

Foreign Direct Investment in the Kosovo Banking Sector - Their Impact on Employment

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Abstract

***The purpose:** is to identify the role and importance of Foreign Direct Investment (FDI) for the Kosovo economy, with a particular emphasis on FDI in the banking sector and their impact on employment growth - comparing FDI levels with countries of the Western Balkans. Kosovo aims to regulate favorable legal infrastructure by trying to attract as much FDI as possible to other countries in the region.*

***Design / Methodology / Approach:** data processing design (on the role and importance of FDI in a country's economy) is in line with established international standards with a focus on data published by local and international organizations and institutions, using methods deductive, comparing research data synthetically and analytically with direct access to literature, scientific journals, official reports published domestically and abroad.*

***Findings:** each state has legal acts by which the government of the country, through the assembly, issues laws, regulations, instructions and other legal provisions regulating the functioning of the country's legal system, in this context in Kosovo the economic field. is regulated by legal provisions covering the field of FDI which is very favorable compared to other Western Balkan countries (it is known that developing countries are most interested in developing countries*

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because developed countries do not need so much FDI). The Government of Kosovo has issued normative acts favoring FDI that are part of this paper.

Practical implications: *This paper provides sufficient data to show the current state of FDI in Kosovo compared to the countries of the Balkan region, as well as the extent to which FDI has affected employment growth in the Kosovo banking sector. The practical implication also relates to identifying the improvement of positive legal conditions for more FDI attraction.*

Originality / Value: *The data in the paper present the real situation of FDI in Kosovo and their role in economic development with particular emphasis on the country's banking sector, and how Kosovo stands for FDI relative to the Western Balkan countries.*

Keywords: FDI, banking system, economic fields, employment, economic development, etc.

INTRODUCTION

In the global economy, different countries pay a great deal of attention to foreign direct investment, as these investments play a key role in economic development. Among the main advantages of FDI can be mentioned technology transfer, promotion of competition in the country, creation of new jobs, growth of host countries etc.

Most host governments have changed their perceptions of FDI. They try to promote as much FDI in certain industries as possible by promoting policies that help their countries economically and socially. Political stability, favorable business climate, and improved infrastructure are some of the incentive policies pursued by host country governments to absorb a significant number of FDIs.

Initially FDI orientation was mainly in manufacturing but now their diversification is also happening in services. Although some services such as: data processing or software programs are more service oriented in the domestic market than in the foreign markets. This has also happened as a result of the privatization of state-owned service companies such as telecommunications, transport, energy and finance (Peter Nunnenkamp p.2)

The main motives that encourage foreign investors to invest in their host countries are:

- Market size and growth prospects;
- Wage level and labor productivity;
- Good infrastructure;
- Political stability and measures to promote FDI;
- Lack of corruption and promotion of competitiveness among firms;
- Improving the investment environment, such as: business registration, licensing procedures, ease of doing business, business-friendly environment etc. Even the tax structure can have a significant impact on investment prospects³.

FOREIGN DIRECT INVESTMENT IN KOSOVO

Approval of the Law on Foreign Investment in Kosovo December 2013 (Law No. 04/2013) provides equal treatment for foreign and domestic investors by offering:

- Non-discriminatory treatment
- Continuous protection and security
- Compensation in case of nationalization or expropriation, including interest payment
- Compensation in case of violations of applicable laws and international law on Kosovo
- Free transfer as well as unlimited use of income
- Protection against retroactive application of laws

Also, investments in new sectors can stimulate the development of new 'know how' infrastructure and technologies, technologies in the country where they are realized, while at the same time increasing professional, management and technical capacity of the EU for candidate countries (as well as for Kosovo) puts the emphasis on improving the business development environment.

The existence of a stimulating legal framework for foreign direct investment, increased levels of security for investing, improved physical infrastructure, reduced administrative barriers, qualified

³ Chakrabati, A. 2001. "The Determinants of Foreign Direct Investments: Sensitivity Analyses of Cross- Country Regressions", *Kyklos*, page 89-114

workforce indicate improved climate and greater opportunities to invest in the country.

