Euroisation of Kosovo: A Retrospective Analysis

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1.Introduction

Kosovo's unilateral adoption of the euro as its currency in the early 2000s was a response to the extraordinary challenges of its post-conflict economy. In the late 1990s, Kosovo's official Yugoslav dinar had been devastated by hyperinflation (annual inflation exceeded 40%), rendering it practically unusable (CBK, 2013). Amid this instability, the German Deutsche Mark (DM) became the de facto currency in 1999—an *ad hoc* choice driven by the population's need for a stable medium of exchange and the DM's widespread prior use in the region (Svetchine, 2005; Maloku & Badivuku Pantina, 2011). The United Nations interim administration (UNMIK) tacitly accepted this *fait accompli* of DM circulation in Kosovo, forgoing any formal negotiation with European authorities at that stage (Svetchine, 2005). In January 2002, as Germany and other Eurozone countries switched from the DM to the euro, Kosovo followed suit. The euro cash changeover was successfully completed on February 28, 2002, fully "euroizing" Kosovo's economy (Svetchine, 2005). In adopting the euro as legal tender without being an EU member, Kosovo's authorities effectively relinquished independent monetary policy and the ability to issue a national currency (CBK, 2013). This *de facto* euroisation provided Kosovo with a much-needed "sound monetary foundation" for economic recovery and rebuilding trust in financial institutions after the conflict (Svetchine, 2005).

More than two decades later, Kosovo's choice of the euro is credited with delivering considerable monetary and economic stability. By importing the credibility of the European Central Bank, Kosovo immediately anchored inflation expectations; inflation, which was in double digits during 2000–2001, decelerated sharply and has generally remained low—often below the Eurozone

average in the ensuing years (Maloku & Badivuku Pantina, 2011; CBK, 2015). Consequently, Kosovo avoided the high inflation and currency crises that plagued some other transition economies in the early 2000s (Maloku & Badivuku Pantina, 2011). The stable pricing environment and elimination of exchange-rate risk helped rebuild the financial sector: confidence in banks increased and deposits grew markedly once the euro was in place (CBK, 2014; World Bank, 2023). Today, Kosovo's banking system is considered healthy and well-capitalized, with low levels of non-performing loans (CBK, 2023). Euroisation also enforced an element of fiscal discipline. Lacking monetary sovereignty, policymakers instituted conservative fiscal rules—notably a statutory public debt ceiling of 40% of GDP—to ensure stability (World Bank, 2023). As a result, Kosovo's public debt has remained among the lowest in the region (around 17–20% of GDP in recent years) (World Bank, 2023), which proved fortuitous during global downturns as it gave the government latitude to provide stimulus without endangering debt sustainability. In essence, the euroized regime "hard-wires" macroeconomic discipline in Kosovo, contributing to consistently positive, if modest, economic growth (often in the range of 3–4% annually in the 2010s) and a reputation for monetary stability (IMF, 2024; CBK, 2023). The overall macroeconomic performance has been robust in recent years—for example, growth accelerated to about 4.25% in 2024 while inflation fell to around 1.8% (CBK, 2023)—underscoring the tangible short-term benefits of the euroized framework.

However, Kosovo's unique form of euroisation also comes with significant structural challenges and policy trade-offs. Most fundamentally, Kosovo forfeited the typical tools of monetary policy. It cannot adjust interest rates, perform quantitative easing, or devalue its currency to respond to economic shocks. This means that shocks must be absorbed through fiscal policy and structural adjustments, while the Central Bank of Kosovo (CBK) lacks a lender-of-last-resort capacity (Maloku & Badivuku Pantina, 2011). One consequence is a constrained ability to counter recessions or stimulate growth through demand-side policies—the government must rely on building fiscal buffers in good times and cannot freely run large deficits (World Bank, 2023). Another consequence is reduced competitiveness flexibility: with a fixed exchange rate, any loss of cost competitiveness cannot be rectified by currency depreciation, putting the onus on internal measures (productivity gains, wage restraint) to adjust. Indeed, Kosovo has persistently run a large trade deficit (on the order of 30% of GDP), reflecting a narrow export base unable to keep pace with import demand (CBK, 2014). The absence of an independent currency is not the sole cause of

this trade imbalance—structural issues like limited industrial capacity and a small domestic market are key factors—but it removes a potential mechanism (exchange rate adjustment) that other countries might use to boost exports (Maloku & Badivuku Pantina, 2011). Kosovo's exports remain undiversified and focused on low-value commodities, while imports cover a broad range of consumer and capital goods (CBK, 2014). The chronic trade gap is financed largely by external inflows, notably diaspora remittances (about 15% of GDP) and foreign aid, which mask the trade deficit in the broader current account (CBK, 2015). This reliance on the diaspora underscores a deep external dependency: the stability of Kosovo's external accounts hinges on continued remittance and investment inflows (CBK, 2015). Any adverse shock that reduces these inflows—for instance, an economic downturn in European host countries for Kosovo's migrants—would strain Kosovo's balance of payments. The IMF's latest assessment highlights that "structural vulnerabilities remain" in Kosovo: despite recent growth and low inflation, the external balance has been deteriorating with a widening trade deficit and softening remittances (IMF, 2024). In summary, euroisation has conferred monetary stability and anchored expectations, but it has not cured Kosovo's structural weaknesses. The country still faces the hurdles of high unemployment, low productivity, and a dependent development model, all of which raise questions about the long-term sustainability of its chosen monetary arrangement.

Against this backdrop, the importance of this research topic becomes evident. Two decades into Kosovo's euroisation experiment, there is a clear need for a comprehensive evaluation of its economic impacts. Much of the existing analysis on Kosovo's use of the euro comes from international financial institutions (e.g., IMF, World Bank) and a handful of early academic studies (such as Maloku & Badivuku Pantina, 2011). These works generally concur that euroisation delivered stability but note unresolved structural issues. What remains less explored in depth is the duality of these outcomes over the longer term: How has euroisation shaped Kosovo's economic trajectory over 20+ years, through global crises and changing regional dynamics? Are the benefits of stability outweighing the constraints and vulnerabilities? This thesis addresses these questions by providing an up-to-date and nuanced analysis of Kosovo's euroized economy. The central research question guiding the inquiry is: **What has been the economic impact of euroisation on Kosovo, particularly with respect to economic growth, macroeconomic stability, and structural vulnerabilities?** In pursuit of this question, the study evaluates both the gains (such as inflation control, financial stability, and fiscal discipline) and the trade-offs or shortcomings (such

as limited policy autonomy, external imbalances, and inhibited competitiveness) associated with Kosovo's use of the euro. By investigating these issues, the research aims to determine to what extent Kosovo's monetary choice has been effective and what improvements or complementary policies might be necessary to enhance economic outcomes.

The significance of this research is manifold. First, it provides a timely scholarly contribution on a unique case of unilateral euroisation. Kosovo and Montenegro are the only two economies in the world to have adopted the euro without EU membership; Kosovo's experience, in particular, offers valuable lessons about the viability of maintaining a currency union arrangement in the absence of formal Eurozone institutions. This study thus contributes to the broader literature on optimal currency areas and monetary regimes by examining an outlier scenario—a small, post-conflict developing economy operating with a hard currency peg it cannot control. Second, the research updates and synthesizes information from disparate sources (IMF reports, Central Bank of Kosovo data, World Bank analyses, and academic findings) to produce a holistic picture of Kosovo's economy under euroisation. In doing so, it fills a gap in the academic literature: since the early 2010s, there have been relatively few comprehensive evaluations of Kosovo's monetary framework, even as the country went through significant events like the global financial crisis of 2008–09, the Eurozone debt crisis, and the COVID-19 pandemic. This thesis's findings will therefore serve as an updated reference on Kosovo's macroeconomic development. Finally, the study has practical policy relevance. Its insights can inform Kosovo's policymakers and stakeholders about the strengths and weaknesses of the current monetary setup, helping guide future economic strategy. For instance, understanding the constraints imposed by euroisation underscores the importance of complementary policies—such as prudent fiscal management, export promotion, and financial safeguards—to compensate for the lack of monetary instruments. The conclusions may also be instructive for other small economies considering fixed currency regimes or for international advisors engaged in Kosovo's EU accession and economic planning.

In terms of methodology, this research utilizes a quantitative empirical approach supported by qualitative context. The analysis is based primarily on secondary data from official sources—including the Central Bank of Kosovo (CBK), the International Monetary Fund (IMF), and the World Bank—covering the period from the early 2000s up through 2024. Key macroeconomic indicators are examined to gauge performance before and after euroisation: for example, trends in

GDP growth, inflation rates, fiscal balances, public debt, the trade balance and current account, foreign direct investment (FDI), and banking sector indicators. The study employs a descriptive statistical analysis of these indicators (e.g., examining averages, volatility, and structural breaks over time) to identify patterns attributable to the change in monetary regime. Where appropriate, simple comparative techniques are used—for instance, comparing Kosovo's inflation or growth trends to those of regional neighbors that did not adopt the euro (such as Serbia or North Macedonia) or to Montenegro, which similarly euroized, as a benchmark. This comparative perspective helps isolate the effects of euroisation by contrasting Kosovo's outcomes with relevant counterfactuals. In addition, the research integrates a review of existing literature and policy assessments: it draws on findings from IMF consultations, CBK reports, and prior academic studies to interpret the data and understand the causal mechanisms at play. No primary surveys or interviews were conducted; rather, the emphasis is on an in-depth case study analysis using published data and reports. Through this mixed-methods approach—quantitative trend analysis grounded in qualitative understanding—the study achieves a comprehensive evaluation of Kosovo's macroeconomic performance under euroisation and the underlying reasons for that performance.

The remainder of this thesis is organized as follows. Chapter 2 provides background on Kosovo's macroeconomic and regional context, and it reviews relevant literature on euroisation. This chapter discusses Kosovo's economic history since the 1999 conflict, key structural features of its economy (such as its demographic factors and production base), and situates Kosovo's indicators in comparison to regional peers (including Montenegro, which also uses the euro, and other Western Balkan countries). Chapter 3 details the research design and methodology, elaborating on the data sources, analytical framework, and any limitations. Chapter 4 presents the empirical findings on the impact of euroisation across several dimensions of Kosovo's economy. This includes subsections analyzing economic growth and business cycle stability, inflation and price stability, external sector performance (trade balance and current account), foreign investment trends, and the development of the financial sector. Each subsection evaluates how these aspects have evolved under the euroized regime and to what extent the outcomes align with or diverge from expectations. Chapter 5 discusses the results, offering an interpretation of the findings and their implications for economic policy. In this chapter, the trade-offs of euroisation are examined in depth, and policy options or measures to address observed challenges (such as export competitiveness or fiscal policy

space) are considered. Chapter 6 concludes the thesis by summarizing the key insights and providing recommendations. The conclusion reflects on whether euroisation has been beneficial overall for Kosovo and what strategies could enhance its economic prospects moving forward, including any considerations for Kosovo's future monetary arrangements in the context of prospective European integration. Through this structured approach, the thesis seeks to thoroughly answer the research question and contribute meaningful knowledge on Kosovo's experience with the euro.

2.Literature Review

The following literature review examines the existing research on Kosovo's unilateral adoption of the Euro – Commonly Referred to as "Euroisation"- Analyzing its macroeconomic impact, structural economic challenges and overall efficacy.

Economic Growth & Stability

Starting in 2008 Private consumption consistently dominated GDP, we can evidently see that since the start remittances and loans can be higher than total GDP, while in the same period, especially 2011, public sector investments and FDI grew by 39% (CBK,2012) and -although they improved slightly in 2012-2013 – Net exports remain persistently negative, further burdening GDP.

This marked the beginning of a persistent challenge with Kosovo's balance of payments. (CBK.,2012). Once again in 2013 we see a 3.4% growth driven by private consumption (104.2% of GDP), remittances and investment loans (CBK,2014). The 2014 period rightfully forecasted a 3.7% growth with a slight decline in public investment (~9.3%) but stable private investment (CBK,2014). Evidently showing in the following year where Construction, energy and agriculture were leading contributors with services such as trade, transport and hospitality making of over 50% of GDP, with strong performance from real estate and public administration. During this period has started to make reasonable strides to diversify and enrich its economy.201

However, from 2016 onward, growth remained consumption-driven and structurally vulnerable, as improvements in exports were offset by rising imports. (CBK,2016). However, an addition to the attempt to enrich the economy was VAT exemptions and favorable tax reforms allowing the private investments to grow around 7.6% in 2016 at the same time export of goods grew by ~3.4% but the

consumption and demand driven nature of the Kosovar economy made imports increase by 3.7%; Ironically widening the trade deficit. (CBK,2016).

In 2019, growth remained moderate at 4.8%, driven again by consumption and remittance inflows (IMF,2024). The COVID-19 pandemic wiped out said growth and caused a 5.3% contraction, noting a heavy drop in exports and investments (World Bank, 2023). Moving on from the pandemic the Kosovar economy managed to massively rebound the next year in 2021 with an almost 11% growth, led here by private consumption and services(Worldbank,2023) , indicating that its unique conditions that make up its environment (remittance dependent and with backbone of Euro) allows it to rebound and adjust to shocks remarkably.

Kosovo has since stabilized with slower and more predictable growth in 2022 and 2023 (3.5% and 4.1% respectively), characterized once again by a consumption led contribution in both cases, and a notable contraction in investment due to high construction costs and a support from diaspora-related tourism and services exports (IMF,2024; European Commission,2022)

Inflation and Price Stability

Once again foregoing control over monetary policy and importing the Euro has provided Kosovo with price stability, in a sense importing stability through the Euro (Svetchine,2005; IMF,2024) with the aforementioned low and stable inflation, any adverse or extreme scenarios are externally driven such as the volatility of commodities globally causing a month on month peak in July of 14.2% (World Bank, 2023). In contrast Core inflation – excluding food and energy – remained low e.g.,0.4% in 2013 (CBK;2014) highlighting the underlying price stability even during global volatility.

There is a high degree of exposure to global price movements due to import dependency, so while Kosovo has good core inflation fluctuation abroad in the price of goods, fuel etc directly affect CPI (CBK,2016). Such volatility has occasionally sparked consumer backlash, reflecting the public's vulnerability to imported inflation. We can clearly see without aid that Kosovo is highly exposed and dependent on inflows such imports and remittances in the tradeable and non-tradeable components of the CPI. Imported goods accounted for roughly 81.9% of the basket, with non-tradables showed deflation in some years (CBK;2016). Unlike most sovereign economies, Kosovo lacks a central bank with monetary authority, leaving it unable to adjust interest rates in response to inflationary shocks (IMF, 2024).

Trade Balance and External Sector

Kosovo has persistently suffered from a large trade deficit, Over the past decade, it has struggled to reduce – let alone eliminate – this widening gap, with net exports contributing negatively to GDP (-29.3% in 2105) (CBK,2016) further emphasized by both earlier and current reports stating that export base is narrow and underdeveloped, focusing mainly on low-value goods and raw materials (CBK;2014, IMF; 2024)

The current situation does not seem to provide Kosovo with a viable strategy to close the balance gap with their exports. In clear contrast its imports are broad and consumption driven, mainly consumer goods, construction materials, fuel, and food make up the majority of the import basket. This highlights the weakness of Kosovo's domestic production capacity but also its reliance on imports to meet basic consumer consumption and investment needs. The lack of a manufacturing backbone or high value added export sector thwarts the country's ability to offset its import bill contributing to the persistence of its trade deficit (World Bank, 2023)

Despite the deficit, the balance of payments has been able to remain relatively stable due to substantial external inflows. Unsurprisingly, majorly from remittances, which accounted for 15.6% of GDP in 2015 (CBK, 2016), and foreign direct investment (FDI), especially in sectors such as real estate, construction, and financial services. These inflows helped finance the current account deficit and stabilize the economy, but they once again ping the deep dependency on the diaspora and external investors (World Bank,2023; IMF, 2024). Making Kosovo even more vulnerable to external conditions showcasing a structural issue.

While monetary stability and predictability has been useful during Kosovo's history, the euroized monetary regime poses fundamental constraints on its ability to address external imbalances, meaning it cannot tackle these problems through conventional means that most sovereign countries possess, e.g., devaluing currency to boost exports (Svetchine, 2005; Maloku and Pantina, 2011; IMF, 2024). Because of the adoption of the euro Real effective exchange rates (REER) are shaped by inflation differences with EU/ CEFTA partners in trade. And at times has appreciated, further weakening Kosovo's export competitiveness (CBK,2016; IMF, 2024). While price stability has been valued during the post conflict incubation it has fundamentally challenged Kosovo's ability to support its external sector through conventional monetary tools.

