveness of Kosovo investment. Twenty-eight (28) foreign companies were interviewed across the country, and they were among the largest investors in the country. As we have seen, the availability of skilled labor force in Kosovo is paramount. Around 27 percent said that finding skilled labor force is problematic (the same percentage of those companies that started being not affected), but this component still represent a serious

concern further almost 36 percent of the investment companies finding technical specialists in the relevant field has been problematic. It remains a challenge for Kosovo government and related agencies to do more regarding attracting new investments, or at least keep the existing ones, even though the outcome is considered being favorable, and current investors rank Kosovo as a favorable country for investment .Positive ranks for future investments in Kosovo are the only positive outcome and at the same time the most important result that this report stressed, GoK, business organizations, businesspeople, and particularly media should do more to promote a business environment in process of drawing potential FDI in Kosovo.

## **Chapter 8: Conclusion, Recommendations, and Further Research**

### **8.1. Conclusion**

The objective of the thesis was to study the effect of human resources on FDI in Kosovo. After a review of earlier studies that have investigated this correlation, the first questions in this thesis was: Is it possible to find reliable indicators of the effect of human capital (and quantified) in the previous research and whether the results can be proved by specific characteristics of previous studies. The previous researches suggested that there are tangible effects of human capital on FDI. It is proved that over half of the world inward FDI is valued to be market or resource-seeking (World Investment Report 2015), and therefore is expected to be little influenced by human capital, makes it challenging for research using aggregate FDI measures to identify any relationship that may exist among human capital and FDI in the rest of the economic activities.

Author's estimations showed that in selected countries the human capital quality counts in attracting foreign direct investment inflows. It seems that foreign investors in these countries are looking for fast and efficient technological transfer, and hence value the human capital quality. This may well be an indicator for GoK and in other Balkan countries, which are competing for attracting foreign direct investment. In order to be a more attractive country for foreign investments, it is necessary to invest in education, particularly at the tertiary level. Appropriate knowledge and market-driven skills occupy the most potent sources of competitiveness and productivity to achieving highly sustainable economic growth and to create a friendly environment for foreign investment.

One of the leading causes of slow socio-economic progress in Kosovo stems from the low knowledge base, inadequate skills, and the use of outdated technology. As we have seen from results of survey, the availability of skilled labor force in Kosovo, interviewed investors distributed in equal, respectively around 27 percent said that finding skilled labor force is problematic the same percentage of those companies that started being not affected and almost 36 percent of the investment companies finding technical specialists in the relevant field has been problematic. These results shows that competences possessed by the Kosovo workers are not the appropriate as demanded by foreign investors which lead to the suggestion in the reform of education system of the country.

Kosovo needs to develop corporate knowledge and market-driven skills to benefit from the increased FDI flows. Human capital is one of the competitive advantages that a developing economy can offer at low cost, multilingual skills, and solid education, particularly technical

education and vocational training. Many countries indicate that countries without vast natural resources can still attract a large inflow of FDI by offering high-quality human capital to foreign investors. Countries that can provide skilled workers at affordable costs will always attract foreign investments. Kosovo so far has achieved little progress in mobilizing required financial resources. The country can attract large amounts of FDI by developing human capital, investing in the major infrastructure such as roads, telecommunications, energy network, and strengthening economic sectors to increase and sustain competitiveness in the global market. The human resource development is the main factor in improving the productivity levels, which significantly contributes to the growth process. Improved human resource development would help in increasing the competitiveness, higher growth of output, exports, employment, overseas migration and remittances, and foreign private investment, particularly FDI. The development of a high educated and skilled labor force in the Kosovo would assist the country in graduating from labor-intensive to technologically advanced nation. Allocations for human resource development, particularly higher education and research and development are increased. Kosovo has to diversify its production structures in the direction of high value-added and modern and sophisticated industries by improving scientific, technological, vocational, and technical skills. The experience of various countries and regions suggests that developing public-private partnership helps to the creation of new technical possibilities, capability to invest, innovate, and improve existing technology. Kosovo can learn from the experience from other countries.

