GLOBAL FINANCIAL TURMOIL: EXAMINING ITS RISKS AND RIPPLE EFFECT ON FINANCIAL SYSTEMS

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Abstract

Over the past two decades, the global economic landscape has faced substantial turmoil, marked by major events such as the 2007 financial crisis and the ongoing challenges posed by the COVID-19 pandemic. This paper aims to theoretically clarify the consequences of the global financial crisis on the developing economy of Kosovo, with a particular focus on its financial system, and to propose potential future reforms in this sector. Using a comparative analysis of different time periods, specifically examining the financial crisis from 2008 to 2023 in Kosovo, the study reveals that the global economic crisis has significantly impacted Kosovo's economy. This is evident in the pronounced fluctuations in key macroeconomic indicators, including gross domestic product (GDP), trade balance, consumer price index (CPI), unemployment rates, remittances, and foreign direct investment (FDI) during this period. The findings suggest that two fundamental factors — the low level of economic integration and the government's shift in priorities towards capital investments — have mitigated the crisis's impact on Kosovo. The paper also highlights the ongoing challenges of inflation and emphasizes the need for strategies to ensure resilience and sustainable economic prosperity in the future.

Keywords: Global Crisis, Effect, Kosovo Financial System, Financial Indicators

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1. INTRODUCTION

In recent years, the global economic landscape has witnessed substantial upheaval, marked by critical events such as the 2007 financial crisis (Ramosaj, 2010) and the enduring challenges posed by the COVID-19 pandemic. This paper investigates the complex interactions between these crises, with a specific focus on their multifaceted impacts on the Western Balkans region, using Kosovo as a central case study. The 2007 financial crisis, initiated by the "housing bubble" on Wall Street, had far-reaching consequences that altered the economic trajectories of both advanced and developing nations (Tmava et al., 2013). Furthermore, the onset of the COVID-19 pandemic in 2019 introduced an unprecedented array of challenges (International Trade Administration, n.d.; Uvalic, 2003), significantly affecting the socio-economic fabric of the Western Balkans, a region already laden with historical and geopolitical complexities (Gamberoni et al., 2010). This study identifies critical gaps in existing literature, particularly concerning the compounded effects of these global crises on Kosovo's economic trajectory. The research is designed with a dual aim: firstly, to assess the impact of these global economic disruptions on Kosovo's economy by thoroughly analyzing key macroeconomic indicators, and secondly, to explore and document the adaptive strategies employed by Kosovo's financial institutions, focusing particularly on the banking sector and pension funds, in response to these crises. The conceptual framework for this study is grounded in established economic theories and empirical research, guiding the hypotheses to be tested. The first hypothesis posits that the global economic crisis has significantly impacted Kosovo's economy, as evidenced by substantial fluctuations in key macroeconomic indicators such as gross domestic product (GDP), trade balance, consumer price index (CPI), unemployment rates, remittances, and foreign direct investment (FDI) from 2008 to 2023. The second hypothesis suggests that Kosovo's financial sector, particularly its banking and pension systems, has undergone significant transformations as a result of strategic adjustments made during and after the crisis. Through the analysis, the paper aims to enhance the understanding of economic resilience and crisis management in small, emerging economies, with specific reference to Kosovo.

The paper is structured as follows. Section 2 provides a detailed review of relevant literature, identifying research gaps and contextualizing the study within existing theoretical and empirical frameworks. Section 3 outlines the methodology employed in this research, detailing the empirical strategies used to assess the economic impacts of the global crises on Kosovo. Section 4 presents the study's findings, focusing on the resilience of Kosovo's financial institutions and governmental responses to external shocks. Finally, Section 5 offers a conclusion, summarizing the research findings and proposing implications for future economic policy and reforms.

2. LITERATURE REVIEW

The 2007–2008 global financial crisis was a pivotal event in economic history, with its effects felt across the globe, including in the Western Balkans. The crisis, which originated in the United States of America (USA) due to the collapse of the housing market, quickly spread worldwide, leading to widespread economic downturns and financial instability. For the Western Balkans — a region characterized by fragile economic structures and limited integration into global markets — the crisis posed significant challenges. Although the region's financial systems were somewhat insulated from direct exposure to the toxic assets that triggered the crisis, the indirect effects, such as reduced foreign investment and declining remittances, were substantial. By 2009, many countries in the region experienced negative GDP growth, signaling a critical downturn in their economic trajectories (Eid & Khawasek, 2013). Despite these challenges, Kosovo and Albania managed to maintain positive, albeit modest, GDP growth during this period, suggesting a degree of resilience in the face of broader economic disruptions.