In recent years it has been become increasingly prudent to push more towards export diversification and investment in production, both the World Bank and IMF have called for it (IMF,2024; World Bank, 2023). While Kosovo has done fairly in regards to external financial shocks, it must not wait to be tested in such ways again, the trade balance is held together by remittances and FDI, improving local business infrastructure and climate is critical and essential for trade expansion in any meaningful sense (World Bank, 2023; IMF, 2024). Service sectors like ICT and diaspora tourism are growing however are not insufficient to cause any real change to shift trade balance or reduce the trade deficit (IMF, 2024)

Financial Sector Stability

Following the 1999 conflict, the financial sector was practically nonexistent. Reconstruction occurred under international supervision, mainly through the Banking and Payments authority of Kosovo (BPK), established by the United Nations Mission in Kosovo (UNMIK). The primary role here was initial bank supervision, provision of payments services, as well as ensuring adequate cash supply (Svetchine, 2005)

In 1999 the Deutsche Mark was adopted unilaterally as the de facto currency due to its high stability and widespread pre-conflict in comparison to the Yugoslav dinar, subsequently formal adoption was quick to be made by UNMIK without any negotiations with German or European monetary counterparts. (Maloku and Pantina, 2011)

Officially the transition from DEM to Euro took place on February 28th 2002, completing Kosovo's euroisation process and ensuring its monetary stability. Aimed at minimizing transaction costs and ensuring monetary stability- the change this time involved cooperation with the European Central Bank (ECB) and other European national banks, unlike the initial adoption of DEM (Svetchine, 2005)

The CBK (previously BPK) was later expanded to regulate and license all financial institutions, including insurance and pension funds. This was supported by comprehensive financial regulation trends in Europe (Svetchine, 2005). Between March and November 2001 there were significant growth comprising of six new commercial banks, marking the beginning of intermediation in

Kosovo, providing necessary competition and financial services (Svetchine, 2005). However, trust in the banking sector was low prior to euro adoption.

2002/2003 served as a pivot point for both the banks and individuals alike. Kosovo's banking sector was further developed with foreign involvement. The American Bank of Kosovo was created with the help of USAID capital and later sold to Raiffeisen Bank which remains to this day, Micro Enterprise Bank transformed into ProCredit Bank which also remains to this day in Kosovo, both prominent players in the financial sector. This period saw a significant rise in deposits –roughly €300 million worth– in the three months preceding the Euro introduction (Svetchine, 2005).

Kosovo's financial sector remains characterized by overwhelming foreign presence. By 2009 foreign banks represented 6 out of the 8 commercial banks providing services, as well as accounting to approximately 91.6% of total banking assets, highlighting the heavy reliance and confidence placed in the international institutions (Maloku and Pantina, 2011). Today, the IMF highlighted continued financial sector stability and deepening, with healthy indicators such as Non-Performing Loans at approximately 2.04%, an average return on assets at around 2.75% –indicating robust profit– and comfortable liquidity ratios around 22.7%. The loan-to-deposit ratio increased to approximately 84.8%, indicating strong but manageable growth in credit expansion. (IMF, 2024)

In the same theme of foreign dependency and trust, euroisation has done well to significantly reduce exchange-rate volatility. Clearly benefiting Kosovo during global financial crises, during the 2008 global financial crisis, Kosovo remained stable thanks to limited currency risk and minimal exposure to volatile currency fluctuations (Maloku and Pantina, 2011). Over the past two decades, depositor confidence has been enhanced by the Euro, resulting in steady and healthy increases in deposits since. Indicating trust in stability and reduced risk of inflation-driven losses (IMF, 2024)

However, we arrive once again to the unique position of Kosovo's economy, euroisation poses fundamental constraints, again at the loss of monetary autonomy–Kosovo cannot independently adjust interest rates or act as lender of last resort during severe banking crises, limiting responses to potential liquidity or solvency shocks (Maloku and Pantina, 2011; IMF, 2024)

External shocks have notably impacted Kosovo's financial sector? It is evident from the 2008-2009 events that the financial sector demonstrated a strong resilience due to Kosovo's disciplined fiscal

policy and prudent regulatory oversight, as well as minimal exposure to high-risk international investments or derivatives. Hence, Kosovo experienced **no systemic banking failures** or **significant liquidity disruptions,** unlike several neighboring countries (CBK;2010, IMF, 2024).

We can also see this resilience and stability at play again during the COVID-19 pandemic where high capital adequacy ratios around 17% and liquidity buffers around 22.7% percent (Noted by IMF,2024) helped maintain stability in Kosovo's banking system. Temporary measures such as loan moratoria and restructuring schemes successfully mitigated borrower defaults, allowing banks to sustain profitability as well as asset quality (World Bank, 2023)

Overall Kosovo displays strong foundational governance and effective crisis management practices during severe global shocks (IMF,2024; World Bank, 2023).

However, sectoral concentration limited financial innovation and depth, and dependance on external inflows are all points that need to be taken into consideration when assessing Kosovo's financial and economic stance. The banks are significantly exposed to real estate and construction, sectors prone to boom-and-bust cycles. Approximately 20-25% of total lending is concentrated in these sectors, making them vulnerable to sector specific downturns. This also relates to the dependence on external inflows. The banks are heavily dependent on external funding and remittances from diaspora, creating vulnerabilities in the economy to fluctuations in conditions abroad. For instance, any significant shift to conditions of diaspora abroad can translate quickly into liquidity pressures domestically. (World Bank, 2023). .

This would not be a concern if there have been strides made in financial innovation and depth, matters that both the IMF and World Bank have shared concerns over, specifically limited financial product diversity and insufficient credit access, in particular, for SME's and innovation enterprises. The World Bank also recommended the implementation of more targeted fintech solutions, expand digital financial services and promote specialized financial products for SME's. If financial inclusion rates remain relatively low as they are, broader economic growth is restricted (IMF, 2024, World Bank 2024). Long term stability is difficult to find assurance in without risk-based supervisory framework. Greater transparency in financial reporting and improved stress-testing mechanisms alongside refined governance structures -all called for by the IMF and World Bank-

To enhance financial sector stability and align with EU guidelines, the CBK has undertaken significant reforms, including modernizing the banking sector regulatory framework and beginning development of a Supervisory Review and Evaluation Process (SREP) manual. As well as a new law governing microfinance and Non-Bank Financial Institutions (NBFI's) is currently being prepared with support from the International Finance Corporation (IFC), all aimed to bolster oversight and improve financial inclusion–recommendations consistently emphasized by the IMF and World Bank (IMF, 2024; World Bank, 2023)

Structural Economic Vulnerabilities

According to the World Bank and IMF, structural economic vulnerabilities are defined as deep-rooted, persistent weaknesses within an economy's core structure, distinct from temporary cyclical problems. Such issues affect economic resilience and sustainable growth significantly, examples include –limited productive base, informality, high unemployment, skill mismatches, heavy reliance on external inflows– (IMF,2024; World Bank, 2023) many of which are immediately evident in the case of Kosovo's economy.

By definition; these vulnerabilities increase susceptibility to external shocks, restricting long-term economic growth that is sustainable and inclusive. It is evident from the findings of this review that these vulnerabilities only compound with the increase of the factors mentioned.

Although its resilience is often praised, over the past decade structural weaknesses have been highlighted by the IMF and World Bank repeatedly. Productivity metrics significantly trail those of the region and the EU, mainly due to reliance on low-value-added sectors such as retail, construction, and basic agriculture. For example, the structure of Kosovo's economy is dominated by services (~50% of GDP) including retail trade and construction (CBK, 2016). High informality further fuels this hindrance, representing roughly 30–35% of GDP, leading to additional fiscal challenges, limiting business scalability, and stifling economic competitiveness (IMF, 2024; World Bank, 2023).

The labor market is a key metric when it comes to any economic assessment, Kosovo faces severe unemployment (nationally 20-25%, youth unemployment ~**40%**+), emphasizing chronic labor market weakness. This issue is further exacerbated by a skill mismatch, a persistent gap exists between education systems output and private sector demands. Unfortunately educational systems do not meet market requirements, causing additional structural unemployment. Outside of

"traditional" education, limited vocational training programs insufficiently address the skill needs of high-value sectors such as technology and manufacturing. (IMF, 2024; World Bank, 2023)

Kosovo's economy lacks significant industrial and manufacturing capacities (accounting only for 10-15% of GDP), there is a notable lack of diversification into sectors that are capable of generating sustainable employment and exports (CBK, 2016). -Being the demand driven economy that it is- overdependence on consumption skews economic activity towards sectors such as construction, real estate, and retail-which represent over 50% of total GDP-limiting growth potential and further increasing vulnerability (World Bank, 2023; IMF, 2024)

A frequently mentioned talking point is the extreme dependency on remittances and diaspora consumption. Kosovo's economy heavily depends on remittances from diaspora (~15% of GDP), due to the remittances inflows arriving mainly from Switzerland, Germany and the United States, their respective economic performance directly affects that of Kosovo. This issue is further compounded by unproductive use of remittances as they primarily support household consumption and real-estate investments as opposed to productive or entrepreneurial investments. (World Bank, 2023; IMF, 2024)

Economic activity is highly concentrated in the capital -Pristina- underscored by significant underdevelopment in rural regions. This is evident from infrastructure investments heavily skewed towards urban centers. Rural areas face critical shortages in basic infrastructure, defined by limited road connectivity, inadequate healthcare facilities, and insufficient educational institutions, once again perpetuating economic stagnation (World Bank, 2023; IMF, 2024).

Institutional bottlenecks or inefficiencies or weaknesses in administrative, governance, or regulatory frameworks, limiting effective policy implementation and economic development. These are evident and closely tied to their economic implications.

Corruption, bureaucratic inefficiencies, inconsistent application of laws and regulations, weak judiciary, and public sector transparency deficits all result in unequal distribution of resources and infrastructure –exacerbating social inequality and increasing internal migration towards urban centers- straining urban resources and increasing unemployment pressures.

The aforementioned corruption risks, paired with unpredictability and regulatory uncertainty create an unattractive business environment for both domestic and international investment inflows.

Kosovo continues to score relatively low on governance indicators (World Bank, 2023). There is also an explicit need to improve governance and institutional efficiency for Kosovo to achieve balanced regional growth and an attractive investment climate. (IMF, 2024).

All of these talking coalesce into one idea – An urgent need for comprehensive reform–.

Structural vulnerabilities require comprehensive policy strategies that address multiple areas simultaneously: reducing informality, enhancing productivity, improving education-labor market alignment, infrastructure investment, and addressing governance and regional disparities.

It is clear that addressing one matter at a time will not be sufficient given how woven all these structural vulnerabilities are, for example, increased focus on manufacturing with economic zones seems as a sound strategy, however it will be stifled by a lack of supply from educational institutions.

The IMF explicitly recommends policy measures to improve productivity and labor market efficiency, including targeted vocational training programs, incentivizing formalization and promoting SME development (IMF, 2024). Additionally, the World Bank stresses infrastructure improvements and governance reforms, notably reducing bureaucratic procedures, strengthening transparency and anti-corruption measures (World Bank, 2023).

Fortunately the World Bank and IMF will not only play a advisory role but also be part of the reform by sustained support from them and other players such as the EU. This is essential for the existing advisory role but to critically finance all this reform. Work has already begun with the World Bank's Country Partnership Framework (CPF) and EU-funded capacity building programs- such as EU funded rural infrastructure projects- that are specifically designed to address Kosovo's structural economic challenges. (World Bank, 2023; IMF, 2024) From a positive lens, these reforms and projects promise increased resilience, sustainable growth, economic diversification, reduced unemployment and greater economic equity.

Underlying Economic Theory of Euroisation

Euroisation and currency adoption decisions can be understood through several key economic theories. Primarily, the **Optimum Currency Area (OCA) theory** developed by Mundell (1961) explains conditions under which it is economically beneficial for a group of countries or a country to adopt a common currency. According to OCA theory, critical factors include labor mobility,

openness of the economy, diversification of production, and fiscal integration (Mundell, 1961). Countries joining a currency union like the eurozone or adopting the euro unilaterally, such as Kosovo, trade off monetary policy autonomy for the benefits of stable exchange rates, reduced transaction costs, and lower currency risk, potentially increasing trade and investment (McKinnon, 1963; Kenen, 1969).

A complementary theoretical framework is the **Impossible Trinity (or monetary policy trilemma)**, which states that a country cannot simultaneously maintain a fixed exchange rate, free capital flows, and independent monetary policy. Kosovo, by adopting the euro, explicitly chooses fixed exchange rates and free capital movement, sacrificing independent monetary policy and thus relying primarily on fiscal policy and structural reforms to manage economic shocks (Obstfeld & Taylor, 1997).

Experience of Eurozone Countries

To contextualize Kosovo's euroisation, experiences from other eurozone members, particularly the most recent joiners, provide valuable insights. Newer members like Slovenia (2007), Slovakia (2009), Estonia (2011), Latvia (2014), Lithuania (2015), and fully euroized non-members like Montenegro offer comparative lessons. These countries have demonstrated mixed outcomes: improved price stability and increased investor confidence, but also challenges such as loss of monetary autonomy, inability to devalue to restore competitiveness, and vulnerability to asymmetric economic shocks (IMF, 2023; ECB, 2023).

For example, the Baltic states (Estonia, Latvia, Lithuania) experienced substantial inflation volatility due to external shocks—highlighting structural vulnerabilities similar to Kosovo's—and undertook stringent internal adjustments in wages and fiscal policy rather than currency adjustments (ECB, 2023). Slovenia and Slovakia have shown that deep integration with EU markets and structural reforms can mitigate the disadvantages of lost monetary autonomy (IMF, 2023).

3.Methodology

Introduction to Methodology

The primary objective of this research is to evaluate the economic impacts of euroisation in Kosovo, analyzing macroeconomic stability, structural vulnerabilities, and the effectiveness of

policy responses. Specifically, the study aims to provide comprehensive insights into Kosovo's economic trajectory since the adoption of the euro, focusing on its growth, resilience, external vulnerabilities, and necessary structural reforms.

2. Research Objective and Questions

Main Research Question:

- What has been the economic impact of euroisation on Kosovo, particularly concerning economic growth, stability, and structural vulnerabilities?

Sub-questions:

- How has euroisation influenced Kosovo’s economic growth, stability, and resilience to global economic shocks such as the 2008 financial crisis and the COVID-19 pandemic?
- To what extent has euro adoption ensured price stability, and what vulnerabilities does it pose due to reliance on external price factors?
- How has euroisation affected Kosovo’s external sector performance, particularly in trade balance, competitiveness, and external imbalances?
- Has euroisation positively influenced the inflow of Foreign Direct Investment (FDI), and how sustainable and diversified are these investments?
- What role has euroisation played in ensuring financial sector stability, and what remaining vulnerabilities exist?
- What structural economic weaknesses does Kosovo face due to euroisation, and how do these vulnerabilities limit its sustainable economic growth?
- What policy measures have been recommended and implemented to mitigate Kosovo's economic vulnerabilities under euroisation, and how effective have these reforms been?

3. Research Gaps

Based on an extensive literature review, three significant gaps have emerged in existing research:

- Comparative studies between Kosovo and similar euroized economies, notably Montenegro, remain scarce.
- Insufficient detailed longitudinal research on Kosovo’s macroeconomic performance under euroisation through significant global economic shocks.
- Limited cohesive analysis linking Kosovo’s structural economic vulnerabilities with detailed evaluations of specific policy response effectiveness.

This research explicitly addresses these gaps by leveraging comprehensive historical data, comparative analyses, and detailed policy effectiveness evaluations, providing a more complete understanding of Kosovo's economic situation under euroisation.

4. Research Approach

This thesis adopts a mixed-method approach predominantly based on quantitative data analysis, complemented by qualitative interpretation from the existing literature. This approach is suitable due to its capacity to robustly analyze macroeconomic data while providing depth and context through qualitative assessments.