## 8.2. Recommendations

Based on research findings and observations of the researcher, the following recommendation can be addressed:

- Kosovo has an urgent need for improvement of the environment of doing business, as well as to attract foreign investments as much as possible, since during the recent years the level of FDI-s remained at low levels, mainly in banking and energy sector. As a result, the FDI levels remain low in comparison to other neighboring countries. Privatization process, as an important catalyst for attracting FDI in different countries, did not show the same result in Kosovo and since this process is almost complete, the withdrawal of other types of investments should be back in priority.
- Government of Kosovo does not have a correct database for the demands of the labor market for the next 5 years. Ministry of Trade, Ministry of Labor, and Ministry of Education should have an immediate list of needs of the labor market. This indicator will provide the adaptations of the curriculums of the professional schools.
- A special attention should be paid to the development of knowledge and information through the encouraging of using the information technology and communication.
- A relatively small productivity gap of workforce between foreign and domestic companies in the manufacturing industry shows a low level of technology in the foreign companies.
- In the banking sector, risk premiums for SME loans are high. Thus, there is a need for agencies for loan guarantying.
- FDI attraction and the increase of competitiveness of domestic companies are important factors for a sustainable economic development in Kosovo. In the recent years there have been approved several reforms to improve the investing climate.
- There is a need for further reforms in legislation implementation, tax collection, VAT refunding, and reduction of bureaucracy.
- Verification/certification of property should be improved and the process of permits issuances should be simplified. Ambiguous procedures cause delays and premises for corruption.
- There should be a better regional implementation of CEFTA agreement. Since the domestic market is small, the implementation of these agreements creates opportunity to access the international markets.

- Stimulation of FDI in less developed regions to reduce regional development inequalities (industrial parks).
- Full functionalization of KIESA investments with the aim of attracting foreign investors.

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Table 12: Stages and participants in the transfer of knowledge

Table 13: Key indicators of the labor market (%)

Table 14: The most important results of the Labor Force Survey, 2014

Table 15: Export and Import with the Region and the EU (in EUR '000)

Table 16: Export and Import by category 2010-2011 (in thousands)

Table 17: Doing Business in Kosovo

Table 18: Foreign direct investments in Kosovo - by countries (net)

Table 19: Kosovo: Selected Economic Indicators

Table 20: Country comparison of key Labor statistics

Table 21: Number of employees in state administration by years 2003-2014

Table 22: Employment rate by years 2001- 2014

Table 23: Registered jobseekers by gender and qualification 2008-2014

Table 24: Employment rate by Economic activity 2001 - 2014

Table 25: Sectoral Composition of public Expenditure

Table 26: Net financial flows to developing countries and economies in transition, 2005–2014.

Table 27: Factors that influenced decision to invest

Table 28: The synthesized form of findings

Table 29: Correlation analyses

Table 25: Sectoral Composition of public Expenditure

## Appendixes

### Questionnaire

#### A. PROFILE OF COMPANY AND ITS INVESTMENT IN KOSOVO

1. What is the main business activity of your company in Kosovo?  
 Production/manufacturing  
 Distribution  
 Sales & marketing  
 Research & Development  
 Headquarter function  
 Other, .....
2. Which business sector most applies to this operation? (see also Annex 1 for overview of sectors)  
.....
3. Please provide a brief description of the products or services provided at this operation  
.....  
.....
4. Year of establishment of this operation in Kosovo: .....
5. Mode of entry in the country:  Joint venture,  New Greenfield,  Merger or Acquisition
6. Value of current investment in Kosovo (in US\$ or EUR)  
US\$ or EUR:.....
7. Current number of employees at company in Kosovo:  
#:.....  
  