In the aftermath of the 2007–2008 crisis, significant disparities in economic performance across the Western Balkans became evident. Tosuni and Misini (2023) conducted an analysis of the economic performance index (EPI) across six Western Balkan countries between 2010 and 2020, revealing notable differences in economic recovery. These disparities were attributed to factors such as differing government policies, population sizes, and macroeconomic conditions. Countries with higher EPI scores experienced increases in private sector wages, while those with larger populations often faced more severe economic challenges. This suggests that while some countries in the region were able to implement effective crisis management strategies, others struggled to maintain economic stability. The evidence from this research highlights the broad impacts of global economic crises on the region's economies, leading to the first hypothesis of this study:

H1: The global economic crises, specifically the 2007–2008 financial crisis and the COVID-19 pandemic, have significantly impacted Kosovo's economy, as reflected in substantial fluctuations in key macroeconomic indicators from 2008 to 2023.

The Stabilization and Association Agreement (SAA), signed by several Western Balkan countries as part of their path toward European Union (EU) integration, has also played a crucial role in shaping the region's economic landscape. Leka and Jusufi (2024) examined the effects of the SAA on trade and economic growth within the Western Balkans, finding that while the agreement was intended to boost trade with the EU, it did not lead to significant export growth. The non-competitiveness of the region's products in the EU market was identified as a key factor limiting the SAA's success in achieving its economic objectives. This highlights the ongoing challenges faced by Western Balkan countries in integrating with larger economic blocs and underscores the need for targeted economic reforms to enhance competitiveness.

The COVID-19 pandemic introduced a new layer of complexity to the economic challenges facing the Western Balkans, exacerbating existing vulnerabilities. Research by Ismajli and Binaku (2023) highlighted the severe impact of the pandemic on the region's labor markets, noting widespread business closures, a sharp rise in unemployment, and a significant increase in informal employment. These findings underscore the region's vulnerability to external shocks and emphasize the need for robust crisis management strategies that can mitigate the long-term effects of such disruptions. In response to these external shocks, Kosovo's financial sector, including its banking and pension systems, has undergone notable changes as part of strategic adjustments aimed at ensuring economic stability. This leads to the second hypothesis of this study:

H2: Kosovo's financial sector, particularly its banking and pension systems, has undergone significant transformations as a result of strategic adjustments made during and after these crises.

The literature reviewed provides a comprehensive understanding of the economic challenges faced by the Western Balkans in the wake of the 2007–2008 financial crisis and the COVID-19 pandemic. The studies highlight the region's economic vulnerabilities, the varied responses of individual countries, and the critical role of international agreements such as the SAA. These insights form the foundation for the hypotheses proposed in this study, focusing on the significant economic impacts and structural transformations in Kosovo's economy from 2008 to 2023.

3. RESEARCH METHODOLOGY

This research utilizes a comprehensive approach to explore the impact of the global financial crisis on Kosovo's economy, with a particular emphasis on its financial system and the identification of necessary reforms. The methodology integrates both qualitative and quantitative data, allowing for a thorough analysis of the economic challenges and responses within Kosovo during this period. The study begins with an extensive literature review that examines the economic conditions of the Western Balkans, particularly Kosovo, during the global financial crisis. This review is critical for contextualizing Kosovo's economic situation within the broader regional framework. By analyzing a variety of academic sources and reports from international institutions such as the World Bank and the International Monetary Fund (IMF), the research identifies key trends and challenges that were specific to the region during and after the crisis. To gather empirical data, the study relies on a detailed analysis of macroeconomic indicators sourced from reputable institutions, including the World Bank, IMF, the Central Bank of the Republic of Kosovo (CBK), and the Ministry of Finance and Economy. The data covers key metrics such as GDP, inflation, unemployment rates, remittances, and FDI from 2008 to 2023. This quantitative analysis is essential for assessing the direct impacts of the financial crisis on Kosovo's economy and understanding the effectiveness of various policy responses.