5. Data Collection

This research utilizes exclusively secondary data from highly reputable sources, including:

- International Monetary Fund (IMF) reports (Article IV consultations, 2024).
- World Bank documents (Country Partnership Framework FY23–FY27, 2023).
- Central Bank of Kosovo (CBK) bulletins, balance-of-payment reports, and macroeconomic development analyses (2009–2024).
- Scholarly articles and institutional papers, notably Svetchine (2005) and Maloku & Pantina (2011).

Secondary data was chosen for its reliability, consistency, and comprehensive coverage of macroeconomic indicators necessary for thorough analysis. However, obtaining detailed pre-2002 data poses significant challenges due to limited availability, historical record constraints, and archival issues. To mitigate this, active correspondence and efforts are ongoing with Kosovar institutions, particularly the Kosovo Agency for Statistics (ASK), to access additional historical economic data.

6. Data Analysis Methods

Quantitative Analysis:

Descriptive statistical methods will analyze key macroeconomic indicators, including GDP growth rates, inflation, trade balance, remittance inflows, Foreign Direct Investment (FDI), and financial sector indicators (Non-performing loans, Capital adequacy ratio). Specific methods include:

- Trend analysis of macroeconomic indicators pre- and post-euro adoption.
- Comparative analysis of Kosovo's macroeconomic indicators with similar euroized economies, particularly Montenegro.

Quantitative analysis will be executed using statistical tools and graphical representation methods (primarily Microsoft Excel).

Qualitative Analysis:

Qualitative analysis will include document analysis of reports and literature from IMF, World Bank, and CBK, providing depth, interpretive context, and policy implications complementary to quantitative findings.

7. Methodological Limitations

This research acknowledges limitations such as reliance on secondary data, potential gaps in historical macroeconomic data availability, particularly pre-2002 data, and absence of primary data collection. Despite these limitations, the authoritative nature of the chosen data sources significantly mitigates these concerns.

8. Ethical Considerations

Given the exclusive use of secondary data, ethical considerations primarily involve accurate and rigorous citation practices, proper attribution of all sources, and maintaining transparency and integrity in data interpretation.

By explicitly addressing the outlined research gaps through robust analytical methods and reliable data sources, this methodology ensures a thorough, credible, and academically rigorous exploration of Kosovo's euroisation impacts.

4.Analysis

This chapter will focus primarily on economic growth and stability in Kosovo, this section will begin with Kosovo in its post conflict state and how it aimed to align with the EU and eurozone. The objective is to analyze the growth and stability, and how it evolved over the past two decades. Assessing GDP trends, resilience to shocks, growth drivers, the impact of euroisation, and fiscal dynamics are all essential to understand this theme. Which aim to highlight how the outcomes of these factors were influenced by euroisation.

Kosovo's economic trajectory has gone through several distinct phases of growth since the beginning of the millennia, generally trending with consisting growth. Following the first year after the end of the war in 2000, Kosovo began a reconstruction boom fueled by massive foreign aid and remittances, with GDP surging by 26.9% in 2000 and remaining in double-digits in 2001 (Bucaj, 2018). Although short lived and followed by a contraction in 2002 (-1% GDP growth), this marked the transition into more self-sustaining growth. The following four years from 2003-2007 saw the resumption of growth at a consistent healthy pace, averaging at 4.3% annually (IMF; 2012). This

is particularly interesting due to the fact that external aid had declined, showing gradual transition from aid to what has come to be one of the biggest factors of Kosovo's economy -demand driven growth- with the trajectory it established by 2007, Kosovo has achieved upper-middle income status by 2018 (World Bank; 2022).

Interestingly, 2008-2009 displayed some resilience on Kosovo's end, while many countries have receded – Kosovo sustained growth through the period (World Bank; 2022). While Read GDP growth had slowed but remained positive (roughly 3-4% in 2009) (IMF; 2012). While notable it can be attributed to Kosovo's infancy in terms of integration towards the global market and its newly adopted Euro, additionally this sort of shielding was further bolstered by steady remittance inflows that helped consistent consumption demand despite the downturn. Diaspora inflows were consistently around 15% of GDP throughout Kosovo's economic life (World Bank, 2023; IMF, 2024).

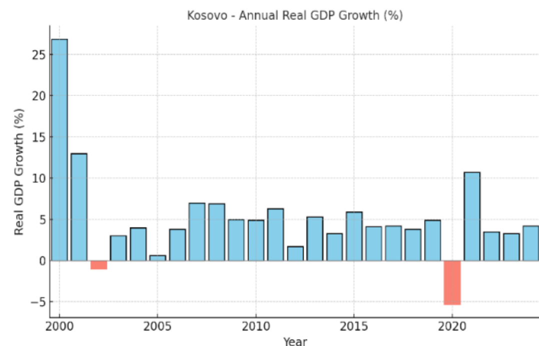


Figure 4.1.1 shows the annual GDP growth (%) in Kosovo from 2000-2024 The post-war boom of 2000–2001 was followed by more moderate growth. Kosovo avoided recession in 2008–09, but suffered a sharp contraction in 2020 due to COVID-19, with a strong rebound in 2021. Sources: World Bank, Kosovo Agency of Statistics, IMF.

Through the 2010s period, Kosovo has been able to sustain steady growth with an average around 4% per year (IMF, 2024; World Bank. 2023). Resulting in around 50% increase in income per-capita throughout this decade (World Bank, 2022). Growth was mainly driven by domestic demand -which is defined by consumption and investment- which are in turn underpinned by diaspora inflows and public infrastructure spending. Particularly, Kosovo's growth has surpassed many players in the western Balkans, showcasing the strength of diaspora-driven consumption and public investment amid a stable macroeconomic environment (World Bank, 2022). Although the economy displayed unique strengths – there are some fluctuations to analyze– 2012 witnessed a slowdown to ~1.5% growth due to the Eurozone crisis impact on exports and investments. Despite this the economy managed to pick up the pace back to over 5% in 2013-2011 (CBK,2014; IMF, 2024). This pace would continue to define the decade until the pandemic swept the globe.

Said pandemic caused the first recessionary markers for Kosovo's post conflict history. GDP contracted by 5.3% in 2020 (World Bank, 2023) Domestic activity and diaspora visits fell. Notably, this shock was not long lived. Support from fiscal stimulus and a resurgence in external demand paved way for a strong recovery to double digits (~11%) growth in 2021.

This sort of V shape recovery was fueled by Private consumption, as diaspora remittances and migrants returned, as a well as a rebound in services. (World Bank, 2023). After which point growth had stabilized again, in 2022 real GDP had grown by roughly 3.5% (World Bank, 2022), and 4% in 2023 (IMF, 2024), showing a return to further sustainable growth rates – even with the increased import prices due to Ukraine's war. To surmise, since the beginning of the millennia until present day Kosovo's real GDP has more than tripled in size, a remarkable achievement for a post-conflict economy (World Bank, 2023).

GDP composition: Consumption, Investment and Trade Balance

Kosovo's GDP is heavily defined by consumption, chronic trade deficits offset partially by external inflows. The biggest share of GDP is private consumption, often around or above 90% in recent years (CBK, 2016; World Bank 2023). The middle of 2010's saw it exceeding 100% of GDP in some years, reflecting the fact that Kosovo imports a substantial margin of what it consumes (the excess being matched by large negative net export figures). Comparatively, government consumption is small, accounting to roughly +-14% of GDP (IMF, 2024), which is consistent with Kosovo's public sector size and hence its constrained budgets. Another important driver is investment by gross capital formation, averaging around 25-30% of GDP. This includes both private and public –the former being often financed through bank credit and FDI. Notably public investments have played a role in boosting said GDP share in those years, with some volatility in a year to year basis as the projects completed (World Bank, 2023).

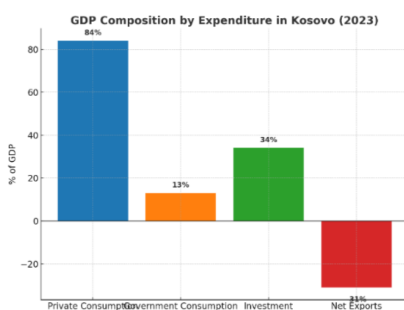


Figure 4.1.2: GDP composition by expenditure (2023). Private consumption (blue) and government consumption (orange) together comprise roughly 97% of GDP, reflecting Kosovo's demand-driven economy. Investment (green) is also significant (~34% in 2023), pushing total domestic expenditures well above 100% of GDP. The excess demand is met by imports, resulting in a large negative net export balance (red) of around -31% of GDP. (Sources: Kosovo Agency of Statistics; Focus Economics 2024)

Consumption is highly prominent driver –especially household– has had important implications for stability. On one side consumption has been a steady engine for growth, fueled by reliable inflows of remittances from diaspora. Keeping the economy afloat when other growth engines failed. In example, during the global financial crisis and the 2012 European downturn, the continued spending of remittances in Kosovo cushioned domestic demand (IMF, 2013). However, the dominance of said consumption indicates structural weaknesses: majority of consumption is defined by imported goods, leading to leakages abroad and a consistent and chronic trade deficit. Due to their consistently negative figures, net exports generally subtract 20-30% of GDP each year.

Good and services exports are relatively punitive–~27% of GDP in 2017– and nullified by imports (~54% of GDP in 2017) (CIA World Fact Book).

Each GDP component has direct implications for stability with respect to their weight and volatility. Private consumption has been relatively stable and proven to be a cornerstone of the economy, but its reliance on external income makes the nation vulnerable to the success of its diaspora living abroad. A downturn in the main host countries such as Germany or Switzerland could reduce remittance inflows, applying pressure on Kosovo's consumption. While stable, government spending has been constrained by law and donor supervision, limited in scale (Seen in figure 4.1.2 ~13% of GDP) and hence providing only modest or marginal counter cyclical buffer. Investment has been the most volatile factor composing GDP. An investment boom in 2011 including FDI and public capital contributed to growth above 6%, however subsequent cuts and pullback in FDI saw said growth sharply fall to around 1%. Clearly showcasing how reliant growth can be on investment cycles. Furthermore, FDI in Kosovo has often been centered around non-tradeable sectors, such as real estate and construction, limiting its impact on export capacity, causing net exports to persistently drag on growth- illustrated in national accounts where they made a large negative "contribution" to GDP each year, in example: -29.3% of GDP in 2015 according to CBK data. This net import dependance dampens the multiplier effect of consumption and investment on domestic output, exposing Kosovo to external shocks such as the hike in import prices.

In summation, Kosovo's model of growth has been demand-driven, led by consumption (heavily backed by diaspora income and subsequently remittance inflows) and investment, combined with chronic trade deficits. This composition dually highlights the strengths (strong domestic demand base and stable inflows) and vulnerabilities (external sector imbalances). Heavy reliance on

external sources to fund consumption and investment means that it is paramount to Kosovo's economic stability to maintain investor confidence and sustain remittance inflows. Further indicating the need for developing the tradable sector: as noted by the World Bank (2023), Kosovo's narrow export base and limited production capacity remain key challenges alongside this consumption driven growth.

Resilience to Shocks: 2009, 2020 Crises and Buffers

Kosovo has displayed some particularly notable performances during major economic crises, notably in part to prudent policies and external buffers. The global financial crisis of 2008-2009 saw deep recessions in the region. However, Kosovo's economy slowed but remained positive in 2009 at 5% (IMF, 2012). This distinct resilience was market to a few factors, Kosovo's banking sector (mostly foreign subsidiaries) had only recently began operations at the time and had conservative portfolios without any complex derivatives or toxic assets (IMF, 2010). Furthermore, the use of the Euro practically eliminated exchange rate volatility. As a result, Kosovo did not encounter crises in relation to currency or balance of payments when capital to emerging markets had seized. Penultimately, diaspora remittances remained stable during the crisis, sustaining counter-cyclical cushioning to household incomes. Finally Kosovo entered the crisis with healthy fiscal accounts and could afford a mild fiscal expansion even. 2008 saw zero public debt and accumulated savings from the government as a result from past fiscal surpluses and privatization proceeds saved in the CBK. Meaning that although others had struggled with financing, Kosovo had the necessary fiscal buffer to maintain spending. Partly because of the balanced budget norm.

The pandemic in 2020 was a distinctly unique case, -and yet- Kosovo managed an agile response. Commerce and travel had abruptly grinded to a halt which had led to a drop of -5.3% in 2020, but this contraction was on par with comparable or even shallower than many peers, in case: Montenegro's GDP plummeted by 15% in 2020 due to the collapse of tourism. Kosovo's resilience manifested partly due to policy buffers built over the years. The nation had maintained low public debt (~17% of GDP in 2019) and a stable banking sector, enabling swift policy responses (IMF, 2021). The government was able to deploy emergency fiscal measures (amounting to ~5% of GDP in direct support) without jeopardizing debt sustainability (the fiscal deficit reached about 7% of GDP in 2020, financed by drawing down reserves and external loans). Meanwhile the CBK, despite its lack of sovereignty over monetary policy, had worked closely with banks to offer loan moratoria

and allow flexibility to borrowers. Paired with international support from the IMF emergency financing and EU assistance helped prevention of a steeper downturn.

Vitaly, Kosovo's banking sector had managed to maintain stability through the pandemic, credited to the benefits of strong capital and liquidity buffers. In the beginning of the pandemic, banks' capital adequacy ratio was around 17-18%, with liquidity ratios about 35% of short-term liabilities – comfortably above regulatory minimums (IMF, 2024). The World Bank (2023) notes, these healthy buffers allowed to banks to absorb shocks without cutting off credit, no banking failures, and non-performing loans stayed low. Come 2021, the banking system's NPL had a ratio of about 2.5%, with profitability quickly rebounding (IMF,2024). Confidence in the banking sector and its system was in part due to the legacy of euroisation, fostering trust, deposit growth, and prudent supervision by the CBK.

In both 2008-2009 and 2020, budget and external buffers played an important role. In terms of budget, Kosovo's low public debt and disciplinary budget allowed it to use deficit in dire times. Figure 4.1.3 below shows the development of the public debt to GDP ratio. Even after a certain increase after the pandemic (when the debt ratio increased from ~ 16% to ~ 22% of GDP), the public debt was only about 17 to 18% of GDP by 2023, very low compared to international standards. This provided (and always provided) in Kosovo a significant fiscal flexibility to meet shocks - the government may increase loans to recover or emergency demand without threatening the sustainability of the debt (IMF, 2024).In addition, the Kosovo legal framework imposed a public debt limit of 40% of GDP (the ceiling is lower than the EU level), which loses a strong budget discipline. Therefore, even after the necessary crisis costs, the debt is still good under the ceiling (IMF, 2024).

Figure 4.1.3: Kosovo's public debt (% of GDP), 2008–2024. Public debt started near 0 in the late 2000s and has been kept under 20% of GDP for most of the period. A jump occurred in 2020 due to COVID-related borrowing (from ~16% to ~22%), but debt has since declined to about 17% of GDP by 2023. The statutory debt ceiling (40% of GDP, red dashed line) has never been approached, reflecting Kosovo's prudent fiscal stance. (Source: Ministry of Finance of Kosovo, IMF Article IV 2024)

On the outside, remittances and donor support back act as buffers. In 2020, for illustration, remittances expanded as a share of GDP (diaspora individuals sent additional reserves to bolster families amid the pandemic), which contributed to prop up consumption. Kosovo too had gathered remote trade saves (basically from the pension funds of annuity stores and government stores contributed overseas) summing to over 10% of GDP pre-pandemic, giving an moment scope buffer. Besides, being singularly euroized, Kosovo had backstop bolster amid the COVID emergency through EU components – the European Central Bank guaranteed euro liquidity universally, by implication profiting Kosovo. The combination of moo obligation, plentiful diaspora back, and the solidness conferred by the euro permitted Kosovo to climate these worldwide storms with moderately constrained harm. In fact, by 2021 the economy not as it were recuperated but surged, and by 2022 GDP had outperformed its pre-pandemic drift.

In summary, Kosovo's track record during the 2008–09 and 2020 crises highlights strong underlying stability. Prudent fiscal management (saving in good times, avoiding excessive debt) and the euroized monetary regime have given it solid shock absorbers. However, it is also clear that these buffers rely on external anchors – the diaspora and the euro area. A risk remains that a shock which simultaneously hits Kosovo and its external partners (for instance, a prolonged recession in Europe reducing both export demand and remittances) could test Kosovo's resilience more severely. Nonetheless, as of 2024, Kosovo enjoys a reputation for sound macroeconomic management, reflected in investor confidence and sustained economic growth (IMF, 2024).