How many of these employees are expatriates?:.....  
How many of these are unskilled production workers?:.....
8. What was the total annual sales revenue of your operation in the last fiscal year (2014)? EUR/ .....
9. What was the approximate % increase / decrease in total annual sales in 2014 compared to the previous fiscal years? (if decrease, please put the percentage number between brackets e.g. [x%]. )  
Compared to 2014..... %  
Compared to 2013..... %  
Compared to 2009..... %
10. What are the top 3 country destinations of your exports?  
  - (1) .....
  - (2) .....
  - (3) ..... None / 100% sales in Kosovo
12. Has your investment in **Kosovo** performed to expectations in the last three years?

**Well Above**      **Above**      **In line with**      **Below**      **Well below**  
                                               

13. What are the main reasons for the answer to question 12?

.....

.....

.....

**B. MOTIVATION FOR INVESTMENT IN KOSOVO**

14. Please check a box for the option that best describes your company's situation:

- 1. Company has made no major new investment or expansion investment since starting operations in Kosovo.
- 2. Company has made a major new investment or expansion investment since starting operations in Kosovo.

15. At time of establishment, if you considered other countries for your investment, which were those countries?

.....

16. How your company was originally made aware of investment opportunities in Kosovo? **(Please tick the most important box only)**

- |   |   |
|---|---|
| <ul style="list-style-type: none"> <li><input type="checkbox"/> Investment Seminar in Home Country</li> <li><input type="checkbox"/> Investment/Trade mission to Kosovo</li> <li><input type="checkbox"/> Direct Contact from KIESA / IPAK</li> <li><input type="checkbox"/> KIESA / IPAK Website</li> <li><input type="checkbox"/> Embassy</li> <li><input type="checkbox"/> Existing Investor</li> <li><input type="checkbox"/> Kosovo Chamber of Commerce</li> </ul> | <ul style="list-style-type: none"> <li><input type="checkbox"/> Customer in Kosovo</li> <li><input type="checkbox"/> Supplier in Kosovo</li> <li><input type="checkbox"/> Other Internet Sources</li> <li><input type="checkbox"/> Newspaper / Business Journal</li> <li><input type="checkbox"/> Intermediary Advisers (Accountants, etc.)</li> <li><input type="checkbox"/> Other Business Contact, please specify<br/>.....</li> </ul> |
|---|---|

17. Why did you choose to invest in **Kosovo**? *(Please tick the appropriate boxes indicating the importance of each factor in your location decision AND tick to indicate if there was any change in those conditions you marked as 'important' or 'crucial')*

	Importance of each factor					How have these factors changed over the past 3 years?				
	Not important	Helpful	Important	Very important	Crucial	Much worse	Worse	Same	Better	Much better
<b>Business Climate Conditions</b>										
Political stability										
Economic stability										
Quality of infrastructure										
Government agency support services										
Country legal framework										
Transparency of investment climate										
Quality of Life										
Physical security										
Existing foreign investor's experiences										
Double taxation treaties										
Bilateral trade agreements										
Availability of Export Processing zones										
<b>Market conditions</b>										
Local market										
Regional/continental market										
Presence of key client(s)										

Take advantage of .....										
<b>Local resources</b>										
Low labour costs										
Availability of skilled labour										
Availability of raw materials										
Local suppliers										
<b>Other location factors</b>										
Incentive package										
Kosovo Investment Board (KIESA / IPAK ) assistance										
Acquisition of existing assets										
Presence of Joint Venture partner										
Specific investment project proposal										
Other.....										

18. Overall, what were the three (3) most critical factors that influenced your decision to carry out your investment in Kosovo?