In addition to the quantitative data, qualitative insights are obtained through interviews with experts familiar with Kosovo's financial sector. These interviews provide valuable context and help interpret the quantitative data within the specific socio-economic environment of Kosovo. The expert opinions enrich the study by offering perspectives that are not always evident in the raw data, particularly regarding the challenges and successes of economic policy during and after the crisis. While the methodology employed in this study is robust and well-suited to achieving its objectives, it also acknowledges the potential benefits of alternative research methods. For instance, employing econometric modeling could provide a more nuanced understanding of the relationships between various economic indicators and the effects of the crisis. Additionally, a comparative analysis with other small, developing economies that experienced similar challenges could offer broader insights into the resilience strategies that could be applied to Kosovo.

4. RESULTS AND DISCUSSION

The analysis reveals significant insights into Kosovo's economic journey from 2008 to 2023, characterized by resilience amidst substantial challenges. Key findings include robust initial GDP growth in 2008 followed by contraction during the global financial crisis, and a severe downturn induced by the COVID-19 pandemic in 2020. Unemployment rates showed gradual improvement over the years, albeit with setbacks during crises. Inflation rates fluctuated, reflecting global and regional economic dynamics. Kosovo's trade balance remained in deficit, underscoring structural challenges in export competitiveness. These results underscore Kosovo's adaptive capacity and the imperative for sustained policy efforts and reforms to bolster economic stability and resilience in a volatile global environment.

4.1. Key macroeconomic trends

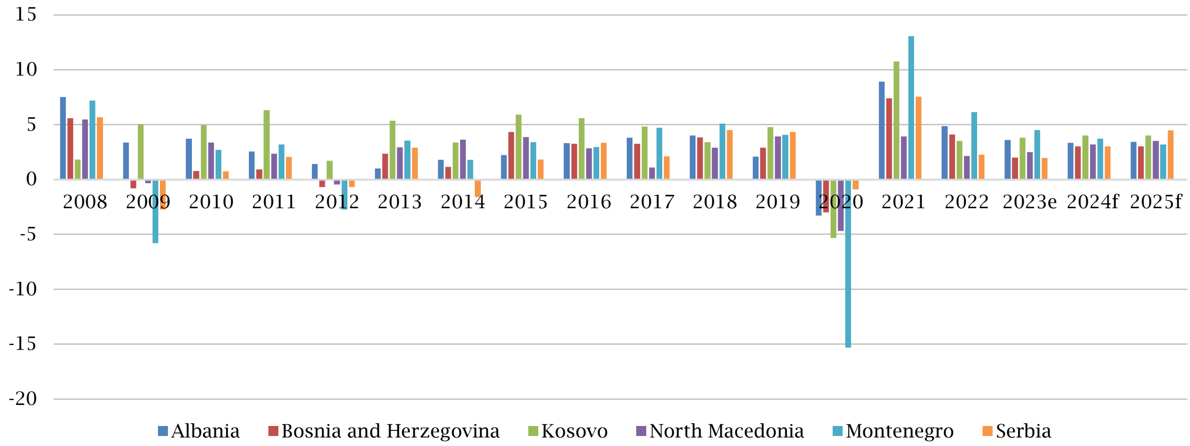
The service industry, a key point in the economic framework of the Western Balkans that contributes 61% to the total GDP, faced unprecedented challenges. The hospitality sector, which includes tourism, banking finance, and industrial services, bore the brunt of the lockdowns, with little recovery in sight. Interventions were proposed for vulnerable communities facing job losses, underscoring the region's commitment to inclusive recovery.

The manufacturing sector, facing supply and demand constraints, witnessed a series of compliance measures, including factory closures. The decline in aggregate demand for manufactured goods further worsened inflation rates, complicating policies aimed at improving production and consumption patterns. The complex network of the supply chain bore the scars of the devastating impact of the pandemic.