The main barriers identified are:

- political instability,
- informal barriers (corruption),
- fiscal barriers,
- legal barriers,
- the small size of the market,

Foreign direct investment also affects the job market through the creation of new jobs. Among the most significant and long-term impacts of FDI is the transfer of technology and know-how embodied in human capital. If foreign investment is undertaken in activities where local firms have limited experience, then FDI will influence the transfer of important knowledge in terms of training, management practices and techniques, and organizational behavior. FDI can also increase productivity through research and development (R&D) by positively affecting the output of Campos & Kinoshita (2002).

But foreign investment, on the other hand, also requires the provision of adequate human resources and a normal infrastructure, especially in attracting serious investment. In general, foreign investment, where generating and expanding businesses, can help hire, raise salaries, or replace critical or declining market sectors. However, not infrequently, the benefits of these investments can only be felt by a very small segment of the population, such as when the relevant employment, qualification and training is limited to a very small group of well-educated elites, ie and in relatively better condition, or even when some urban investment uses a pronounced "differentiator", even in some cases as deep pay discrimination.

At the same time, the role and impact of FDI in human capital development should be emphasized. The education and training system needs to be upgraded in order to comply with the requirements of foreign investors for new hires. In addition, FDI can be transformed into employment opportunities, greater local competitiveness and penetration of local producers into foreign markets.

The development of economic policies in Kosovo which came into force in 2009 has increased FDI in countries. The resumption of

the privatization process, and the reduction of corporate tax, can be singled out as more positive developments.

Table 1. Corporate Income Tax Rate in Kosovo

Corporate Income Tax	
Until 2008	From 2009
20%	10%

Source: Law no. 03 / L-113, corporate tax rate

Also, Kosovo's membership in international institutions in 2009 such as: the International Monetary Fund (IMF) and the World Bank (WB) are a positive impetus for potential investors. The increase in FDI has also contributed to the increase in investment in the road infrastructure sector.

The membership of the Republic of Kosovo in the EBRD (December 2012) has assisted in economic development, implementation of European reforms and standards and infrastructure development by supporting the development of the private sector, mobilizing external capital and improving the investment environment.

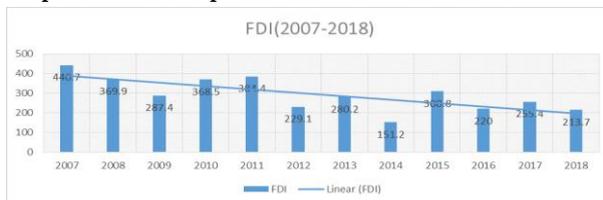
Table 2. FDI in Kosovo 2008 - 2018 (in mil. euro)

Viti	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
IHD	440.7	369.9	287.4	368.5	384.4	229.1	280.2	151.2	308.8	220.0	255.4	213.70

Source: Central Bank of Kosovo 2019 (CBK)

In Kosovo, FDI remains largely concentrated in sectors of the economy such as real estate, renting and other business activities, commercial services and financial services. Higher FDI growth was recorded in the financial services and construction sector (32.6 and 22.6 million euros more than in the same period last year), while the trade sector was characterized by a decline of 7.4 percent.

Graph.1 FDI report in Kosovo presented in a linear fashion



Source: 2019 Annual Report – CBK

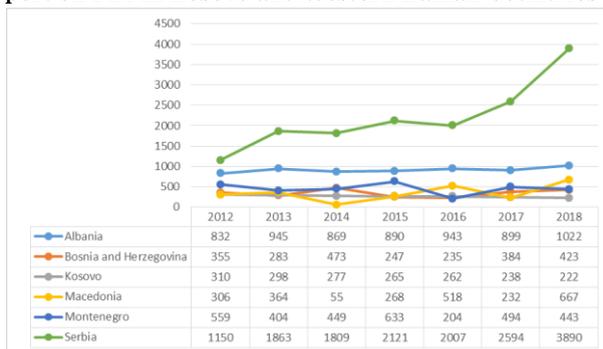
Southeast European countries attracted a significant number of foreign direct investment thanks to the good business climate, lower labor costs, ease of access to European markets and, mainly, the privatization of state-owned enterprises.

In its investment report, UNCTAD, puts Southeast European countries in the group of transition countries. Foreign direct investment increased last year in Southeast Europe by 34 per cent to 6.7 billion euros.