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

### **C. EXPERIENCE IN KOSOVO AND WITH KIESA / IPAK**

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19. How would you rate your understanding of what services the KIESA / IPAK offers to investors? (tick one box)

- Very good Understanding**
 **Good understanding**
 **Some understanding**
 **Poor understanding**
 **Very poor understanding**

20. Overall, what are the three most valuable service(s) that come to mind when you think about KIESA / IPAK ?

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

4. Don't know

21. What services did you request/need from KIESA / IPAK *before* you decided to invest in Kosovo? (Please indicate both how important you consider this service to be AND how you would rate the quality of the service provided by the KIESA / IPAK )

Type of <u>pre-investment</u> services requested/used	How important is/was this service to you?			How well was this services provided to you?		
	Not	Important	Crucial	Not	Provided	Provided

	important			provided by KIESA / IPAK	well	poorly
Information on general country business climate						
Information on doing business in country (permits, labour regulations, etc. etc.)						
Information on cost of doing business in the country (labour costs, property costs, utilities costs, etc.)						
Information on corporate taxation and incentives						
Information on professional bodies						
Information on customers or markets						
Information on importing/exporting regulations and tariffs						
Information on existing industry or sector						
Information on suppliers						
Information on service providers (legal support, recruitment support, etc.)						
Pre-investment fact finding trip organised by KIESA / IPAK						
Environmental impact assessment						
Business introductions to potential (joint venture) partners in the country						
Feasibility studies						
Finding suitable sites/property						
Other.....						
Other.....						

22. What services, if any, did your company request/avail from the KIESA / IPAK *during and after* establishing your business in Kosovo? (Please indicate both how important you consider this service to be AND how you would rate the quality of the service provided by the KIESA / IPAK )

Type of investment and post-investment services requested/used	How important is this service to you?			How well is this services provided to you?		
	Not important	Important	Crucial	Not provided by KIESA / IPAK	Provided well	Provided badly
Company registration and licensing						
Obtaining permits (work permits, import/export permits, etc.)						
Introduction to legal & accounting services						
Incentive applications						
Office/Factory purchase/lease						
Finding suitable sites						
Building construction						
Utilities and infrastructure						
Equipment purchase						
Recruitment support						
Staff training support						
Finding local suppliers						
Business start-up problem solving						
Operational problem solving .....						
Other.....						

### E. Additional Questions and contact details

23. Would you like to be contacted by KIESA / IPAK to discuss your investment in Kosovo?  
 Yes  No

*If you indicated yes, please be assured that, unless you give permission by answering yes to Question 43, apart from your contact details none of the answers to the questions you have provided will be passed on to KIESA / IPAK !*

24. Do you wish to give your permission to KIESA / IPAK to publish any information from this interview on its website?  
Yes  No

43.a. If yes, which information can KIESA / IPAK publish with your consent: (KIESA / IPAK likes to generally announce any reinvestment plans by established investors mainly including the reinvestment activity; the number of new jobs to be created and any other relevant information - the client may wish to share a corporate press release for publication on KIESA / IPAK website)

.....  
.....  
.....

25. Would you provide a testimonial to KIESA / IPAK so that it may include it on its website and / or marketing materials?  
Yes  No

If yes:

.....  
.....  
.....

If you prefer to take your time before providing a testimonial; when would be a good time to contact you to get the testimonial from you?

.....  
.....

**Company in Kosovo:**

- A. Company Name: .....
- B. City: .....

**Parent company:**

- A. Company Name: .....
- B. Country: .....
- C. City: .....

**Name of person representing company being interviewed –**

Family Name ..... First Name  
..... Mr. .... Mrs. .... Ms. .... Dr. ....