Impact of Euroisation on Macroeconomic Stability and Policy Trade-offs

Kosovo's decision to unilaterally adopt the euro (officially in 2002, following use of the Deutsche Mark in 1999–2001) has been central to its macroeconomic stability. In many respects, euroisation has delivered exactly what was intended: a stable currency, low inflation, and avoidance of currency crises. By importing the credibility of the European Central Bank, Kosovo immediately anchored inflation expectations. Inflation in Kosovo has indeed been low and stable for most of the 2000–2020 period, generally in the low single digits and often below the ECB's 2% target (IMF, 2024). For example, consumer price inflation dropped to just 1.8% in 2013 and averaged around 2% in the 2010s. Only external price shocks have disturbed this stability – notably, global commodity price spikes caused inflation to temporarily reach double digits in 2022 (peaking around 11% year-on-year) before subsiding to ~4% in 2023 (CBK, 2023; IMF, 2024). Overall,

monetary stability has been a clear benefit of euroisation. Kosovo has been free of exchange-rate volatility and has not experienced the high inflation or currency collapses that plagued some other transition economies in the early 2000s (Maloku and Pantina, 2011). This stable pricing environment has in turn fostered financial deepening: banks rapidly expanded after 2000, and by the 2010s Kosovo enjoyed a sound, predominantly foreign-owned banking sector with high levels of public trust.

However, euroisation also entails significant policy trade-offs. By foregoing an independent currency, Kosovo surrendered control over monetary policy and the ability to act as a lender of last resort. The CBK cannot create euros to inject liquidity in a crisis, nor can it use interest rate policy to stimulate or cool the economy. This puts the onus on fiscal policy and structural measures to manage economic cycles. For instance, during the 2020 pandemic, Kosovo could not deploy quantitative easing or currency depreciation; it had to rely on fiscal stimulus and external aid. Likewise, to address any loss of competitiveness, Kosovo cannot devalue its currency – adjustments must come through internal measures (wage and productivity changes). Indeed, the persistent trade deficit partly reflects this rigidity: with higher inflation than the euro area in some periods, Kosovo's real exchange rate appreciated, hurting export competitiveness (Svetchine, 2005; Maloku and Pantina, 2011). Lacking the exchange rate tool, Kosovo's exports have struggled to gain price advantage, forcing reliance on other competitiveness enhancements (e.g. lowering business costs, improving skills). Euroisation thus implies a monetary policy trilemma choice: Kosovo opts for a fixed exchange rate (actually a common currency) and free capital mobility, at the cost of monetary autonomy. This choice has largely been vindicated by the greater stability achieved, but it limits macroeconomic policy options.

Euroisation also imposes fiscal constraints and responsibilities. Without a lender of last resort or the ability to monetize debt, Kosovo must maintain fiscal discipline to avoid solvency issues. This reality led to the adoption of a legal debt limit (40% of GDP) and conservative fiscal rules, effectively a self-imposed constraint to ensure credibility (IMF, 2024). The upside is that Kosovo has one of the lowest debt levels in Europe, giving it a reputation for prudence (World Bank, 2023). The downside is a somewhat constrained fiscal flexibility: Kosovo cannot run large sustained deficits without risking financing difficulties, as it lacks an independent central bank to backstop government bond markets. In practice, however, this has not been a binding constraint so far –

Kosovo's government has generally run small deficits and even surpluses in some years, accumulating fiscal buffers. In essence, euroisation forced Kosovo to adopt a hard-budget constraint, which has arguably been beneficial in building investor confidence and stability (at the cost of foregoing deficit-financed stimulus in some instances).

Another cost of euroisation is the loss of seigniorage revenue (the profit from money issuance). Kosovo must use euros printed by the ECB, meaning any seigniorage accrues to the Eurozone, not to Kosovo. In the early years, donors compensated Kosovo to some extent (through grants) and the stability gains likely outweighed this cost. But over the long term, it is a sacrifice of a modest revenue stream.

From a monetary theory perspective, Kosovo's euroisation can be analyzed through the lens of the Optimum Currency Area (OCA) theory and the monetary policy "trilemma". According to OCA criteria (Mundell, 1961), for a country to share a currency, it ideally should have synchronized business cycles, labor mobility, and fiscal integration with the currency area. Kosovo's case is unusual – it unilaterally adopted the euro without being institutionally integrated into the Eurozone. It does not fully meet OCA criteria with the Eurozone: for instance, its business cycle is not strongly correlated with core Europe, and there is no automatic fiscal transfer mechanism from Frankfurt or Brussels to Pristina in downturns. In many respects, Kosovo is not an optimum currency area member – it is a small, relatively less diversified economy tied to a much larger currency zone. Yet, the decision was driven by the specific context of the early 2000s: post-conflict Kosovo had no credible domestic currency or central bank track record, so adopting a stable foreign currency was a pragmatic choice to instill confidence (IMF, 2002). Over time, some OCA compensating mechanisms have developed: Kosovo has very high labor mobility with the Eurozone (through its diaspora). In effect, migration and remittances play a role akin to fiscal transfers or shock absorbers – when Kosovo's economy underperforms, more people may work abroad or send money home, buffering incomes (this is not an official mechanism but a real one). Additionally, Kosovo's banking system is integrated with the Eurozone's (via foreign parent banks), and this financial integration provided stability (but also means dependence on foreign banking health).

The Impossible Trinity (trilemma) of international economics states that a country cannot have all three of: independent monetary policy, fixed exchange rate, and free capital movement simultaneously – it must choose two. Kosovo, by euroizing, chose to fix its exchange rate

irrevocably (by using the euro) and it allows free movement of capital (open financial flows, no exchange controls on euros). Consequently, it gave up independent monetary policy entirely. This has shaped all macroeconomic choices since. The burden of macroeconomic adjustment falls on fiscal policy and structural policies. The CBK uses only prudential tools to manage credit cycles (e.g. bank reserve requirements), but cannot change interest rates (Eurozone rates apply). Kosovo's experience confirms the trilemma: it has gained exchange rate stability at the price of policy flexibility. In practice, this trade-off has been largely positive for stability – Kosovo avoided the currency crises that hit some other Balkan countries in the 1990s and maintained low inflation. But it also meant that during recessions, Kosovo lacked monetary stimulus and during booms it could not use rate hikes to cool inflation (though inflation mostly stayed low until the external shock of 2022).

Overall, euroisation has underpinned Kosovo's macro stability while necessitating greater discipline elsewhere. Empirical studies (e.g. Svetchine 2005; Maloku & Pantina 2011) have generally found that euroisation in Kosovo lowered transaction costs, eliminated exchange risk, and contributed to financial sector development, at the expense of policy autonomy and with only limited progress on some structural vulnerabilities. Kosovo's policymakers have managed these trade-offs by building fiscal buffers and strengthening the banking system. As a result, Kosovo enjoys inflation and interest rates on par with Eurozone economies, instilling confidence for investors. But the structural challenges – a narrow production base and high external deficit – remain areas where euroisation's constraints are felt. Without the option to adjust the currency, Kosovo must double down on competitiveness reforms (improving infrastructure, education, governance) to grow its exports and reduce the trade imbalance (World Bank, 2023). These efforts are ongoing, as highlighted in Kosovo's National Development Strategy.

Comparative Perspective: Kosovo, Montenegro, Serbia, and Slovenia

A comparison of key macroeconomic indicators across Kosovo, Montenegro, Serbia, and Slovenia provides context for Kosovo's performance and the implications of its policy choices. These four economies represent a spectrum: Kosovo and Montenegro are both small Western Balkan economies that use the euro (Montenegro is de facto euroized like Kosovo), Serbia is a large Western Balkan economy with its own currency (Serbian dinar), and Slovenia is a former Yugoslav economy that is now an integrated Eurozone member.

Economic growth in Kosovo has been robust relative to its peers. Kosovo's real GDP growth averaged around 4–5% per year in the decade before COVID (2010–2019), the fastest among the group. This reflects its post-war catch-up and diaspora-supported demand. Montenegro also experienced high growth in the mid-2010s (around 3–4% on average), buoyed by tourism and construction, but with much greater volatility (including a severe recession in 2020). Serbia's growth has been more modest – roughly 3% on average in the 2010s – as it faced earlier transitional recessions and structural adjustments. Slovenia, as a developed economy, grew more slowly (about 2–3% average in the 2010s) and was hit hard by the 2009 global crisis and a banking crisis in 2012–2013. Notably, Kosovo was the only one of these countries not to experience a recession in 2009, highlighting its unique resilience (IMF, 2010).

Inflation dynamics differ primarily by monetary regime. Kosovo and Montenegro, both euroized, have generally had low inflation in line with the Eurozone (usually ~2% or lower, barring external shocks). Serbia, with an independent central bank, struggled with higher inflation in the 2000s

(often in the mid-single digits or higher) but by the 2010s Serbia's inflation stabilized around a target of 4%, albeit with occasional spikes. Slovenia, as part of the Eurozone since 2007, enjoyed Euro-area price stability (inflation typically 2% or below, except for the recent global commodity shock which saw 2022 inflation above 9%). Kosovo's inflation has been particularly low and less volatile than Serbia's, illustrating the price stability benefit of euroisation (IMF, 2024). Even during the 2022 inflation spike, Kosovo's core inflation remained modest (excluding food and energy, inflation was near 4%, showing contained underlying pressures).

Country	**GDP Growth**	**Inflation**	**Public Debt**	**Fiscal Flexibility**
Kosovo	~4.0%	~2%	~17%	Moderate-High (low debt, no monetary tools)
Montenegro	~3.5%	~2%	~80%	Low (high debt, no monetary policy)
Serbia	~3.0%	~5%	~55%	Medium (own currency, moderate debt)
Slovenia	~2.5%	~2%	~70%	Medium (Eurozone, ECB support)

Table 1: Comparison of key macroeconomic indicators for Kosovo, Montenegro, Serbia, and Slovenia. Sources: IMF World Economic Outlook (2024); World Bank data; national central banks. (Real GDP Growth figures are approximate averages for the pre-pandemic 2010s decade; Inflation is approximate average in the 2010s; Public Debt is as of 2023. Fiscal flexibility is a qualitative assessment based on monetary regime and debt levels.)

Public debt levels and fiscal flexibility vary widely, largely reflecting past fiscal discipline and access to financing. Table 1 summarizes key metrics for the four countries. Kosovo stands out for its very low public debt (~17% of GDP) and consequent high fiscal space (despite not having monetary autonomy). Montenegro, by contrast, has accumulated high public debt (around 80% of GDP), largely due to large infrastructure loans (e.g. a highway project financed by China) and persistent deficits. This high debt, combined with the lack of monetary sovereignty, severely limits Montenegro's fiscal flexibility – it faces high debt service costs and depends on external assistance or markets' willingness to roll over debt (IMF, 2021). Serbia's public debt is moderate (~55% of GDP); as Serbia has its own currency and central bank, it retains the option (in extremis) to finance debt via money creation or to let the currency depreciate to stabilize debt, giving it a different kind of flexibility (albeit with inflation risks). Slovenia's public debt is about ~70% of GDP (it spiked after the 2012 banking crisis, then moderated); as a Eurozone member with a credible record, Slovenia benefits from low financing costs and ECB support (e.g. eligibility for bond purchases), giving it fiscal room to maneuver within EU rules. Kosovo's case is unique: its fiscal flexibility is achieved by keeping debt low, since it cannot devalue or print money. This disciplined approach has served it well in maintaining stability, though it means government spending is constrained by revenues and grants.

Several insights emerge from this comparison. Kosovo and Montenegro, both euroized, have stable inflation akin to the Eurozone, underscoring the credibility gained from using the euro. However, their fiscal situations diverge drastically: Kosovo's conservative fiscal policy versus Montenegro's heavy borrowing show how different choices can be under the same monetary regime. Montenegro's experience highlights a risk of euroisation: without fiscal discipline, debt can climb to unsustainable levels and the country lacks monetary recourse – indeed, Montenegro has faced episodes of stress where it required international financial support due to its high debt and inability to devalue or print money. Kosovo avoided this by maintaining low debt and building buffers, illustrating that euroisation demands prudent fiscal management (IMF, 2024).

Serbia, in contrast, shows the benefits and challenges of having an independent currency. It has been able to run more flexible fiscal and monetary policies – for example, the National Bank of Serbia actively manages the dinar and targets inflation, and the government debt was stabilized partly through dinar depreciation earlier in the 2010s. Serbia did experience higher inflation historically and had to implement stricter inflation targeting and structural reforms to maintain stability. Its moderate debt and independent central bank give it policy space (it used a mix of rate cuts and currency adjustments to respond to COVID-19 and earlier shocks). Yet, Serbia also endured more macro volatility in the 2000s (including a significant recession in 2009 of -3% and another contraction in 2012) than Kosovo did. This underscores a trade-off: monetary independence can be double-edged – it allows stimulus in bad times, but also requires credible institutions to avoid instability. Serbia's inflation and interest rates have generally been higher than Kosovo's, reflecting that added risk.

Slovenia offers the example of a fully integrated Eurozone economy. It has no control over monetary policy, similar to Kosovo, but it benefits from belonging to the EU's economic architecture (including access to European stabilization mechanisms). Slovenia's challenges have been more about banking sector issues and the need for fiscal consolidation after crises, rather than currency instability. Its inflation has matched the Eurozone's, and it could rely on EU support when resolving its banking crisis. In essence, Slovenia has the advantages of euroisation (stability, low inflation, access to ECB liquidity) with fewer of the disadvantages, because as an EU member it receives structural funds and can participate in collective decisions. Kosovo and Montenegro, by contrast, use the euro unilaterally, which means they do not have a seat at the ECB or EU fiscal support (beyond ad hoc aid). This limits their influence on policy decisions that affect them (for instance, ECB interest rate changes) – a point sometimes noted in discussions on the political economy of euroisation.

In conclusion, Kosovo's experience from 2000 to 2024 demonstrates a balance of stability and sacrifice. By anchoring its economy to the euro and adhering to strict fiscal discipline, Kosovo achieved enviable stability: solid growth, low inflation, and resilience to shocks. These outcomes compare favorably with regional peers, validating many of the choices made by its policymakers. At the same time, Kosovo's case underscores the importance of complementary policies when monetary policy is unavailable – fiscal prudence, financial sector vigilance, and structural reforms

become all the more critical. The period under review shows that while Kosovo still faces structural challenges (high unemployment, external deficits, limited export base), it has maintained macro-financial stability as a foundation upon which to build future development. The coming years will test how well this model can deliver convergence with more advanced economies, but the record from 2000–2024 provides reason for cautious optimism about Kosovo's economic stability and growth prospects under the euroized regime (IMF, 2024; World Bank, 2023).

4.2 Inflation and Price Stability in Kosovo (2000–2025)

Historical CPI Trends. In the immediate post-conflict period, Kosovo experienced high inflation as the economy adjusted and reconstruction accelerated. In 2000–2001, consumer prices rose at double-digit annual rates, fueled by massive foreign aid and private inflows(Svetchine, 2005). With the adoption of the Deutsche Mark (and later the euro) as legal tender, inflation decelerated sharply after 2001. By the mid-2000s, inflation in Kosovo had fallen below the Eurozone average, aided by the hard-currency anchor and weak domestic demand (high unemployment) containing price pressures (Svetchine, 2005). As Figure 4.2.1 shows, inflation remained low and even dipped around zero in 2004–2005 before global commodity shocks ignited new price pressures later in the decade.

Figure 4.2.1: Kosovo's annual CPI inflation, 2000–2025. After double-digit inflation in 2000–01, Kosovo saw mostly low and stable prices, aside from spikes during global commodity booms (2007–08, 2010–11) and the recent 2021–22 surge, followed by a sharp disinflation in 2023. Forecasts for 2024–25 anticipate a return to low single-digit inflation. (Source: KAS, CBK, IMF)

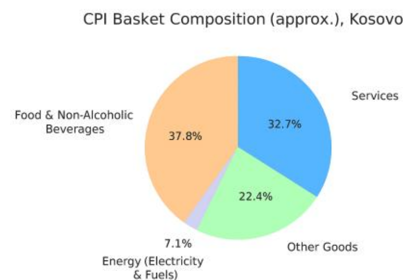
The COVID-19 pandemic initially kept inflation low – near 0% in 2020 due to collapsing oil prices – but this was followed by a global inflationary surge in 2021–2022. Kosovo, like its peers, saw inflation accelerate from roughly 3% in 2021 to over 11% in 2022 (IMF,2022)(IMF,2024). Headline inflation hit a historic peak of about 14% year-on-year in July 2022 (IMF,2024), before gradually easing. By late 2023, inflation had decelerated sharply to near 0%, and the annual average for 2023 was about 5% (CBK,2011)(IMF,2022). Current IMF projections anticipate inflation will normalize to around 2–3% in 2024–2025, assuming stable commodity prices (IMF, 2024).