Serbia has been the biggest attractor of foreign direct investment by 3,890m euros, increasing it by 44 per cent year-on-year. The increase was caused by a large wave of investment in equity. In Albania, direct investment was 1.022 million euros, up slightly from a year earlier. In Northern Macedonia, investments have tripled, reaching 667m euros, an increase caused especially by investments in vehicle production in industrial areas.

The country with the least foreign direct investment in Southeast Europe is Kosovo with 222 million euros, Bosnia and Herzegovina with 423 million euros. Montenegro had 443m euros in foreign direct investment, 60.63m euros less than a year ago.

Graph 2. Report on FDI in Kosovo and Western Balkan Countries in mil. Euro

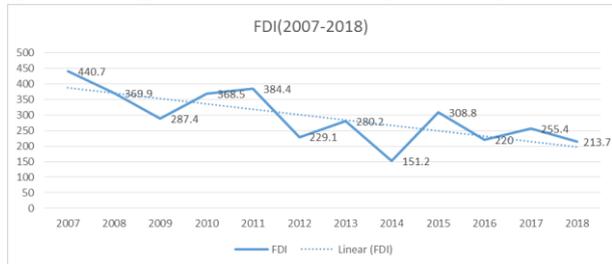


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During the period 2017-2018, Kosovo recorded the highest employment growth during this period (8.5 percent). Although the unemployment rate declined across the region, it still remains high, especially in Kosovo at 30.5 percent. The youth unemployment rate is

a major concern: more than half of Kosovo's youth are unemployed, while its level in Albania reached the lowest rate of 26.4 percent⁴.

Graph 3. Graph of Foreign Direct Investment (2007-2018) in Kosovo



Edited by the authors

The main origins of FDI inflows continue to be: Germany, Switzerland and Austria, partly due to the Kosovar diaspora in these countries. Implementation of the SAA, recent improvements in the business environment and stronger growth of the Eurozone continue to support FDI inflows and remittances.

FOREIGN DIRECT INVESTMENT IN THE KOSOVO BANKING SYSTEM

Commercial banks in Kosovo have been operating since the end of 1999. Even before the war in Kosovo, various banks operated but they were of an outdated economic and political system. Commercial banks or commercial banks carry out their business in accordance with the law on banks and therefore the Central Bank of Kosovo (CBK) is responsible for licensing banks.

Kosovo's banking sector is the youngest in the region and Europe, with 10 commercial banks, with over 90.50% foreign working capital, and the Central Bank of Kosovo, which became operational in 2008. Its journey begins in a state of flux, where Kosovo's economy was in an emergency survival phase, and continues to remain stable, despite Kosovo's economic situation.

Kosovo's banking sector constitutes Kosovo's largest financial sector, Banking sector assets in 2018 recorded an annual growth of 8.2 percent, reaching a value of euro 4.19 billion, up from euro 6.32

⁴ <http://pubdocs.worldbank.org/en/502631475173890972/al-SEE-RER-n-10-KOS.pdf>

billion in 2018, which corresponds to an annual growth of 6.9 percent assets of the entire financial sector in Kosovo⁵.

There are 10 (ten) commercial banks operating in Kosovo today, accounting for 66.14 percent of total financial sector assets. Their products and services include bank accounts, loans, domestic and international payments, bank cards, bank guarantees, letter of credit, e-banking. Access to these banks' services is currently enabled through 217 branches and sub-branches, 518 ATMs and 10,631 POSs and 288,016 e-banking accounts⁶.

If we compare the number of commercial banks in Kosovo and the region then based on statistics from the Central Banks of these countries Kosovo still has the smallest number, while countries such as: Albania which has 16 commercial banks, Macedonia 16 banks commercial banks, Serbia has 29 commercial banks, Montenegro has 12 commercial banks and Bosnia and Herzegovina 24 commercial banks.

The banking sector capital structure continues to be dominated by foreign capital, where at the end of 2018, eight (8) out of ten (10) licensed banks operating in the country are foreign-owned and account for 90.2% of total equity capital. The most attractive investment sector to date has been that of banks, mainly equity from Austria (Raiffeisen Bank), Germany, the Netherlands (Pro Credit Bank), Italy, Switzerland, Liechtenstein, and the EBRD (BpB)⁷, Slovenia's capital. (NLBanka) created by the merger of BRK and Kasabank⁸, most recently Turkish capital (BTK, TEB & BNP Paribas - Turkey & France)⁹ iŞ Bankasi¹⁰, Ziraat Bankasi¹¹ as well as some international financial institutions. Whereas, the insurance sector has attracted investment from Albania, Croatia and the Kosovar diaspora. A World Bank study shows that a market economy legislation has

⁵ According to data from CBK 2019

⁶ According to data from CBK 2019

⁷ The EBRD has been a shareholder in BpB since 2011 with 10% of the Bank's total capital

⁸ NLB BRK and NLB Kasabank from 01.01.2008 have been integrated into a bank "NLB Prishtina" (approved by CBAK on 18.12.2007).