## Author's measurements using SPSS

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
School enrollment, primary (gross), gender parity index (GPI)	119	0.9598	1.0034	0.988386	0.0089038
School enrollment, primary and secondary (gross), gender parity index (GPI)	119	0.9658	1.0497	0.997946	0.0151349
School enrollment, tertiary (gross), gender parity index (GPI)	120	1.0511	1.8882	1.412065	0.1891389
Current education expenditure, primary (% of total expenditure in primary public institutions)	87	78.616	99.022	91.94243	4.199958
Current education expenditure, secondary (% of total expenditure in secondary public institutions)	85	80.647	98.565	92.39103	3.536456
Current education expenditure, tertiary (% of total expenditure in tertiary public institutions)	102	73.94	100	88.6976	5.45136
Current education expenditure, total (% of total expenditure in public institutions)	100	79.75	98.98	91.2348	3.18446
Government expenditure per student, primary (% of GDP per capita)	95	9.71	33.7	19.7881	5.65314
Expenditure on primary as % of government expenditure on education (%)	94	13.4	33.71	21.2155	5.68518
Government expenditure per student, secondary (% of GDP per capita)	94	10.241	32.127	21.47866	4.413576
Expenditure on secondary as % of government expenditure on education (%)	93	33	56.45	42.8485	5.40448
Government expenditure per tertiary student as % of GDP per capita (%)	112	11.59	34.16	22.6417	4.59499
Expenditure on tertiary as % of government expenditure on education (%)	111	13.45	28.47	20.7193	3.03639
Expenditure on education as % of total government expenditure (%)	111	2.33	16.37	10.5213	3.08701
Government expenditure on education, total (% of GDP)	111	2.94	21.8	6.0323	4.16788
Labor force with primary education (% of total)	120	5.6	60.1	18.3642	14.34287
Labor force with secondary education (% of total)	120	22.9	80.2	61.3625	14.21506
Labor force with tertiary education (% of total)	108	9.1	37.7	20.3102	6.68955
Foreign direct investment, net inflows (% of GDP)	120	13.1	98	47.398333	20.64702548
Country	120	1	10	5.5	2.884
Year	120	2001	2012	2006.5	3.467
Valid N (listwise)	71				

Case Processing Summary

	Cases					
	Included		Excluded		Total	
	N	Percent	N	Percent	N	Percent
Foreign direct investment, net inflows (% of GDP) * School enrollment, primary (gross), gender parity index (GPI)	119	99.2%	1	.8%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * School enrollment, primary and secondary (gross), gender parity index (GPI)	119	99.2%	1	.8%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * School enrollment, tertiary (gross), gender parity index (GPI)	120	100.0%	0	0.0%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Current education expenditure, primary (% of total expenditure in primary public institutions)	87	72.5%	33	27.5%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Current education expenditure, secondary (% of total expenditure in secondary public institutions)	85	70.8%	35	29.2%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Current education expenditure, tertiary (% of total expenditure in tertiary public institutions)	102	85.0%	18	15.0%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Current education expenditure, total (% of total expenditure in public institutions)	100	83.3%	20	16.7%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Government expenditure per student, primary (% of GDP per capita)	95	79.2%	25	20.8%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Expenditure on primary as % of government expenditure on education (%)	94	78.3%	26	21.7%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Government expenditure per student, secondary (% of GDP per capita)	94	78.3%	26	21.7%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Expenditure on secondary as % of government expenditure on education (%)	93	77.5%	27	22.5%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Government expenditure per tertiary student as % of GDP per capita (%)	112	93.3%	8	6.7%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Expenditure on tertiary as % of government expenditure on education (%)	111	92.5%	9	7.5%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Expenditure on education as % of total government expenditure (%)	111	92.5%	9	7.5%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Government expenditure on education, total (% of GDP)	111	92.5%	9	7.5%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Labor force with primary education (% of total)	120	100.0%	0	0.0%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Labor force with secondary education (% of total)	120	100.0%	0	0.0%	120	100.0%
Foreign direct investment, net inflows (% of GDP) * Labor force with tertiary education (% of total)	108	90.0%	12	10.0%	120	100.0%

ANOVA Table

			Sum of Squares	df	Mean Square	F	Sig.
Foreign direct investment, net inflows (% of GDP) * School enrollment, primary (gross), gender parity index (GPI)	Between	(Combined)	46770.556	114	410.268	.462	.923
	Groups	Linearity	2276.063	1	2276.063	2.560	.185
		Deviation from	44494.493	113	393.757	.443	.933
		Linearity					
	Within Groups		3555.810	4	888.952		
Total		50326.366	118				