Because Kosovo is a small, import-dependent economy, imported price shocks have been the dominant driver of inflation volatility (CBK,2015)(CBK,2014). Notably, food and energy imports play a large role. Food products and fuels constitute a substantial share of the consumer basket and imports, so swings in global prices for these items feed directly into domestic inflation (CBK,2014)(CBK,2015). For example, during 2011 when average inflation topped 8%, the main contributors were surging cereal and fuel prices, reflected in a 10.4% increase in Kosovo's import price index(CBK,2015). Similarly, the 2022 inflation spike was driven by imported energy and food costs following the COVID supply disruptions and the war in Ukraine – transport costs and food prices together accounted for roughly 80% of the inflation increase (IMF, 2023)(IMF,2022). Kosovo, being a net importer of nearly all fuel and many staples, is highly vulnerable to such external cost-push forces (IMF,2023).

Another external factor is the global supply chain environment. Periods of global disinflation (e.g. 2013–2016) saw Kosovo's inflation constrained by cheap imports and low euro-area inflation. Conversely, global supply bottlenecks in 2021 amplified price rises for tradable goods. The euro's exchange rate also transmits external prices: however, with Kosovo using the euro, nominal exchange rate changes against trading partners are muted (trade is largely euro-denominated) (CBK,2014). This means external price shocks pass through directly rather than via currency adjustments. Indeed, the Central Bank of Kosovo (CBK) noted that higher inflation relative to the euro-area in 2006–09 led to a real effective exchange rate appreciation, eroding competitiveness (CBK,2014)(CBK,2015).

CPI Basket and Structural Vulnerabilities. The structure of Kosovo's CPI basket makes inflation particularly sensitive to supply shocks. Essential commodities with volatile prices constitute a large portion of household expenditures. Food and non-alcoholic beverages alone make up approximately 38% of the CPI basket, and "energy" (electricity, gas and fuels) adds around 7% (CBK,2016). When combined with alcoholic beverages and tobacco (about 5%), nearly half of the CPI basket consists of items subject to seasonal or volatile price movements (CBK,2016). This share is significantly higher than in advanced economies, so global price swings in these categories have a disproportionate impact on Kosovo's overall inflation(CBK,2016). By contrast, more stable core components (services, rents, etc.) form a smaller share. In recent years the weight of food and energy has gradually declined as incomes rose, but it remains high (CBK,2016).

Figure 4.2.2: CPI basket composition in Kosovo (approximate weights). Food prices represent the largest component (~38%), while energy (electricity & fuels) is about 7%. "Other goods" (incl. clothing, household goods, etc.) and services (incl. housing, transport services, education, health, etc.) make up roughly half. Volatile categories (food, energy, alcohol/tobacco) comprise around 50% of the basket (CBK,2016), making overall inflation highly sensitive to supply shocks in those items. (Source: KAS/CBK consumer price data, 2013 base year)



Another structural aspect is the market structure and wage-setting in Kosovo. Domestic production in agriculture and energy is limited, so there is little local buffer when import prices rise – e.g. Kosovo is not self-sufficient in electricity and must import when domestic generation falters (wiww,2022). The oligopolistic market structure in some import sectors (fuel distribution, etc.) may also lead to quicker pass-through of external price hikes to consumers, as firms face limited competitive pressure to absorb costs. On the other hand, chronic high unemployment and informal labor markets have generally restrained wage-driven inflation. Indeed, core inflation (excluding food, energy, alcohol, tobacco) has historically been low – often near 0–2% – indicating subdued underlying price pressures (CBK,2016). When headline inflation spiked in 2022, core inflation peaked at only ~5.8%, reflecting that much of the surge was imported rather than due to domestic overheating (IMF,2024). This dynamic aligns with a Phillips curve interpretation: large economic slack has kept a lid on Kosovo's wage/price spiral in normal times (Svetchine, 2005). However, one emerging risk is if wages begin catching up (e.g. public sector wage hikes or rising minimum wage could push costs upward), though thus far such second-round effects have been moderate (IMF,2022).

Role of Euroisation and Monetary Constraints. Kosovo's unilateral use of the euro has been a cornerstone of its price stability framework. Euroisation has provided a hard nominal anchor – Kosovo effectively imports the credibility of the European Central Bank (ECB) monetary policy, which helped contain inflation expectations over the long run (Svetchine, 2005). The risk of exchange rate depreciation has been eliminated, removing a major source of inflation seen in other transition economies (indeed, by 2002 Kosovo's inflation was tamed to low levels as the DM/euro stabilized the money supply) (Svetchine, 2005). This has contributed to relatively low core inflation and prevented the re-emergence of high sustained inflation after the early 2000s. As noted by the CBK, "adopting the euro brought monetary stability... the economy of Kosovo does not face significant exchange risks" (Svetchine, 2005).

That said, euroisation comes with a trade-off: Kosovo has no independent monetary policy to respond to idiosyncratic shocks. According to the classic monetary policy trilemma, a country that forgoes its own currency (fixed exchange rate and free capital flows) cannot adjust interest rates or exchange rates to stabilize domestic prices. The CBK cannot use typical tools (interest rate hikes, open market operations) to fight inflation or stimulate during deflation – it must passively accept euro-area monetary conditions. For example, during the 2007–08 and 2010–11 inflation spikes, Kosovo could not tighten monetary policy; inflation only subsided when global prices receded or when the ECB's policy (and recessionary effects) cooled demand. Likewise in 2020, Kosovo could not deploy quantitative easing or currency depreciation to counter deflation – policy support had to come via fiscal measures and imported low interest rates. Fiscal policy and macroprudential measures remain the main levers for domestic stabilization under euroisation. In practice, this means Kosovo's inflation largely follows external trends and converges to euro-area inflation over the long term, with deviations in the short term due to local factors (e.g. higher share of food causing somewhat higher inflation than the euro average in boom times) (CBK,2014).

Euroisation also implies that inflation differentials vis-à-vis the euro-area translate into real exchange rate movements rather than nominal ones. During periods when Kosovo's inflation outpaced the Eurozone's, the real effective exchange rate appreciated, potentially harming competitiveness (CBK,2015). The adjustment mechanism in a monetary union is through prices and wages, not exchange rates. Thus, maintaining price stability is crucial not just for consumer welfare but also for external competitiveness. The Phillips curve trade-off in Kosovo is influenced by this constraint: stimulating growth via low interest rates or mild inflation is not an option locally – structural reforms are needed to reduce unemployment without igniting inflation. Overall, euroisation has anchored Kosovo's inflation to a low baseline, but it limits policy responses to supply shocks, effectively outsourcing inflation control to the ECB (which targets euro-area conditions).

Policy Responses to Inflation/Deflation. Despite limited monetary tools, Kosovo's authorities have employed several measures to manage inflation and mitigate its effects. The government has often relied on fiscal policy to cushion price shocks. For instance, during the 2022 inflation surge, fiscal support measures were implemented to protect vulnerable groups' purchasing power (e.g. temporary increases in social transfers and pensions, and subsidies for energy bills) (IMF,2024).

Such crisis-related fiscal support helped sustain consumption despite high inflation in 2022 (IMF,2024). The government also resisted calls to cut VAT or excises on fuel – instead, it monitored prices and in some cases imposed temporary price caps on essential foods and fuel margins to prevent excessive mark-ups (a measure also used by some neighboring countries)(IMF,2024). During deflationary periods (like 2014–2015), policy responses were more subdued since falling prices were supply-driven; the government focused on stimulating the economy through public investment and structural reforms rather than trying to reflate prices directly.

The Central Bank of Kosovo, while not setting interest rates, has taken steps to maintain financial stability and smooth credit conditions, which indirectly supports price stability. It kept adequate liquidity in the banking system so that credit to the private sector continued even during shocks (e.g. credit grew steadily in 2022 despite high inflation)(IMF,2023). The CBK has also used communication tools, acknowledging that inflation is externally driven and managing public expectations that it will revert once external pressures abate. In effect, "do no harm" is a key monetary stance – ensuring the banking system does not amplify inflation (through excessive lending booms) or deflation (through credit crunches). In 2023, as inflation fell, the CBK monitored for any risks of abrupt disinflation or financial strain on borrowers, but overall inflation deceleration was orderly (IMF, 2024). It's worth noting that other euroized or pegged economies (e.g. Montenegro, Bosnia) have similarly limited monetary policy, putting more onus on fiscal discipline to prevent demand-pull inflation. Kosovo's government has generally maintained a stable fiscal stance in the last decade (low public debt and deficits), which has helped avoid aggravating inflation from the demand side(IMF,2023). Fiscal rules adopted (e.g. a deficit cap) provide credibility that large fiscal-induced price shocks are unlikely.

Comparative Perspective (Montenegro, Baltics, others). Kosovo's inflation dynamics share similarities with other small economies that use or peg to the euro. Montenegro, which like Kosovo is fully euroized, has experienced broadly parallel trends: low underlying inflation with periodic spikes due to external shocks. One key difference is that Montenegro had extremely high inflation in the early 2000s as it emerged from the Yugoslav hyperinflation – inflation was still ~24% in 2001 and 19% in 2002 before the euro-based stabilization took hold (Indexmundi via CIA World Fact Book). By mid-decade Montenegro's inflation converged to low single digits, and it too saw peaks in 2008 and 2011 (though slightly lower in magnitude than Kosovo's, partly due to different

consumption patterns). During the recent episode, Montenegro actually registered an even higher inflation surge in 2022 than Kosovo – about 17% year-on-year at its peak (Central Bank of Montenegro, 2023) (IMF,2024) – in part because of a large domestic wage increase (the 2022 "Europe Now" reform doubled the minimum wage, boosting demand) alongside the imported food and fuel shocks (IMF,2024). Unlike some peers, the Montenegrin government did not heavily subsidize prices in 2022, aside from short-term caps on retail margins for essential goods (IMF,2024). As a result, Montenegrin inflation passed through to consumers more fully. By early 2024, however, inflation in Montenegro had fallen to about 4% year-on-year, closely tracking the Eurozone disinflation (IMF, 2024). Overall, Montenegro's experience underscores similar vulnerabilities: high import content of CPI and no monetary autonomy, leading to synchronized inflation cycles with Kosovo (Figure 4.2.3). Both countries rely on fiscal measures and hope that euro-area policy (now tightening) reins in inflation – effectively importing ECB credibility but also its one-size-fits-all policy.

The Baltic states (Estonia, Latvia, Lithuania) offer another point of comparison. Prior to joining the euro area (2000s), they operated currency boards pegged to the euro, and after 2011–2015 each adopted the euro. They too experienced pronounced inflation volatility from external shocks. During the mid-2000s boom, the Baltics had some of the highest inflation in Europe (e.g. Estonia ~11% in 2008) due to rapid growth and rising food/energy prices. All three went into deflation in 2009 with the global crisis, then recovered. Notably, in the 2021–2022 surge, the Baltics saw the highest inflation in the entire Eurozone – Estonia's CPI jumped nearly 20% in 2022 (Eurostat) (luminor,2024), reflecting their high energy import dependence and faster wage growth. This was despite being under ECB monetary policy, illustrating that structural factors (energy mix, consumption basket, fiscal responses) can lead to divergent outcomes within a currency union. Kosovo's 2022 inflation (11.6%) was lower than the Baltics' ~18–20%(luminor,2024), likely because Kosovo's recession in 2020 was deeper and its post-pandemic demand rebound more modest, and perhaps because wages did not rise as fast. Nonetheless, the pattern is alike: all these euro-linked economies had inflation broadly tracking global commodity swings, with differences mostly in magnitude and persistence. The policy implication is that euroized economies must bolster their resilience to shocks – e.g. improving energy self-sufficiency (Kosovo's heavy reliance on imported energy was costly in 2022)(wiww,2022), diversifying import sources, and using fiscal buffers to absorb price hikes.

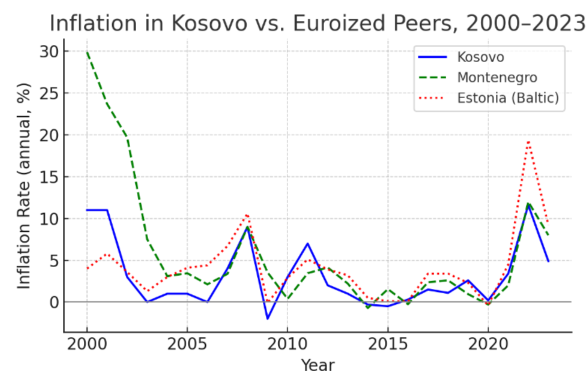


Figure 4.2.3: Inflation in Kosovo vs. selected euroized/euro-pegged peers, 2000–2023. Kosovo (blue line) and Montenegro (green dashed) have both converged to low inflation under the euro, aside from shock-induced jumps. The Baltic experience (Estonia, red dotted line as example) shows even higher volatility, with a dramatic 20% spike in 2022 (Luminor,2023). Montenegro's early-2000s inflation was very high (legacy of 1990s hyperinflation) but dropped to single digits by 2003 (Indexmundi,2024). All these economies illustrate that imported inflation is the primary force – their inflation rises and falls in line with global trends, given the lack of independent monetary policy.

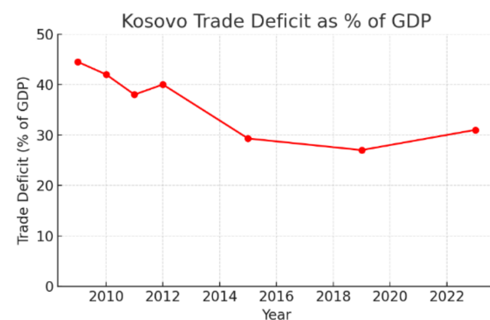
In summary, Kosovo's inflation record from 2000 to 2025 reflects a tension between external shocks and the stabilizing influence of the euro. Euroisation has anchored long-run inflation at low levels (generally in the 0–3% range, consistent with Eurozone price stability)(Svetchine, 2005). However, the large weight of food and energy in consumption and the inability to cushion external price swings mean that short-term inflation can be volatile. Periodic spikes – in 2008, 2011, 2022 – have tested policymakers' ability to respond without monetary instruments. The government and CBK have resorted to fiscal easing and regulatory measures to soften the impact, while relying on the self-correcting nature of external shock cycles (and ECB policy) to eventually bring inflation down. Comparisons with other euroized or pegged economies reinforce the point that structural reforms are crucial to enhance price stability: diversifying the economy, improving domestic production (especially in agriculture and energy), and maintaining disciplined fiscal policy can all reduce vulnerability to inflationary shocks. Going forward, as global conditions normalize, Kosovo's inflation is expected to realign with low Eurozone levels, with the euro framework continuing to provide nominal stability – albeit at the cost of limited flexibility in the face of future shocks. All claims considered, price stability in Kosovo over 2000–2025 has been preserved on average, but ensuring it amidst volatility requires prudent fiscal management and targeted measures to address the sources of inflation that lie beyond the reach of monetary policy.

4.3 Trade Balance and External Sector

Kosovo has persistently run a large trade deficit over the past decades, reflecting a structurally weak export base and high import dependence. Net exports have continuously contributed negatively to GDP growth – for instance, around **−29.3% of GDP in 2015** (CBK, 2016). As **Figure 4.3.1** illustrates, the trade deficit was extremely high during the late 2000s (around 45% of GDP in

2009) and, despite some improvement in the mid-2010s, still hovers near one-third of GDP in recent years. This chronic deficit underscores Kosovo's inability to produce enough tradable goods and services to offset its consumption of imports. Exports remain narrow and underdeveloped, focused mainly on low-value commodities (e.g. base metals) and a few services, whereas imports are broad-based and consumption-driven – chiefly consisting of consumer goods, construction materials, fuel, and food (CBK, 2014; IMF, 2024). This imbalance indicates a **fundamental competitiveness problem**: domestic production and export capacity are insufficient to meet domestic demand or earn foreign exchange, resulting in a widening trade gap that the country has struggled to contain.