The relatively large banking and financial industry in the Western Balkans faced indirect impacts from the pandemic. Governments played a key role in revitalizing fiscal and monetary policies, lowering interest rates for borrowing by individuals and firms. The economic recovery, pegged at 2.5% in 2021, with inflation exceeding the national average, showed the delicate balance required for sustained growth. Additional financing for small and medium-sized enterprises (SMEs), especially in critical areas such as payment of wages to employees, suppliers, taxes, and dividends, underlined the comprehensive approach adopted for recovery.

The insurance industry, an integral part of the financial and banking sector, faced challenges stemming from economic conditions affecting business models. The lack of specific products tailored to address the nuances of the COVID-19 status raised concerns in an industry characterized by a relatively undiversified product range.

Figure 1. Gross domestic product growth (%) for Western Balkan countries during 2008–2025



Note: "e" stands for data that is based on estimates, "f" stands for data that is based on future projections.
Source: IMF (n.d.).

As highlighted in our previous discussion in 2020, the Western Balkans region grappled with economic challenges, as the global repercussions of the COVID-19 pandemic led to negative real GDP growth rates across most countries. Montenegro, in particular, faced a significant contraction, registering a substantial decrease of -15.3%. However, a robust rebound characterized the region in 2021, marked by positive growth rates across all nations. Notably, Montenegro demonstrated a remarkable recovery with a growth rate of 13.0%.

Looking ahead to the period from 2022 to 2025, forecasts indicate a continuation of positive growth for the majority of Western Balkan countries, albeit at varying rates. Montenegro is anticipated to sustain strong growth, and other nations are also expected to undergo economic expansion. The collective economic landscape of the Western Balkans is projected to maintain positivity during this timeframe. It is noteworthy that Kosovo is expected to uphold relatively high growth rates, indicative of economic resilience and developmental potential. Nevertheless, these projections acknowledge the variability among countries, underscoring diverse economic performances within the Western Balkans. While the outlook is optimistic, it remains crucial to consider potential risks and uncertainties. External factors such as global economic conditions, geopolitical events, and public health situations have the potential to influence the accuracy of these forecasts. Therefore, continuous monitoring of these variables is essential for a comprehensive understanding of the economic dynamics in the Western Balkans region.

Shifting the focus to the global economic landscape, the projected outlook anticipates a deceleration in growth, projecting a decline from 3.5% in 2022 to 3.0% in 2023 and further to 2.9% in 2024. These anticipated growth rates fall notably below the historical average of 3.8% observed from 2000 to 2019. Advanced economies are expected to witness a slowdown, transitioning from 2.6% growth in 2022 to 1.5% in 2023 and 1.4% in 2024, driven by the impacts of policy tightening. Conversely, emerging markets and developing economies are forecasted to experience a marginal dip in growth, moving from 4.1% in 2022 to 4.0% in both 2023 and 2024. Projections suggest a gradual decline in global inflation, from 8.7% in 2022 to 6.9% in 2023 and further to 5.8% in 2024, attributed to tighter monetary policy and lower international commodity prices. While core inflation is expected to decrease more gradually, a return to target inflation is not anticipated until 2025 in most scenarios.

Table A.1 (see Appendix) provides a detailed analysis of Kosovo's economic evolution from the onset of the 2008 global financial crisis through the challenges of the COVID-19 pandemic and beyond, up to 2023. During this period marked by significant economic turbulence and external shocks, Kosovo demonstrated resilience and adaptive capacity in facing multifaceted challenges while pursuing sustainable economic development.

As for the GDP growth rate, Kosovo initially showed robust expansion with a GDP growth rate of +6.9% in 2008. However, the global financial crisis led to a contraction of around 4% in 2009–2010. Subsequent years saw modest growth rates of 4.7–4.9% as Kosovo worked towards recovery. The COVID-19 pandemic in 2020 caused a severe contraction of -5.0%, highlighting its profound impact on Kosovo's economy.