Measures of Association

	R	R Squared	Eta	Eta Squared
Foreign direct investment, net inflows (% of GDP) * School enrollment, primary (gross), gender parity index (GPI)	.213	.045	.964	.929

ANOVA Table

			Sum of Squares	df	Mean Square	F	Sig.
Foreign direct investment, net inflows (% of GDP) * School enrollment, primary and secondary (gross), gender parity index (GPI)	Between	(Combined)	50286.966	116	433.508	22.005	.044
	Groups	Linearity	473.809	1	473.809	24.051	.039
		Deviation from	49813.157	115	433.158	21.988	.044
		Linearity					
	Within Groups		39.400	2	19.700		
Total		50326.366	118				

ANOVA Table

			Sum of Squares	df	Mean Square	F	Sig.

Foreign direct investment, net inflows (% of GDP) * Current education expenditure, tertiary (% of total expenditure in tertiary public institutions)	Between	(Combined)	37601.983	100	376.020	208.321	.055
	Groups	Linearity	968.716	1	968.716	536.685	.027
		Deviation from	36633.266	99	370.033	205.004	.056
		Linearity					
	Within Groups		1.805	1	1.805		
	Total		37603.788	101			

**Measures of Association**

	R	R Squared	Eta	Eta Squared
Foreign direct investment, net inflows (% of GDP) * Current education expenditure, tertiary (% of total expenditure in tertiary public institutions)	-.161	.026	1.000	1.000

**ANOVA Table**

			Sum of Squares	df	Mean Square	F	Sig.
Foreign direct investment, net inflows (% of GDP) * Labor force with primary education (% of total)	Between	(Combined)	43939.576	92	477.604	1.899	.030
	Groups	Linearity	660.402	1	660.402	2.626	.117
		Deviation from	43279.174	91	475.595	1.891	.031
		Linearity					
	Within Groups		6790.083	27	251.485		
	Total		50729.660	119			

**Measures of Association**

	R	R Squared	Eta	Eta Squared
Foreign direct investment, net inflows (% of GDP) * Labor force with primary education (% of total)	.114	.013	.931	.866

ANOVA Table

			Sum of Squares	df	Mean Square	F	Sig.
Foreign direct investment, net inflows (% of GDP) * Labor force with secondary education (% of total)	Between Groups	(Combined)	48828.848	100	488.288	4.881	.000
		Linearity	3226.208	1	3226.208	32.248	.000
		Deviation from Linearity	45602.640	99	460.633	4.604	.000
	Within Groups		1900.812	19	100.043		
Total		50729.660	119				

Measures of Association

	R	R Squared	Eta	Eta Squared
Foreign direct investment, net inflows (% of GDP) * Labor force with secondary education (% of total)	-.252	.064	.981	.963

ANOVA Table

			Sum of Squares	df	Mean Square	F	Sig.
Foreign direct investment, net inflows (% of GDP) * Labor force with tertiary education (% of total)	Between Groups	(Combined)	28380.867	86	330.010	.992	.537
		Linearity	9846.282	1	9846.282	29.588	.000
		Deviation from Linearity	18534.584	85	218.054	.655	.910
	Within Groups		6988.350	21	332.779		
Total		35369.217	107				

Measures of Association

	R	R Squared	Eta	Eta Squared
Foreign direct investment, net inflows (% of GDP) * Labor force with tertiary education (% of total)	.528	.278	.896	.802