⁹ *TEB Bank (Turkish Economy Bankasi) joint venture with BNP Paribas, obtained full license from CBAK (now CBK) on 18.12.2007.*

¹⁰ Turk IS Bankasi A.S. is the largest Turkish bank, which entered the Kosovo market under a CBK license in November 2012

¹¹ Ziraat Bankasi - founded in June 2015. Ziraat Bankasi, or Bank of Agriculture, is one of the three Turkish public banks, established nearly 150 years ago

been created in Kosovo, but the main problem lies in the operational level where his.

The Banking and Insurance sectors were among the most attractive sectors for foreign investment in Kosovo. These sectors have absorbed € 30.6 million, of which 19.3 (63%) is the share of foreign capital comprising € 13 million of the banking sector and € 6.3 million of insurance.

Compared to most other countries in the Region, Kosovo's banking system is characterized by several positive features:

- Possesses a deposit-based financing structure (the ratio of loans to deposits was 81.90 percent at the end of 2018);
- It is well capitalized (capital adequacy stands at 17 percent, minimum required is 12.0 percent at the end of 2018) and has plenty of liquidity protection, without relying on external financing although dominated by foreign owned banks (accounting for about 90 per cent of all banking assets, with the two largest German banks ProCredit and Austrian Raiffeisen, each with 26 per cent market share)
- The ratio of nonperforming loans to total loans decreased to 2.7 percent at the end of 2018, by 0.4 percentage points lower than in the previous year. This ratio of nonperforming loans to total credit stock remains the lowest in the region¹².
- Profitability indicators continue to be stable. Return on Average Assets (RAA) and Return on Average Equity (RAE) were 2.5 percent and 20.4 percent, respectively.

Table 3. Structure of Commercial Banks

COMMERCIAL BANKS	
Number of banks	10
Foreign owned banks	8
Number of units	217
Concentration rate	61.4%
Foreign ownership	88.3%
Number of Employees	3,303

Source: 2019 Annual Report – CBK

During the years of research, there has been a decrease in branch outreach in 2019 to 217 branches and a reduction in staff in 2019 of 3,303 and as a result of the expansion of automated services such as e-banking, ATMs, sales terminals, mobile banking etc.

¹² CBK Annual Report, 2019

Table 4. Report between bank branches and banking sector employee

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 May
branch	287	295	311	310	310	298	277	265	262	238	222	217
employers	3,607	3,459	3,610	3,728	3,722	3,549	3,507	3,375	3,375	3,319	3,255	3,303

Source: 2019 Annual Report – CBK (edited by the authors)

Having the youngest population in Europe for Kosovo can be a competitive advantage in terms of labor supply and availability of human capital.

In most of these studies, human capital is listed as a very important, and sometimes important, determinant in the process of attracting FDI and increasing the level of FDI inflows.

To assess the impact of Foreign Direct Investment in Kosovo on the banking sector, research questions were formulated that PH1: Did foreign direct investment affect banking sector employment and research question PH2: How does business environment change affect growth? FDI

The main questionnaire questions that will help in verifying PH1 are: P1, P2, and P4 questionnaire dedicated to the banking sector employees, derived from the Likert scale formulation.

Table 5. Reviews on the impact of FDI on employment in the banking sector

Question	Formulations	Employees in the banking sector	
		Level of compliance	Interpretation
RQ1\Q1	Main reasons that influence FDI companies' decision to invest in Kosovo	>4	Subscribe
RQ1\Q2	Assessing the availability and quality of human capital in Kosovo	>4	Subscribe

(edited by the authors)

To carry out this study, the questionnaire was distributed electronically and personally "face to face" to senior management and bank managers in Kosovo. There were also direct interviews with managers of some banks. To assess the problematic of investment in the banking sector, 3 assertions were used (Spaho, 2011; Lin and Li, 2006), on a 5-point Likert scale, with 1 indicating 'strongly disagree' and 5 'strongly agree'. Cronbach's alpha coefficient was calculated to test the reliability of the data on the Likert scale.