Figure 4.3.1: Kosovo's trade deficit as percentage of GDP. The trade gap was about 44.5% of GDP in 2009 amid the global crisis, narrowed to ~29% by 2015, but remains around one-third of GDP in recent years (Maloku and Pantina, 2011; CBK, 2016; IMF, 2024))



Importantly, **the trade deficit is partly "masked" in the current account by substantial inflows from abroad**, including donor aid, remittances, and foreign investment. For example, **remittances from the diaspora accounted for about 15% of GDP in 2015** (CBK, 2016) and have continued to play a vital role in financing Kosovo's external deficit. These unrequited transfers, alongside **foreign direct investment (FDI)** inflows, help cover the trade shortfall, keeping the overall balance of payments manageable despite the large merchandise trade gap (World Bank, 2023; IMF, 2024). However, this also highlights a **deep external dependency**: the stability of Kosovo's external accounts is heavily reliant on its diaspora and foreign investors. Any adverse development affecting these external inflows – for instance, an economic downturn in host countries for Kosovo's diaspora – would directly strain Kosovo's ability to fund its import bill, making the economy vulnerable to external shocks (World Bank, 2023; IMF, 2024).

At the core of Kosovo's external imbalance is a lack of competitive, high-value exports. The country's export base remains narrow, concentrated in a few primary products and basic services. Even after a decade of development, exports of goods and services hover around *only 20–30% of GDP*, while imports are roughly *50–60% of GDP*, resulting in a large net export deficit (CBK,

2016; World Bank, 2023). The **composition of GDP by expenditure** (see **Figure 4.1.2**) underlines this issue – private and government consumption together far exceed domestic output, and investment adds further demand, while net exports are a large negative portion. In 2023, for example, private consumption constituted roughly 84% of GDP and investment about 34%, whereas net exports were around **–30% of GDP**, reflecting an economy that absorbs much more than it produces. This structure signals that Kosovo's growth model is driven by internal demand (fueled by remittances and imports) rather than export-led, which is unsustainable for external balance in the long run.

Crucially, Kosovo's **euroized monetary regime** limits the tools available to address external imbalances. Unlike most countries, Kosovo cannot use exchange rate adjustments to improve trade competitiveness – there is no national currency to devalue since the euro is in use (Svetchine, 2005; IMF, 2024). As a result, real exchange rate alignment depends solely on relative inflation: at times, higher inflation in Kosovo has led to **real effective exchange rate (REER) appreciation** against trading partners, eroding export competitiveness further (CBK, 2016; IMF, 2024). The inability to devalue or otherwise adjust monetary policy means Kosovo must rely on structural measures to correct the trade imbalance. So far, however, progress has been limited. Initiatives like the Stabilization and Association Agreement (which improved access to EU markets) and tax incentives for manufacturers have had only modest impact on exports (European Commission, 2022; CBK, 2016). **Service exports** such as ICT outsourcing and especially diaspora tourism have grown in recent years, providing some boost to the external sector, but these remain insufficient in scale to materially narrow the overall deficit (IMF, 2024). In short, Kosovo's external sector is constrained by fundamental structural issues – a small tradable sector and high import reliance – that monetary stability alone cannot solve.

Both the **IMF (2024)** and **World Bank (2023)** stress the urgency of export diversification and productivity improvements to strengthen the external sector. They note that Kosovo's **current model – wherein remittances and aid finance a perpetual trade gap – is not sustainable** for long-term development. To reduce external vulnerability, Kosovo needs to expand its capacity in tradable industries, move up the value chain in exports, and reduce barriers for domestic producers. Improving the business climate and infrastructure, investing in skills, and leveraging diaspora ties for export promotion are among the recommended strategies (World Bank, 2023; IMF, 2024). Until

such structural changes take hold, however, Kosovo's trade balance will likely remain in deficit, with the economy **exposed to external conditions**. The heavy reliance on foreign inflows to prop up the external account is a key structural weakness (and is discussed further in Section 4.6), one that continues to **underscore Kosovo's vulnerability in the external sector**.

Foreign Direct Investment (FDI) Trends

Foreign direct investment inflows into Kosovo have remained modest and volatile throughout the post-2000 period. In theory, the adoption of the euro was expected to attract FDI by eliminating exchange-rate risk and providing monetary stability. In practice, however, euroisation **"neither helped in lowering the borrowing cost nor in increasing the investments on a major scale"** (Maloku & Pantina, 2011, p.14). Annual FDI has fluctuated at relatively low levels (generally only a few percent of GDP), with brief surges tied to specific privatizations or one-off projects followed by declines amid global or regional crises (Central Bank of Kosovo [CBK], 2016). The late-2000s global financial turmoil, for example, dampened investor appetite across the Western Balkans, and Kosovo was no exception (CBK, 2016). Thus, despite the currency stability granted by euroisation, Kosovo's success in attracting foreign investment has lagged behind initial expectations, constrained by other fundamental factors. Crucially, the business environment – including governance, rule of law, and market size – plays a larger role in investor decisions than the monetary regime alone (Maloku & Pantina, 2011; International Monetary Fund [IMF], 2024). Researchers note that **"lack of stable state institutions"** and the **"lack of explicit guarantees discourages foreign direct investments"** in Kosovo, suggesting that currency stability by itself was insufficient to overcome institutional weaknesses (Maloku & Pantina, 2011, p.14). Euroisation provided a helpful backdrop of low inflation and removed exchange risk, but it did not automatically translate into an FDI boom – other reforms and conditions have proven decisive in shaping investment trends.

The composition of FDI in Kosovo also reflects structural limitations of the economy. Foreign investments have been heavily concentrated in non-tradable sectors such as real estate, construction, and basic services, rather than in export-oriented manufacturing or high-value industries (CBK, 2016; World Bank, 2023). For instance, by 2015 over half of FDI stock was in real estate alone, with construction and financial services making up much of the remainder (CBK, 2016). Such investments, often driven by diaspora capital and regional investors, have provided

short-term growth and employment, but their impact on long-run development is limited – they do little to bolster Kosovo's export capacity or productivity base (IMF, 2024; World Bank, 2023). The dominance of real estate and retail trade FDI means that while inflows help finance the external deficit (by bringing in foreign capital), they have not transformed the economy's structure. In fact, Kosovo's FDI experience under euroisation underscores a broader point: macroeconomic stability is necessary but not sufficient for attracting robust and diversified investment. Sustainable FDI growth will likely depend on improving **fundamentals** – strengthening institutions, expanding market access, and upgrading infrastructure and human capital – so that investors beyond the property and retail sectors see Kosovo as an appealing destination (World Bank, 2023; IMF, 2024). In summary, two decades into euroisation, Kosovo's FDI record is one of **stable yet underwhelming** inflows, constrained by structural challenges. Currency stability provided by the euro has kept certain risks at bay, but unlocking stronger FDI will require deeper reforms to the investment climate going forward (Maloku & Pantina, 2011; World Bank, 2023).

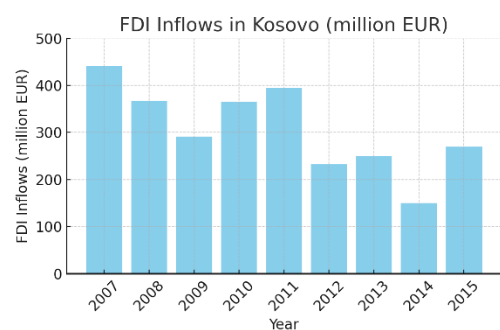


Figure 4.4.1: Foreign direct investment inflows in Kosovo (2007–2015). FDI peaked at over €400 million in 2007, then dropped during the 2009 global crisis and again in 2012 (Eurozone crisis). Inflows hit a low of ~€150 million in 2014 before recovering to €270 million in 2015 (CBK, 2013; CBK, 2016)

4.4 Structural Economic Vulnerabilities

Every economy has underlying structural features that determine its long-run resilience and growth potential. In Kosovo's case, despite periods of solid growth and stability, **deep-rooted structural vulnerabilities** continue to hinder sustainable development. Such vulnerabilities are defined by the IMF and World Bank as persistent weaknesses in an economy's fundamental structure – as opposed to short-term cyclical issues – that make it more susceptible to shocks and that constrain **inclusive, long-term growth** (IMF, 2024; World Bank, 2023). For Kosovo, these structural issues are interlinked and mutually reinforcing, creating a challenging environment that policy must address comprehensively. Key structural economic vulnerabilities include:

- **Limited productive base and export capacity:** Kosovo's economy is dominated by low-value services and basic goods. **Services account for roughly 50% of GDP** – mainly retail trade, transportation, hospitality, and public administration – while **manufacturing and**

industry contribute only around 10–15% (CBK, 2016). This lack of a diversified industrial base means productivity is low and the economy struggles to generate high-value exports. Agriculture is largely subsistence-based and also contributes modestly. With few internationally competitive industries, Kosovo cannot easily raise incomes or exports, leaving it dependent on imports and external assistance (World Bank, 2023). The narrow production structure also means **job creation is limited to certain sectors** and many potential workers (especially the highly educated) do not find opportunities in fields like technology or manufacturing domestically.

- **High unemployment and skill mismatches: Overall unemployment remains around 25%** in Kosovo, with youth unemployment estimated over **40%** (IMF, 2024). Such chronically high joblessness points to structural labor market weaknesses. A significant issue is the **mismatch between education and market needs** – the education system's output (both secondary and tertiary) does not align well with the skills in demand. Many young people attain degrees but lack practical or vocational skills needed by employers. At the same time, fast-growing sectors (like IT or specialized manufacturing) struggle to find qualified local labor. The result is paradoxical: jobs exist but Kosovo's young workforce isn't adequately prepared for them, contributing to both high unemployment and the need to import some skilled labor or expertise. Moreover, long-term unemployment erodes skills and can lead to social issues, and many youths instead seek opportunities abroad, exacerbating brain drain.
- **Large informal economy:** An **estimated 30–35% of economic activity occurs in the informal sector** – i.e. unreported or under-the-table (IMF, 2024; World Bank, 2023). This high informality has multiple negative effects. Fiscally, it narrows the tax base, reducing government revenues needed for public investment. It also means many workers have insecure jobs without legal protections or benefits, and firms in the informal sector tend to stay small and uncompetitive (since they cannot access credit easily or integrate into formal supply chains). The prevalence of informality often reflects and perpetuates governance issues like weak enforcement and corruption (if firms can operate informally with impunity). It creates a vicious cycle: informality undermines the development of a robust formal private sector, which in turn limits growth and job creation.

- **Heavy reliance on external inflows (remittances and aid):** As discussed earlier, Kosovo's economy is heavily supported by the diaspora. **Remittances constitute about 15% of GDP** on average (World Bank, 2023), one of the highest shares in Europe. These inflows have positive aspects – they boost household incomes and consumption – but also signal a vulnerability. The population's spending power, and by extension business sales, are partly dependent on conditions in foreign labor markets (like Germany or Switzerland where much of the diaspora resides). If those economies falter or immigration policies change, Kosovo could see a drop in remittances, directly impacting domestic demand. Additionally, a significant portion of remittances goes into **non-productive uses**, especially consumption and residential construction (World Bank, 2023). This means the money, while alleviating poverty for families, does not substantially increase Kosovo's productive capacity. Similarly, foreign aid has been important over the years (though decreasing as Kosovo develops), and any reduction in external support can strain public finances. This external dependence implies that Kosovo's economic fate is partly out of its own hands, tied to global conditions and diaspora dynamics.
- **Regional development disparities and infrastructure gaps:** Economic activity in Kosovo is **highly concentrated in the capital, Pristina, and a few other urban centers**, while large swathes of the country (especially in the rural south and north) lag behind. This regional imbalance is evident in much lower employment and income levels in rural municipalities. One cause is the **uneven infrastructure development** – rural areas face inadequate roads, limited public transportation, weaker utility services, and fewer educational and health facilities (World Bank, 2023). Such deficiencies discourage private investment outside the capital and drive internal migration (people moving to Pristina in search of work and services). The strain on cities grows while rural economies stagnate. Over time, this also contributes to social inequality and disenchantment in neglected areas. A lack of connectivity (both physical and digital) means potential resources – like agricultural land, tourism sites, or labor in those regions – are underutilized, representing lost growth potential for the country as a whole.
- **Institutional and governance weaknesses:** Governance remains a critical vulnerability. Issues of **corruption, bureaucratic inefficiency, and a weak rule of law** persist in

Kosovo's public sector (World Bank, 2023). These institutional problems manifest as cumbersome business regulations, unpredictable enforcement of contracts, and perceptions of favoritism in economic opportunities. For businesses, this creates uncertainty and extra costs (e.g. needing to pay bribes or spend undue time in administrative procedures). For the economy, it deters both domestic and foreign investment and breeds informality (firms stay informal to avoid complex regulations). Although Kosovo has made progress in building legal frameworks aligned with EU norms, implementation is often lacking. **Transparency International indices and World Bank governance indicators consistently rank Kosovo lower than many of its Balkan peers** in areas like control of corruption and government effectiveness (World Bank, 2023). Weak institutions also mean public resources are not always used efficiently – for example, public procurement might yield overpriced or low-quality infrastructure, undermining the effectiveness of public investment. Furthermore, slow court procedures and contract enforcement issues impede credit growth (banks are wary to lend when collateral collection is uncertain) and discourage entrepreneurship.

These structural weaknesses collectively **increase Kosovo's vulnerability to shocks and constrain its growth**. For instance, with a narrow production base and high informality, a shock like COVID-19 hit Kosovo harder in terms of unemployment and business closures, as many informal workers had no safety nets and the economy couldn't pivot to producing different goods. High unemployment and diaspora reliance mean that any global downturn not only affects exports but also remittances, creating a double whammy. Moreover, these vulnerabilities are interwoven – e.g. poor education outcomes feed unemployment and informality; informality feeds corruption; corruption in turn can worsen regional disparities by diverting resources. This interdependence implies that **piecemeal solutions won't suffice**. Addressing only one area (say, unemployment) without tackling others (education, investment climate, etc.) will have limited impact, because bottlenecks in other areas will stifle progress.

The policy response advocated by the IMF and World Bank is a **comprehensive reform agenda to tackle structural vulnerabilities on multiple fronts simultaneously**. Key recommendations include: improving the business environment (streamlining permits, strengthening contract enforcement) to encourage private sector growth and job creation; **investing in education and**

vocational training to reduce skill mismatches (IMF, 2024); incentivizing firms to formalize (through tax policy and better enforcement) to widen the tax base and improve worker protections; and targeted infrastructure development in lagging regions to promote more balanced growth (World Bank, 2023). Anti-corruption efforts are paramount – implementing e-governance, judicial reforms, and stronger oversight can gradually improve public trust and efficiency. The **IMF (2024)** specifically suggests measures like vocational training programs for youth, facilitation of SME financing, and reforms to labor regulations to make hiring easier. The **World Bank (2023)** emphasizes governance reforms and infrastructure – for example, upgrading road connectivity and investing in reliable electricity and internet access across the country, which would enable businesses to operate in more regions.

Many of these recommendations are being pursued. Kosovo is partnering with the EU and international donors on various initiatives: the EU has funded projects to improve municipal infrastructure and is supporting reforms in public administration; the World Bank's current program (CPF FY2023–27) provides financing for energy, education, and regional development projects aimed at alleviating some of these bottlenecks (World Bank, 2023). The government has also launched an Economic Reform Program that identifies similar priorities, such as increasing formal employment and enhancing export competitiveness. Crucially, there is recognition that **coordination is required** – success depends on moving forward in all these areas so that improvements in one domain reinforce progress in others. For instance, better roads won't yield growth unless accompanied by better skills training so that businesses can actually expand in those newly connected areas.

If effectively implemented, these structural reforms promise to **transform Kosovo's economic landscape** over time. Reducing informality would increase tax revenues, allowing more public investment in education and health. A more skilled workforce and a friendlier business climate would attract investment beyond construction and trade – potentially into manufacturing, agriculture processing, or services outsourcing, which could create higher-paying jobs and improve the trade balance. Lower corruption and stronger institutions would ensure fairer distribution of resources and bolster public confidence, which in turn encourages talent to stay in the country rather than emigrate. While progress may be gradual, each step strengthens Kosovo's resilience: the economy becomes more self-reliant (less dependent on remittances), more inclusive (providing

opportunities in regions and for youth), and better able to withstand external shocks. In summary, **addressing structural vulnerabilities is the critical path for Kosovo to achieve sustainable, long-term growth**. The challenges are significant and interlinked, but with sustained commitment and support from international partners, Kosovo can build on its post-war stability to overcome these structural hurdles in the years ahead.