Correlations			
		Foreign direct investment, net inflows (% of GDP)	
Pearson Correlation	Pearson Correlation	School enrollment, primary (gross), gender parity index (GPI)	.109
		School enrollment, primary and secondary	.116
		School enrollment, tertiary (gross), gender parity	.014
		Current education expenditure, primary (% of total	.083
		Current education expenditure, secondary (% of	.098
		Current education expenditure, tertiary (% of total	-.113
		Current education expenditure, total (% of total	-.013
		Government expenditure per student, primary (%	-.083
		Expenditure on primary as % of government	-.257
		Government expenditure per student, secondary	.085
		Expenditure on secondary as % of government	.012
		Government expenditure per tertiary student as %	.224
		Expenditure on tertiary as % of government	.179
		xpenditure on education as % of total government	-.350
		Government expenditure on education, total (% of	-.109
		Labor force with primary education (% of total)	-.433
		Labor force with secondary education (% of total)	.156
		Labor force with tertiary education (% of total)	.266
		Country	-.433
		Year	.366
Sig. (1-tailed)		Foreign direct investment, net inflows (% of GDP)	
		School enrollment, primary (gross), gender parity	.184
		School enrollment, primary and secondary	.169
		School enrollment, tertiary (gross), gender parity	.454
		Current education expenditure, primary (% of total	.245
		Current education expenditure, secondary (% of	.209
		Current education expenditure, tertiary (% of total	.174
		Current education expenditure, total (% of total	.457
		Government expenditure per student, primary (%	.246
		Expenditure on primary as % of government	.015
		Government expenditure per student, secondary	.241
		Expenditure on secondary as % of government	.459
		Government expenditure per tertiary student as %	.030
		Expenditure on tertiary as % of government	.068
		Ependiture on education as % of total government	.001
		Government expenditure on education, total (% of	.182
		Labor force with primary education (% of total)	.000
		Labor force with secondary education (% of total)	.098
		Labor force with tertiary education (% of total)	.013
		Country	.000
	Year	.001	

Variables Entered/Removed <sup>a</sup>			
Model	Variables Entered	Variables Removed	Method
1	Year, Current education expenditure, primary (% of total expenditure in primary public institutions), Labor force with secondary education (% of total), Expenditure on primary as % of government expenditure on education (%), Current education expenditure, tertiary (% of total expenditure in tertiary public institutions), Country, School enrollment, primary and secondary (gross), gender parity index (GPI), School enrollment, primary (gross), gender parity index (GPI), Government expenditure per student, secondary (% of GDP per capita), Expenditure on tertiary as % of government expenditure on education (%), Government expenditure per tertiary student as % of GDP per capita (%), School enrollment, tertiary (gross), gender parity index (GPI), Government expenditure per student, primary (% of GDP per capita), Labor force with tertiary education (% of total), Current education expenditure, secondary (% of total expenditure in secondary public institutions), expenditure on education as % of total government expenditure (%), Expenditure on secondary as % of government expenditure on education (%), Current education expenditure, total (% of total expenditure in public institutions), Government expenditure on education, total (% of GDP), Labor force with primary education (% of total) <sup>b</sup>		Enter
a. Dependent Variable: Foreign direct investment, net inflows (% of GDP)			
b. All requested variables entered.			

#### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.934 <sup>a</sup>	.872	.821	5.96425904

- a. Predictors: (Constant), Year, Current education expenditure, primary (% of total expenditure in primary public institutions), Labor force with secondary education (% of total), Expenditure on primary as % of government expenditure on education (%), Current education expenditure, tertiary (% of total expenditure in tertiary public institutions), Country, School enrollment, primary and secondary (gross), gender parity index (GPI), School enrollment, primary (gross), gender parity index (GPI), Government expenditure per student, secondary (% of GDP per capita), Expenditure on tertiary as % of government expenditure on education (%), Government expenditure per tertiary student as % of GDP per capita (%), School enrollment, tertiary (gross), gender parity index (GPI), Government expenditure per student, primary (% of GDP per capita), Labor force with tertiary education (% of total), Current education expenditure, secondary (% of total expenditure in secondary public institutions), expenditure on education as % of total government expenditure (%), Expenditure on secondary as % of government expenditure on education (%), Current education expenditure, total (% of total expenditure in public institutions), Government expenditure on education, total (% of GDP), Labor force with primary education (% of total).