Responses were coded prior to their processing in SPSS, after the data coding process, the next step was to transform the coded data

from Excel into SPSS. Data analysis and processing were done through SPSS 16.0 statistical processing software (Sandalowski, Voilse and Knafl, 2009) (Trochim, 2006). Through different forms of reporting and examining different variables.

The 'employment growth' variable has a value of 1 if the sum of the values of the 3 variables on the Likert scale above is greater than the corresponding mean of the whole choice and 0 otherwise. The Cronbach's alpha coefficient value of this variable was 0.802. For our degree of reliability we find the Cronbach's alpha coefficient value to be (Cronbach's Alpha 0.802) for the 10 questions asked.

DESCRIPTIVE ANALYSIS

Of the 8 (eight) banks surveyed in the study, data were found showing that the total investment made by foreign and domestic banks in Kosovo is as follows: one bank invested less than € 1 million, two banks invested 1-10 mil. euros, three banks invested 50-100 mil. euros and one bank over 100m euros.

While in terms of years of operation in Kosovo, the first commercial bank started operating in Kosovo in 2000, then in 2001 two more commercial banks were opened, continuing until 2015 when the last bank that started operating in Kosovo.

Table 6. Regression of dependent variables

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.649 ^a	.421	.389	1.227

a. Predictors: (Constant), PH1.1, PH 1.2
(edited by the authors)

The major changes in education recommended by FDI companies to make human capital more appropriate to their need is decisive in increasing FDI in the banking sector with independent variables.

The Model Summary gives the R values for evaluating the overall fit of the model. The adjusted R-square value in this case is (.421). This tells us that the two independent variables in our model accounted for 42.10 percent of the variance in the model-dependent performance variable.

Table 7. Results of ANOVA regression for banking sector employee growth as a result of FDI growth in this sector

		ANOVA ^b				
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	39.374	2	19.687	13.073	.000 ^a
	Residual	54.216	36	1.506		
	Total	93.590	38			

a. Predictors: (Constant), PH1.1, PH1.2

b. Dependent Variable: PH1.8 (edited by the authors)

Anova or analysis of variance was used to compare the averages of the two populations, revealing the main effects of the interaction of the independent variables on more dependent variables

Table 8. Regression results for the growth of banking sector employees as a result of FDI growth in this sector
Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.681	.419		1.624	.113
	RQ1.1 The main reasons that influence the decision making of FDI companies to invest in Kosovo	.285	.152	.300	1.876	.069
	RQ1.3 Assessing the availability and quality of human capital in Kosovo	.456	.174	.420	2.623	.013
a. Dependent Variable: PH.1.8 (edited by the authors)						

From this logistic regression we conclude that the variable: "The main reasons that influence the decision making of FDI companies to invest in Kosovo" is significant (significance level .069) with the dependent variable being in this case that the increase of banking sector employees through FDI. Elimination of corruption indicates that it depends on the dependent variable (significance level .021). and Assessment of the availability and quality of human capital in Kosovo (significance level .013).

Table 9.Reviews of thinking on improving the business environment in increasing FDI

Question	Formulations	Employees in the banking sector	
		Level of compliance	Interpretation
RQ2\Q7	Improving Kosovo's education system increases FDI interest	>4	subscribe
RQ2\Q9	How do you assess the business climate in Kosovo in terms of FDI	>4	subscribe
RQ2\Q10	Eliminate Corruption	≤3	inconclusive

(edited by the authors)

Dependent Variable Regression The changing business environment influences the growth of FDI-independent variables.

Table 10. Dependent Variable Regression Improvement of the Doing Business Environment on FDI Growth-Independent Variables

Model Summary			
R	R Square	Adjusted R Square	Std. Error of the Estimate
.782 ^a	.611	.575	1.043

a. Predictors: (Constant), PH2.7, PH 2.9, PH 2.10 (edited by the authors)

The Model Summary gives us the R values for evaluating the overall fit of the model. The adjusted R-square value in this case is (.575). This tells us that the two independent variables in our model account for 57.50% of the variance in the model-dependent performance variable.