Indicator	Value
Unemployment rate (overall)	~25% (IMF, 2024)
Youth unemployment rate	40–50% (IMF, 2024)
Informal economy size	~30–35% of GDP (World Bank, 2023)
Remittances	~15% of GDP (World Bank, 2023)
Services share of GDP	~50% (CBK, 2016)
Manufacturing & industry share	~10–15% (CBK, 2016)

Chapter 5: Discussion of Findings and Policy Implications

Macroeconomic Context and Key Findings

Kosovo's post-conflict economic trajectory has been characterized by **steady growth and remarkable resilience** in the face of global shocks. The analysis showed that since the early 2000s, real GDP has more than tripled, with growth averaging around 4% per year over the past decade (World Bank, 2023; IMF, 2024). This sustained expansion lifted Kosovo to upper-middle-income status by the late 2010s (World Bank, 2022). A combination of factors underpinned this performance. *Domestic demand*, especially private consumption fueled by diaspora remittances, has been the primary engine of growth. Indeed, household consumption in recent years hovers near or above 90% of GDP – even exceeding 100% in some mid-2010s years – underscoring a demand-driven model largely financed by external inflows (CBK, 2016; World Bank, 2023). Public investment in infrastructure, often funded through fiscal resources and foreign assistance, also contributed to growth spurts in certain years, while foreign direct investment (FDI) provided capital mainly into non-tradable sectors like real estate and services.

A notable finding is **Kosovo's resilience during global economic crises**, which is unusual for a small, open economy. During the 2008–09 global financial crisis, Kosovo avoided recession – real GDP growth merely slowed to around 3% in 2009 while many neighbors contracted (IMF, 2012).

Likewise, in 2020, the COVID-19 pandemic caused a GDP contraction of about 5.3% (World Bank, 2023), but this was on par with regional peers, and a vigorous *V-shaped recovery* followed with ~10–11% growth in 2021 (IMF, 2024). Several factors explain this resilience. First, **Euroisation** – the unilateral adoption of the euro – provided Kosovo with a stable currency and **anchored inflation** expectations. Inflation has generally been low and stable, often below the Eurozone's 2% target, except during external commodity price spikes. For example, consumer price inflation was only ~1.8% in 2013 (CBK, 2013) and averaged around 2% in the 2010s. Only global shocks disturbed this stability – notably the surge in import prices in 2022, when inflation temporarily spiked to about 11% before subsiding to ~4% in 2023 (CBK, 2023; IMF, 2024). Crucially, **the absence of exchange-rate volatility** meant Kosovo did not face currency crises or abrupt balance of payments crunches when global conditions turned adverse (Maloku & Pantina, 2011). This monetary stability fostered confidence in the nascent financial sector and encouraged foreign banks to establish operations early on.

Another key buffer has been the **Kosovo diaspora**. Remittances from Kosovars working abroad consistently amount to roughly 15% of GDP (World Bank, 2023; IMF, 2024). These inflows have acted as an informal safety net and counter-cyclical stabilizer. During downturns, diaspora transfers tend to hold steady or even increase – as seen in 2009 and 2020 – sustaining household incomes and consumption when domestic output falters. The diaspora's role is so pronounced that it effectively functions as a substitute for formal fiscal transfers or insurance: when Kosovo's economy underperforms, migrants often send additional support home, analogous to an automatic stabilizer (IMF, 2010; World Bank, 2023). This dynamic was observed in 2020, when remittances actually rose as a share of GDP as overseas workers bolstered their families during the pandemic shock. In the absence of an independent monetary policy, such external income has been vital in maintaining **financial inflows and demand**.

At the same time, the findings highlight persistent **structural vulnerabilities**. Kosovo runs a **chronic trade deficit** of significant magnitude. Exports of goods and services remain only on the order of 20–30% of GDP, whereas imports are on the order of 50–60% of GDP, resulting in net exports around **–25% to –30% of GDP each year** (CBK, 2016; World Bank, 2023). This gap is only partially closed by remittances and other inflows; even with those included, the current account deficit tends to range in the high single digits of GDP. In essence, Kosovo **absorbs far**

more than it produces, reflecting limited domestic productive capacity and competitiveness. The narrow export base – concentrated in a few mineral commodities and some services – has meant that strong GDP growth has not translated into a balanced external position. As the analysis noted, this demand-fueled growth model is not export-led and thus raises questions of long-run sustainability (World Bank, 2023). The **external dependency** also creates exposure: Kosovo's stability is heavily reliant on conditions in host countries for its diaspora and on foreign investor sentiment. A severe downturn in Europe, for instance, could simultaneously reduce export demand, FDI, and remittances, which would test Kosovo's resilience more severely (World Bank, 2023; IMF, 2024).

Euroisation: Benefits, Trade-offs, and Policy Constraints

Kosovo's use of the euro has been a double-edged sword, and the discussion must interpret the analysis findings in light of this **policy choice**. On one hand, **euroisation has clearly delivered macroeconomic stability** in line with the policy's original intent. By "importing" the European Central Bank's credibility, Kosovo immediately established low inflation and avoided the currency instability that many other transition economies experienced in the 1990s and early 2000s (Maloku & Pantina, 2011). The analysis confirms that Kosovo enjoyed inflation and interest rates on par with Eurozone economies, providing a stable environment for businesses and households. This stability has also facilitated financial deepening: confidence in the currency encouraged people to deposit money in banks rather than hold cash, and foreign banks entered the market bringing capital and expertise. By 2008, 6 of 8 commercial banks in Kosovo were foreign-owned, holding over 90% of banking assets (Maloku & Pantina, 2011). The banking sector became well-capitalized, liquid, and well-regulated under the Central Bank of Kosovo (CBK) – which adopted European banking supervision standards. As a result, **financial sector stability** is a notable success: non-performing loan ratios are extremely low (around 2–3% in recent years) and capital adequacy ratios high (~17–18%), even through shocks (IMF, 2024; World Bank, 2023). Moreover, because loans and deposits are all in euros, banks do not face currency mismatch risks. This contributed to **Kosovo's ability to weather the 2008–09 financial crisis and the 2020 COVID-19 shock without any bank failures or liquidity crises**. Prudent oversight by the CBK (which cannot act as lender-of-last-resort, so it must enforce conservatism) and the inherent stability of using a strong currency kept the financial system sound (IMF, 2024).

On the other hand, **euroisation comes with significant policy trade-offs**. By unilaterally adopting the euro, Kosovo surrendered **monetary policy autonomy** and the typical tools a central bank would have. The CBK cannot set interest rates (Eurozone rates apply) nor print money to provide emergency liquidity. This means **Kosovo's economic management relies entirely on fiscal policy and structural policies** for macroeconomic adjustment. The analysis noted that during recessions, Kosovo lacked the option to deploy monetary stimulus (e.g. lowering interest rates or quantitative easing), and during booms it could not raise interest rates to cool inflation or credit growth (IMF, 2024). For example, in the pandemic downturn Kosovo had to rely on fiscal stimulus and international aid, since currency devaluation or central bank asset purchases were off the table. The **"Impossible Trinity"** principle is evident here: Kosovo maintains a fixed exchange rate (by using the euro) and free capital mobility, so it cannot have an independent monetary policy (Mundell, 1961). This choice has **largely been vindicated by greater stability**, but it constrains crisis response options. Another cost is the **loss of seigniorage revenue** – Kosovo forgoes the profits of issuing currency (which accrue to the ECB), though donors helped compensate this in early years and the stability gains were deemed worth the cost.

Perhaps the greatest challenge posed by euroisation is in addressing Kosovo's structural imbalances, notably the trade deficit. With no national currency, **Kosovo cannot devalue to regain competitiveness**. Adjusting the real exchange rate can only occur through relative price and wage changes, which is a slow and often painful process ("internal devaluation"). In practice, Kosovo experienced periods where inflation outpaced that of the Eurozone (for instance, during local booms or import price surges), causing the real effective exchange rate to appreciate and further erode export competitiveness (Svetchine, 2005; IMF, 2024). Lacking the monetary lever, Kosovo must **double down on structural reforms** to improve competitiveness – for example, investing in infrastructure, education, and technology to boost productivity, or implementing business climate improvements to attract export-oriented FDI. Indeed, Kosovo's National Development Strategy 2030 emphasizes reorienting the economy toward production and exports, increasing employment, and ensuring sustainability (World Bank, 2023). The analysis suggests that while progress has been made (e.g. the Stabilization and Association Agreement with the EU improved market access), results so far have been modest – the export base remains narrow (European Commission, 2022; CBK, 2016). This underscores a policy implication that **euroisation, while stabilizing, puts the onus on government to enact tough structural changes**, since traditional monetary adjustments

are unavailable. Euroisation also enforces **fiscal discipline**: without the ability to monetize deficits, running large fiscal imbalances could lead to financing crises. Kosovo's policymakers recognized this, adopting a legal debt ceiling of 40% of GDP – much lower than in many countries – and generally adhering to conservative budgets (IMF, 2024). As a result, public debt has remained among the lowest in the region (around 17–20% of GDP in recent years), which proved fortuitous when fiscal space was needed for crisis stimulus. In essence, **the euroized regime "hard-wires" discipline**, and Kosovo largely benefited by avoiding the debt traps seen elsewhere. The policy trade-off is that Kosovo has less flexibility to run deficit-financed stimulus at will; it must carefully build fiscal buffers in good times to use in bad times.

Policy Implications for Economic Management and Financial Stability

The findings carry several policy implications for Kosovo's economic management and financial stability framework. **Maintaining prudent fiscal policy** is paramount. Given the constraints of euroisation, fiscal policy is the primary macroeconomic tool available. The government should continue its track record of caution by keeping public debt low and deficits under control, except in clear counter-cyclical need. The experience of 2008–09 and 2020 shows that entering a crisis with low debt and savings in reserve allows Kosovo to respond robustly without jeopardizing sustainability (IMF, 2024; World Bank, 2023). For example, Kosovo was able to finance a deficit of ~7% of GDP in 2020 (through loans and drawing down accumulated reserves) and provide emergency support of about 5% of GDP, all while keeping debt below 25% of GDP (IMF, 2024). This would not have been possible if the country had started with high debt. The implication is that **fiscal rules like the 40% debt ceiling and a de facto balanced budget orientation remain critical** to preserve credibility and room for maneuver. Kosovo might even consider establishing a formal stabilization fund or saving mechanism for excess revenues (such as privatization proceeds or windfalls) to enhance its buffers for future shocks. Over the longer term, strengthening domestic revenue mobilization – e.g., through improved tax administration and broadening the tax base – could provide more fiscal space for development spending while maintaining discipline.

On the monetary and financial side, **Kosovo must continue to fortify its financial stability measures**. The CBK's success in supervising a mostly foreign-owned banking sector has yielded low NPLs and high capital ratios, which must be sustained (IMF, 2024). With no lender of last resort facility, prevention is far better than cure – strict regulatory oversight and early intervention

in any sign of bank distress are essential. Policy should ensure banks maintain robust liquidity and capital buffers, and that credit growth is aligned with deposit growth (as currently, a healthy loan-to-deposit ratio ~85% indicates banks are not over-leveraging) (IMF, 2024). Another implication is the need for **contingency arrangements in lieu of monetary tools**. While Kosovo cannot unilaterally create a safety net like an ECB facility, it can deepen cooperation with international partners. For instance, continued coordination with the European Central Bank and European banking authorities can help in crisis scenarios (e.g., in 2020 the ECB's actions to flood euro liquidity globally indirectly benefited Kosovo's banks). Additionally, pursuing membership or association in European frameworks (such as the Single Euro Payments Area, or eventually the European Stability Mechanism support on an ad-hoc basis) could be explored to enhance financial safety nets, although formal inclusion is challenging without EU membership. Meanwhile, **maintaining a credible deposit insurance scheme** and strong bank resolution plans domestically will bolster confidence that even without a central bank backstop, deposits are safe and any bank failures can be handled in an orderly way. So far, Kosovo's record is very positive – no systemic bank failures in two decades – and preserving that record is a clear policy priority.

The heavy reliance on the diaspora also suggests policy steps. While remittances are private flows, the government can craft policies to **engage the diaspora in development**. This could include issuing *diaspora bonds* or creating investment funds to channel a portion of remittances into productive domestic investments (Ketkar & Ratha, 2010). Facilitating diaspora investment in local businesses – for example, through informational programs, matching grant schemes, or improved property rights and contract enforcement – could help convert some of the consumption-driven inflows into capital for growth. Additionally, as labor mobility has effectively served as Kosovo's adjustment mechanism (many Kosovars work abroad), policies should maintain openness and skills recognition with EU countries, but also encourage return migration of talented individuals. Returnees can bring skills, entrepreneurship, and know-how that bolster the home economy (Gërxhani, 2021). Over time, a strategy for **gradual formal integration into the Eurozone's institutional structures** (should Kosovo progress on EU accession) would cement the benefits of euroisation while providing more explicit support mechanisms. In the interim, **regional cooperation** (through CEFTA and other regional initiatives) can expand market opportunities for Kosovo's firms and perhaps create avenues for risk-sharing.

For **development strategy**, the implication is clear that Kosovo must **diversify its economy and reduce external imbalances** to achieve sustainable long-term growth. The current growth model, while effective for raising incomes in the short run, is not a formula for resilient development over decades. Policymakers should prioritize improving the *tradable sector*. This means investing in areas like manufacturing, agriculture value-addition, and exportable services (e.g. IT outsourcing, tourism) where Kosovo may have comparative advantages or unexploited potential. Removing bottlenecks – unreliable energy supply, insufficient transport infrastructure, and bureaucratic hurdles – is critical to lower costs for businesses (European Commission, 2022). The government's National Development Strategy, aligned with these needs, highlights infrastructure upgrades, green energy investments, and vocational education to better match workforce skills with market needs (Government of Kosovo, 2021). Successfully shifting toward an **export-oriented growth strategy** would gradually alleviate the trade deficit and lessen the dependence on remittances. It would also generate more **productive employment** at home – an essential goal given persistent high unemployment (over 20% in recent years, with youth unemployment even higher) (World Bank, 2023). The policy implication is that macro-stability alone is not enough; it must be complemented by targeted development policies that foster private sector growth, competitiveness, and job creation. Encouraging FDI into export sectors is one tactic – for example, offering incentives for investors in manufacturing or tech, rather than the current pattern where FDI has flowed mainly to construction and real estate. Strengthening governance and the rule of law will support this by creating a better business climate.

In sum, Kosovo's economic management should continue to **balance stability with strategic reforms**: preserving the hard-won stability gains from euroisation and fiscal prudence, while aggressively addressing the structural weaknesses that leave the economy vulnerable. The analysis' broader context suggests that Kosovo's relative stability is a strong foundation upon which to build a more self-sustaining and inclusive growth model. The government's policies must integrate short-term macroeconomic management with a **long-term vision for development** – aiming to eventually have an economy that is not only stable, but also more competitive and diversified.

Limitations of the Analysis

While the analysis provides valuable insights into Kosovo's macroeconomic performance and the role of euroisation, it is important to acknowledge its limitations. First, the study relies heavily on

aggregate macroeconomic indicators (GDP, inflation, debt ratios, etc.) and **does not deeply disaggregate microeconomic or distributional effects**. This means that important issues such as income inequality, poverty reduction, or sector-specific dynamics were largely outside the scope. Kosovo's strong GDP growth, for instance, does not automatically imply broad-based welfare gains – unemployment and labor force participation challenges persist, which the aggregate analysis could not fully illuminate. Future research might incorporate household survey data or micro-level evidence to complement the macro findings.

Second, the analysis is constrained by data availability and quality. Kosovo is a relatively young country in terms of statistical capacity; consistent data series only exist from the early 2000s onward, and some figures (especially in the immediate post-war years) are estimates with a margin of error. There may also be **limitations in the accuracy of external account figures** – informal remittance channels and unrecorded border trade could mean that the true scale of inflows and outflows is somewhat different than reported. The analysis had to rely on the best available data from sources like the IMF, World Bank, and CBK, but these sources themselves sometimes revise figures. Any conclusions drawn are thus subject to the usual caveats regarding data reliability in an emerging economy context.