ANOVA<sup>a</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	12116.405	20	605.820	17.031	.000 <sup>b</sup>
	Residual	1778.619	50	35.572		
	Total	13895.025	70			

a. Dependent Variable: Foreign direct investment, net inflows (% of GDP)

b. Predictors: (Constant), Year, Current education expenditure, primary (% of total expenditure in primary public institutions), Labour force with secondary education (% of total), Expenditure on primary as % of government expenditure on education (%), Current education expenditure, tertiary (% of total expenditure in tertiary public institutions), Country, School enrolment, primary and secondary (gross), gender parity index (GPI), School enrolment, primary (gross), gender parity index (GPI), Government expenditure per student, secondary (% of GDP per capita), Expenditure on tertiary as % of government expenditure on education (%), Government expenditure per tertiary student as % of GDP per capita (%), School enrolment, tertiary (gross), gender parity index (GPI), Government expenditure per student, primary (% of GDP per capita), Labour force with tertiary education (% of total), Current education expenditure, secondary (% of total expenditure in secondary public institutions), expenditure on education as % of total government expenditure (%), Expenditure on secondary as % of government expenditure on education (%), Current education expenditure, total (% of total expenditure in public institutions), Government expenditure on education, total (% of GDP), Labour force with primary education (% of total)

## Confirmation letter



Adresa: Bina Tereza, Nr.25, 10000 Prishtine - KOSOVA  
Tel: + 381 45 38 224 241, Telefaks: + 381 45 38 224 239  
email: info@kcc.org.kc, www.kcc.org.kc

Prishtine , 13.06.2016

### Confirmation Letter

To: Regional Joint Doctoral Programme in Entrepreneurship and SME Management for Western Balkan Countries

Dear Mr. Fatmir Memaj,

Kosovo Chamber of Commerce (KCC) within the "Foreign Investors Club" consisting of the heads of accredited Chambers of Commerce in Kosovo has conducted a study on foreign direct investments in Kosovo. More specifically, the aim of this study was that through a survey of the largest investment companies in the country, to understand the real situation of the investment environment in Kosovo and evaluated segments where Kosovo needs to work more on attracting foreign direct investment.

This study was designed and conducted under the responsibility of KCC, supported by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), and approved in advance of the board of the "Club of the Foreign Investors".

For the purposes of the study, we have surveyed 28 largest companies investing in the country. Companies are selected from lists provided by the Investment Promotion Agency (KIPA) and provided lists of accredited Chambers of Commerce in Kosovo. Participation in the survey was voluntary, since the quality of the results depends on the willingness of entrepreneurs to participate in the interview.

Moreover, **Mr. Shpresim Vranovci** was part of the study as an interested third party since the beginning and has contributed actively during all phases of the study. Therefore, we confirm that Mr. Shpresim Vranovci can use any material from the study as a part of his PHD dissertation.

If you have any additional related questions, please feel free to contact us.

Sincerely,

Sufet Gerxhaniu

President



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<sup>i</sup> In last report , Kosova ranks 60th out 189

<sup>ii</sup> When economic development is not related to the increase in employment, it should be created mainly by increasing productivity

<sup>iii</sup> The World Bank reports that it is required 10 years for young men to go from school to work in Kosova, and Macedonia required four to five years and in developed countries is also required less time (World Bank: Youth at risk: being young, unemployed and poor in Kosova, 2008).

<sup>iv</sup> Not all the unemployed live in poor households, and not all employees are out of poverty.

<sup>v</sup> Such as : Development of Quality Assurance, Accreditation and Development of NQA&NQF in Kosovo with the aim of Supporting the Government of Kosovo in order to improve the quality and efficiency of education for lifelong learning and employment prospects

<sup>vi</sup> In June 1999,the Ministry of higher education of 29 European countries signed the Bologna Declaration, which lays down the fundamental principles in order to create the European Education Area(EHEA)

<sup>vii</sup> Kosova Population and Housing Census 2011. Final Results. Main data, p. 143 (September 2012).