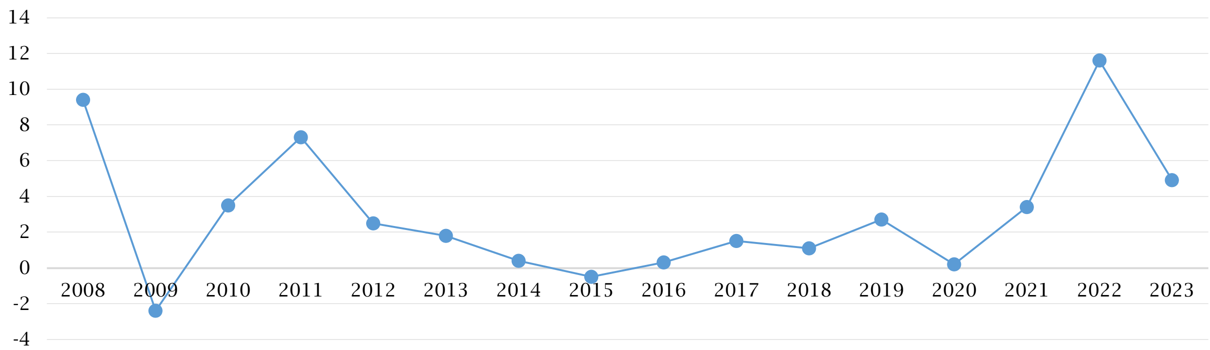
As for the unemployment rate, Kosovo faced high unemployment of 30.9% in 2008, improving gradually in later years. The COVID-19 pandemic reversed this trend, increasing the unemployment rate slightly to 27.8% in 2020.

Kosovo experienced high inflation of 9.4% in 2008, followed by deflation of -2.41% in 2009 due to the global financial crisis. Inflation remained moderate in subsequent years but fluctuated in 2022–2023 due to global commodity prices and regional tensions.

Kosovo struggled with a widening trade deficit of -30.2% of GDP in 2008, exacerbated by the global financial crisis. Efforts to rebalance trade dynamics showed fluctuations, with the deficit standing at -32.0% in 2020.

Overall, Kosovo's economic narrative from 2008 to 2023 illustrates its resilience in navigating challenges while striving for economic development. Despite progress, structural reforms and international cooperation are essential for enhancing economic stability, inclusive growth, and resilience amid ongoing global uncertainties.

Figure 2. Consumer price index (%) fluctuation during 2008–2023



Source: Directorate-General for Economic and Financial Affairs (2023).

Another indicator that reflects the impact of the crisis is the unemployment rate, which was already worrying for the countries of the Western Balkans, especially Kosovo, with an unemployment rate of about 45% of the total labor force in 2010. However, according to data from the IMF (n.d.), the countries of the Western Balkans recorded the highest unemployment rate in 2012, not in 2009, as the euro crisis affected these countries more directly during that period. In 2012, the results of the Kosovo labor force survey conducted by the Kosovo Statistics Agency showed a decrease in the unemployment rate in Kosovo to 36.9%, indicating that Kosovo was less affected by the crisis in comparison with other Balkan countries.

The annual report of the CBK for the year 2008 (CBK, 2008) shows that the incoming flows of remittances in Kosovo constituted about 14% of the country's GDP, while in 2012, remittances constituted about 11.4% of GDP. The decrease in the percentage of the age of remittances in relation to GDP is not significant because approximately 64% of inflows of remittances come from the euro countries, mainly from Germany, which was not severely affected by the crisis. "Impulse models" developed by the IMF (2013) in Country Report No. 223 confirm Kosovo's dependence and vulnerability to developments in the host countries of immigrants. The host countries of the majority of Kosovo emigrants, including Germany, Switzerland, and the United Kingdom, accounted for more than half of remittance transfers to Kosovo in 2011 and contributed to around 40% of total annual FDI inflows since 2007 (IMF, 2013). These countries, especially Germany and Switzerland, were less affected by the crisis, and the decrease in the amount of remittances to Kosovo was insignificant compared to how these remittances were spent. Consumption preferences shifted towards basic goods, resulting in the impact of remittances being felt most by the construction industry and capital investment in general. During periods of crisis, most remittance inflows were spent on basic goods and services, not capital investment.