Third, the **methodological approach** of this thesis (largely descriptive and analytical, using comparisons over time and with literature benchmarks) does not establish strict causal inference. We interpret that euroisation contributed to stability and that remittances cushioned shocks, but one must be cautious about attributing cause and effect definitively. For example, Kosovo's avoidance of recession in 2009 can be ascribed to limited global integration and steady remittances, but we cannot **counter-factually prove** how an independent currency might have behaved under the same conditions. Likewise, while we observe that fiscal discipline coincided with stability, we infer its importance rather than test it with a formal model. These interpretative leaps are informed by theory and comparative cases, but future rigorous testing (e.g., econometric analysis or synthetic control comparisons with non-euroized peers) would strengthen confidence in the conclusions.

Another limitation is that the analysis focused on the **macroeconomic and financial sector outcomes**, and only briefly touched on structural reforms and political economy factors. Issues such as governance, corruption, EU integration progress, and geopolitical aspects (e.g., relations with Serbia or recognition status) can have significant economic implications. These were mostly

beyond the scope of this thesis. For instance, political instability or delays in reforms could influence investor confidence and diaspora decisions, yet our analysis treated external inflows and policy choices somewhat exogenously. A more holistic approach could enrich understanding of how non-economic factors interplay with the economic outcomes observed.

Finally, the unique nature of Kosovo's situation – a unilateral adoptee of the euro – means there are limited direct comparators. The thesis referenced Montenegro's similar experience and general literature on dollarized/euroized economies, but findings are somewhat specific to Kosovo's context. This limits generalizability. The policy implications drawn, while sensible for Kosovo, may not apply neatly to other countries with different institutional setups. Even within Kosovo, future changes (e.g., an EU accession scenario) could alter the relevancy of some conclusions. Thus, the analysis should be viewed as a **context-specific case study** with lessons that stimulate further inquiry rather than provide universally applicable answers.

Recommendations for Future Research

Building on the findings and acknowledging the above limitations, several avenues for future research are recommended:

- **Comparative Studies of Euroisation**: It would be valuable to compare Kosovo's long-run outcomes with those of similar economies that did not euroize. For example, a study contrasting Kosovo with other Western Balkan countries (like Albania or North Macedonia, which kept their currencies) or with Montenegro (which also uses the euro) could yield insights into how much euroisation per se influenced stability and growth. Such research could use quantitative techniques (e.g., difference-in-differences or synthetic control methods) to attempt to isolate the impact of the common currency from other factors.
- **External Shock Scenarios and Buffer Analysis**: Future research could delve into scenario analysis or stress-testing of Kosovo's economy under various shock scenarios. For instance, modeling the impact of a significant recession in EU countries (reducing remittances and exports) or a financial crisis affecting parent banks could help quantify Kosovo's vulnerabilities. This would inform how robust the current buffers are and what additional contingency plans might be needed. Linked to this, an assessment of the adequacy of fiscal reserves, or the potential role of international financial support (IMF programs, etc.) under severe stress, would be useful.

- **Effectiveness of Structural Reforms**: As Kosovo implements reforms aimed at improving exports and investment, research should monitor and evaluate these efforts. Did the Stabilization and Association Agreement with the EU meaningfully increase exports? Are tax incentives for businesses resulting in diversification? Detailed sectoral analyses (for example, an in-depth look at the nascent tech sector, or agriculture and food processing potential) could identify success stories or ongoing bottlenecks. This micro-founded research would complement the macro perspective by showing which strategies are bearing fruit in transforming the economic structure.
- **Diaspora Engagement and Social Impact**: Given the outsized role of the diaspora, further research could explore how to better leverage this asset. Surveys or interviews with diaspora members might reveal what would incentivize them to invest in Kosovo (bonds, real estate, startups) beyond sending remittances. Additionally, studying the social impact of remittances – on education, entrepreneurship, and labor supply in Kosovo – could provide insights into how this inflow shapes development. For example, do remittance-receiving households invest more in schooling or become dependent on transfers? Understanding these patterns can guide policies to maximize positive impacts of diaspora money.
- **Monetary and Financial Policy Alternatives**: Although Kosovo is likely to remain euroized, research can still consider alternative policy tools or arrangements. One idea is examining the feasibility of establishing emergency liquidity facilities, perhaps via agreements with the ECB or neighboring central banks, to backstop Kosovo's banks in a crisis. Another is studying the potential for integrating more with regional financial markets (could Kosovo's government or firms borrow in regional capital markets in local currency, or access development bank financing in ways that mitigate the lack of a central bank?). Such forward-looking research would inform policymakers on creative ways to enhance resilience despite monetary constraints.
- **Long-Term Development Trajectories**: Finally, as Kosovo aspires to EU membership and to achieve higher-income status over the coming decades, research could adopt a long-term lens. For instance, using growth accounting or convergence analysis to project Kosovo's path under different scenarios (continued current model vs. successful reform push) would be illuminating. This could tie in non-economic factors like demographics – Kosovo has a

young population – and how education and labor market policies will influence growth. Aligning these projections with the Sustainable Development Goals or the EU's criteria for accession could help identify where Kosovo needs to accelerate progress. Essentially, this line of inquiry ensures that short-term stability is translated into long-term prosperity and inclusiveness.

In conclusion, while this thesis has covered substantial ground in analyzing Kosovo's macroeconomic stability and challenges, these proposed research directions would deepen understanding and support evidence-based policymaking going forward. Kosovo's economic story is still evolving, and ongoing scholarship will be key to navigate the next stages of its development.

Chapter 6: Conclusion and Policy Recommendations

Conclusion

Kosovo's experience over the past two decades offers a compelling case study of a post-conflict economy achieving **macroeconomic stability and moderate growth** through prudent policies and an unusual monetary arrangement. The analysis throughout this thesis demonstrated that **unilateral euroisation** provided a foundation of low inflation and financial stability, which in turn fostered investor confidence and steady economic expansion. Backed by disciplined fiscal management and substantial diaspora inflows, Kosovo managed to avoid the worst outcomes of global crises and steadily improve its standard of living. Real GDP growth averaging around 4% annually, a stable banking sector with high capital buffers, and public debt maintained below 20% of GDP are notable achievements for one of Europe's youngest economies (IMF, 2024; World Bank, 2023). These outcomes validate key policy choices – notably the hard budget constraints and the embrace of the euro – in delivering stability.

However, the thesis also highlighted that **stability has come with enduring structural challenges**. Kosovo's growth model, heavily reliant on consumption financed by remittances and imports, has yielded persistent trade deficits and limited progress in developing a competitive export base. The country remains vulnerable to external conditions, given its dependency on the diaspora and foreign capital. Unemployment and underemployment are still pressing concerns, indicating that growth has not yet been fully inclusive or job-rich. Moreover, the lack of independent monetary policy means Kosovo's toolkit for managing future shocks or overheating is narrower than that of most

countries – a constraint that will persist unless Kosovo eventually integrates into Eurozone institutions.

In summary, **Kosovo's key takeaways** are the following: **(1)** *Euroisation has broadly succeeded* in stabilizing the macroeconomy – delivering low inflation, shielding the financial sector from currency risk, and instilling policy discipline. **(2)** *Prudent fiscal stewardship* has been essential, allowing Kosovo to utilize its limited tools effectively and avoid debt distress. **(3)** *External anchors* (the diaspora and integration with European markets) have been a lifeline for growth and shock absorption, but they also represent potential points of weakness if those external conditions falter. **(4)** *Structural transformation is the unfinished agenda* – to secure long-run prosperity, Kosovo must transition from a consumption-driven, import-dependent model to a more balanced economy with robust domestic production, higher exports, and greater job creation at home. The lessons from the past twenty years underscore that macro-stability, while hard-won and vital, is not an end in itself but a platform from which to advance development.

Ultimately, Kosovo's economic journey reflects a **balance of trade-offs**. The choice to sacrifice monetary sovereignty yielded stability at the cost of flexibility. The decision to maintain strict fiscal discipline ensured solvency but sometimes at the expense of under-investment or insufficient stimulus. These trade-offs have been judiciously managed so far, resulting in a credible record that should serve Kosovo well as it seeks deeper integration into Europe and aspires to raise its citizens' prosperity. Moving forward, the focus must increasingly shift to **leveraging that stability for transformative growth** – meaning structural reforms, institution building, and strategic investments that can broaden the economic base. The conclusions drawn from this thesis reinforce the notion that Kosovo's story is one of resilience and potential: a small economy that has navigated considerable adversity, now standing at a crossroads where wise policy choices can unlock a more dynamic and sustainable future.

Policy Recommendations

Building on the analysis and findings, the following **specific and actionable policy recommendations** are proposed to Kosovo's policymakers:

1. **Maintain Fiscal Prudence and Build Buffers**: Continue to enforce fiscal rules that keep public debt low (well below the 40% of GDP ceiling) and deficits in check during normal

times. Government should **save windfalls and build a stabilization fund** (for example, allocating a portion of revenues or privatization proceeds to a reserve account). This buffer fund can then be drawn on in crises or downturns, providing stimulus without compromising debt sustainability. By institutionalizing *counter-cyclical fiscal saving*, Kosovo will reinforce investor confidence and ensure it has firepower when needed most (IMF, 2024).

2. **Enhance Domestic Revenue and Spending Efficiency**: To create room for development spending within a prudent fiscal envelope, Kosovo should **strengthen tax collection and reduce informality**. Implementing modern tax administration systems, cracking down on evasion, and bringing more of the informal economy into the tax net will increase revenues over time (World Bank, 2023). On the expenditure side, conducting public expenditure reviews to cut waste and improve the efficiency of public investment can ensure each euro spent yields maximum growth impact. Essentially, *spend better, not just more* – prioritize investments in infrastructure, education, and health that boost productive capacity and human capital.

3. **Strengthen Financial Sector Resilience**: While banks are healthy, the CBK and government should not be complacent. **Maintain strict supervisory oversight**, including rigorous stress testing of banks for various shock scenarios (e.g., sudden stops in remittances or FDI). Given the lack of a lender of last resort, it's recommended to **raise banks' required liquidity ratios or capital buffers further** during good times, above Basel minimums, to provide extra safety margins. Additionally, **update the financial crisis contingency plans** regularly: ensure the Deposit Insurance Fund is adequately funded and has arrangements to borrow in extreme cases, and clarify the legal framework for swift bank resolution if a bank were to become insolvent. Engaging in regional cooperation for financial safety (for instance, MoUs with the ECB or neighboring central banks for emergency liquidity lines) could also be pursued as a contingency.

4. **Leverage Diaspora for Investment and Development**: Develop programs that go beyond remittances to actively **mobilize diaspora resources for long-term development**. This could include issuing **"Diaspora Bonds"** – special government bonds targeted at Kosovo citizens abroad, offering a secure investment with patriotism appeal (World Bank, 2017).

The proceeds can fund development projects like renewable energy or technology parks. Also, create a *Diaspora Investment Platform* to match diaspora investors with local start-ups and SMEs, potentially with government or donor guarantees to share risk. By tapping into the diaspora's capital and know-how, Kosovo can transform what is mostly consumption financing into productive investment. Additionally, streamline procedures for diaspora returnees to start businesses or transfer qualifications, to encourage brain gain.

5. **Promote Export Competitiveness and Diversification**: Launch a focused initiative to **boost the tradable sector**. This should be multi-faceted: improve infrastructure critical for exporters (e.g., upgrade logistics, reduce energy outages), provide targeted support or tax breaks for firms in high-potential export industries, and actively court FDI in sectors like manufacturing, agribusiness, and IT/BPO services. The government can establish Export Processing Zones or industrial parks with plug-and-play facilities to attract investors. Further, work with educational institutions to align vocational training with skills needed in manufacturing and services exports, ensuring labor supply meets investor requirements. In agriculture, invest in food processing facilities and certifications to help farmers move up the value chain and access EU markets. In essence, make it a national priority to **reduce the trade deficit** by substituting some imports with local production and capturing even a modest share of international markets with niche products.

6. **Deepen Regional and European Integration**: Continue to actively pursue integration into broader markets and frameworks. Fully implement the Stabilization and Association Agreement reforms to improve the business climate and legal alignment with the EU (European Commission, 2022). Seek closer ties with regional neighbors through initiatives like the Common Regional Market in the Western Balkans – this can expand opportunities for Kosovo's businesses and workers beyond the small domestic market. Moreover, sustain the momentum on the EU candidacy path: even though full Eurozone membership is a longer-term prospect, meeting EU acquis standards in areas like competition policy, state aid, and financial regulation will indirectly boost investor confidence and economic governance. *Integration is also about institutions*: adopt best practices from the EU in public administration and regulatory quality as part of the EU accession reforms, which will create a more predictable environment for economic activity.

7. **Invest in Human Capital and Inclusive Growth**: For development to be sustainable, it must also be inclusive. Kosovo should **invest heavily in education and job creation** to address its high unemployment, especially among youth. Expand active labor market programs, such as skills training, apprenticeships, and job matching services, possibly with donor support, to equip the large young population for the jobs that a diversifying economy will demand. In parallel, improve tertiary education linkages with industry to foster innovation and entrepreneurship (e.g., incubators at universities, partnerships with tech companies). Ensuring that women and minority communities have equal access to these opportunities will enlarge the effective workforce. Over time, a more skilled and inclusive labor force not only drives growth but also makes the economy more flexible and resilient (World Bank, 2023). In concert with this, strengthen social safety nets (like unemployment insurance or cash assistance programs) to protect the vulnerable, so that economic reforms and shocks do not unduly harm those least able to cope. This balanced approach will help maintain social cohesion and public support for the economic strategy.

By implementing these policy recommendations, Kosovo can build on its existing strengths – macroeconomic stability and a supportive diaspora – to address its weaknesses and seize new opportunities. The overarching goal is to **transition from stability to prosperity**: safeguarding the hard-won stability gains while ambitiously pushing for the next stage of development. The recommended actions are interrelated; together, they form a strategy to fortify Kosovo's economic fundamentals, mitigate risks, and create an environment where growth is not only robust, but also sustainable and broadly shared. If pursued with commitment and supported by Kosovo's partners, these policies can help ensure that the next twenty years tell a story of successful development built upon the stable foundations laid in the past twenty.

Appendix

Appendix A: Macroeconomic Indicators

- **Real GDP growth:** Kosovo's economy rebounded strongly after the COVID slump. Growth reached 10.7% in 2021 (following –5.3% in 2020) and stabilized around 4% in 2022–23imf.org (IMF, 2024).
- **Inflation:** Consumer price inflation was generally low (around 2–3% pre-2021) but surged to 11.6% in 2022, before easing to ~4.9% in 2023imf.org (IMF, 2024).
- **Public debt:** Kosovo's public debt remains very low. Debt (including guarantees) was about 17.5% of GDP in 2023imf.org (IMF, 2024), far below typical levels in the region, reflecting conservative fiscal policy.

Appendix B: External Sector

- **Remittances:** Worker remittances are very large by international standards. In 2023 they amounted to roughly 18% of GDPimf.org (IMF, 2024), financing household consumption and helping to offset the trade deficit.
- **Trade and current account:** Kosovo runs a persistent external deficit. In 2023, goods exports were only about 9% of GDP versus imports ~56%imf.org (IMF, 2024), leaving a current account deficit around –7.6% of GDPimf.org.
- **External balance:** These imbalances (large trade and remittance dependence) result in a structural current account deficit on the order of 6–10% of GDP in recent yearsimf.org imf.org (IMF, 2024).

Appendix C: Structural and Labor Indicators

- **Unemployment:** The overall unemployment rate remains high despite recent declines. Official unemployment fell from ~25.7% in 2019 to about 10.9% in 2023imf.org (IMF, 2024). Youth unemployment is especially elevated (on the order of 40–50% in recent years).
- **Informal economy:** A large share of activity is outside the formal sector. The informal sector is estimated to employ roughly 25–40% of Kosovo's workforce documents1.worldbank.org (World Bank, 2023), limiting tax revenues and social protection coverage.

- **Economic structure:** Services dominate GDP (about half of output), while manufacturing/industry is small (~10% or less of GDP)file-ncm71mdjqkpntcrqddwpry (Central Bank of Kosovo, 2016). This concentration implies limited diversification and heavy reliance on imports.

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