Table 11. ANOVA regression results for banking sector employees

ANOVA ^b						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	54.800	3	18.267	16.779	.000 ^a
	Residual	34.838	32	1.089		
	Total	89.639	35			

a. Predictors: (Constant), PH 2.7, PH2.9, PH 2.10

b. Dependent Variable: PH 2.6 (edited by the authors)

From this logistic regression we conclude that the variable: "Improving the business environment affects FDI growth" is significant (significance level .002) with the dependent variable being in this case the increase in employees. in the banking sector through FDI. The elimination of corruption indicates that it depends on the

dependent variable (significance level .021). and that improving the education system in Kosovo increases FDI interest (significance level .032).

Table no. 12 Regression results for banking sector employees

Model		Coefficients ^a				
		Unstandardized Coefficients		Standardized Coefficients Beta	t	Sig.
		B	Std. Error			
1	(Constant)	-.823	.582		-1.414	.167
	RQ2.7 Improving Kosovo's education system increases FDI interest	.288	.128	.272	2.240	.032
	RQ2.9 How do you assess the business climate in Kosovo in terms of FDI	.469	.135	.477	3.467	.002
	RQ.10 Eliminate Corruption	.308	.127	.320	2.429	.021

a. Dependent Variable: PH 2.6 (edited by the authors)

Because the data are grouped into different categories and purposes, the data submission will not be presented in the order of the questionnaire questions.

The more we look at the findings, the more accurate our findings will be. The variety of general data used in this research will only have a positive impact on the findings presented and on the research as a whole.

CONCLUSIONS

Given an improved business climate, a stable macroeconomic environment, large natural resources, and especially low labor costs, Kosovo can become an attractive place for foreign investors to do business. However, it should be noted that attracting FDI, in addition to monetary and fiscal incentives, must be accompanied by continued development and an increase in the level of human capital, as a prerequisite for attracting FDI.

The World Bank report in 2018 ranked Kosovo among the top 10 economies worldwide that have seen the biggest improvement in doing business reforms. Kosovo ranks 44th out of 190 countries for 2019 in terms of ease of doing business, compared to 40th place it had a year ago, leaving behind Southeast European countries like Montenegro (50), Albania (63), Serbia (48), Bulgaria (58), BiH (86). Kosovo can survive most of its neighboring countries when it comes to low labor costs and the simplicity of hiring new employees. With the

average monthly labor cost estimated at € 519, the main advantage of the labor force in attracting FDI remains the low cost.

The relationship between new foreign investment, high unemployment, the functioning of the education system and the current level of human capital development is considered a very critical combination of Kosovo's economic development policies in the future. What kind of human capital and education system Kosovo is able to create can determine the future level and types of foreign investment.

Our main conclusion is that, in fact, human capital exerts a positive and significant impact on attracting FDI. The study provided a strong assessment of the value of human capital (before and after investments) by foreign investors investing in Kosovo. Of course, this is not to say that human capital is the sole determinant of investment. The study also revealed perception of corruption as a major obstacle to boosting foreign investment in the country. Many international and local organizations have previously identified this as an obstacle to progress.

The research showed that the perception of corruption is still widespread and remains a major concern for all Kosovo citizens. formal and business needs (relation: theory vs practice). We argue that an important development would be more access to staff training, which is cheaper and more efficient than trying to provide general university education at all levels, including those areas for which there is already satiety in the labor market. From the research we conclude that the opening of new specialized and vocational schools is one of the options.

Government and private initiatives have been taken to improve and reform the education system in Kosovo, but they may not be enough.

The business environment in the Republic of Kosovo is becoming one of the most competitive in the region. The advantages created, such as a favorable tax system, abundant natural resources, fast and easy business registration, cheap labor force, transparent foreign investment laws and other advantages, make Kosovo an attractive and favorable environment. for foreign investors. Human capital ranks as a very important determinant in the process of attracting FDI and increasing the level of FDI inflows.

Given this definition, human capital is considered among the most important capital for any economy. Human capital is the area where the transition process has had particularly important and long-term implications. Having the youngest population in Europe for Kosovo can be a competitive advantage in terms of labor market supply and availability of human capital, but reforms are needed ongoing in the education system.

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