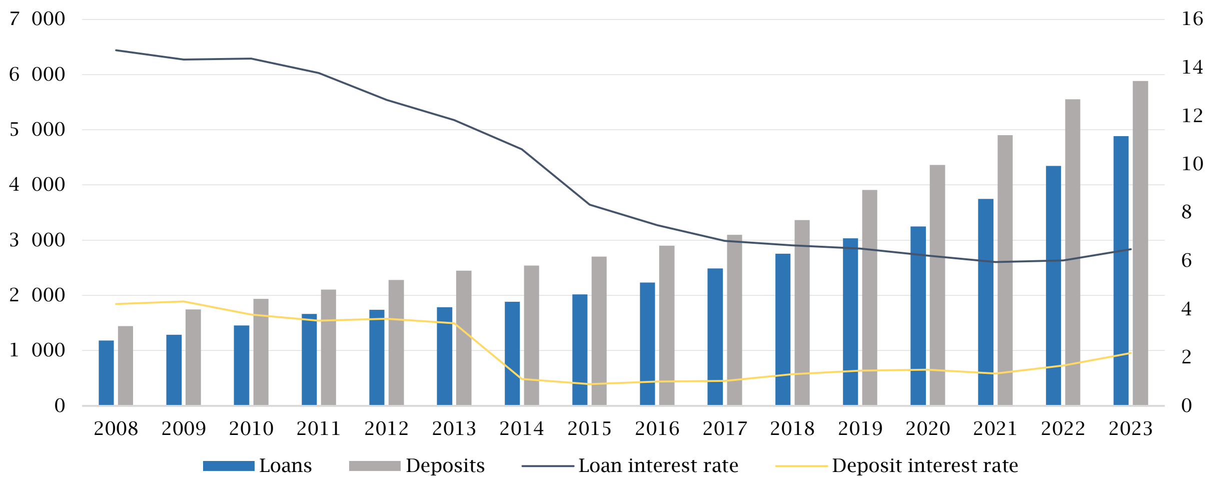
The dropping remittances have also reflected a drop in consumption, especially in capital investments. Meanwhile, Kosovo's economy is significantly dependent on donor funds, which have been drastically reduced during that period. In combination with lower FDI and the structure of the economy, this directly affected the decrease in economic growth and the decrease in economic activity in Kosovo.

4.2. Implications of the global crisis on the financial system of Kosovo

Kosovo's financial sector, which emerged in the early 2000s, remains less developed compared to Western Europe and even neighboring countries. This sector includes banks, microfinance institutions (MFIs), insurance companies, and pension trusts, with the banking sector being the most significant. According to the CBK, the banking sector consists of 20 institutions, nine of which are foreign-owned, and are supported by 215 offices. The sector's robustness is highlighted by its 51.9% concentration rate and 84.3% foreign ownership. With a workforce of over 4,000, it plays a pivotal role in Kosovo's financial system. MFIs and non-bank financial institutions (NBFIs) further enhance financial accessibility, particularly for underserved populations, through 161 offices and a concentration rate of 53.0%. The insurance sector, comprising 12 companies (seven of which are foreign-owned), provides a mix of life and non-life insurance products, with a concentration rate of 36.5%. The pension sector is managed by the Kosovo Pension Saving Trust (KPST) and the Slovenian-Kosovo Pension Fund (SKPF), which collectively manage assets worth over EUR 2.6 billion, primarily invested in foreign markets.

During the global financial crisis of 2008, Kosovo's banking sector largely avoided severe impacts due to its low exposure to high-risk instruments. The sector focused on domestic lending and borrowing, avoiding the international financial market's volatility. Despite ongoing development, the sector continued to offer simple products, minimizing sensitivity to global financial turbulence. However, the crisis did significantly affect the KPST, which saw a 30% decline in the value of its investments in foreign markets. As of 2022, the financial system in Kosovo, particularly the banking sector, continued to demonstrate resilience despite global economic uncertainties, including rising energy prices and inflation due to the Ukrainian war. The sector's reliance on deposits, primarily from households and non-financial corporations, saw steady growth, although at a slower pace than in previous years. Total deposits reached EUR 5.6 billion by the end of 2022, indicating the sector's sustained strength amid global financial challenges. Moving forward, the financial stability of Kosovo will be influenced by ongoing geopolitical tensions, persistent inflation, and further potential monetary tightening within the euro area.

Figure 3. Financial indicators of the Kosovo banking sector for 2008–2023

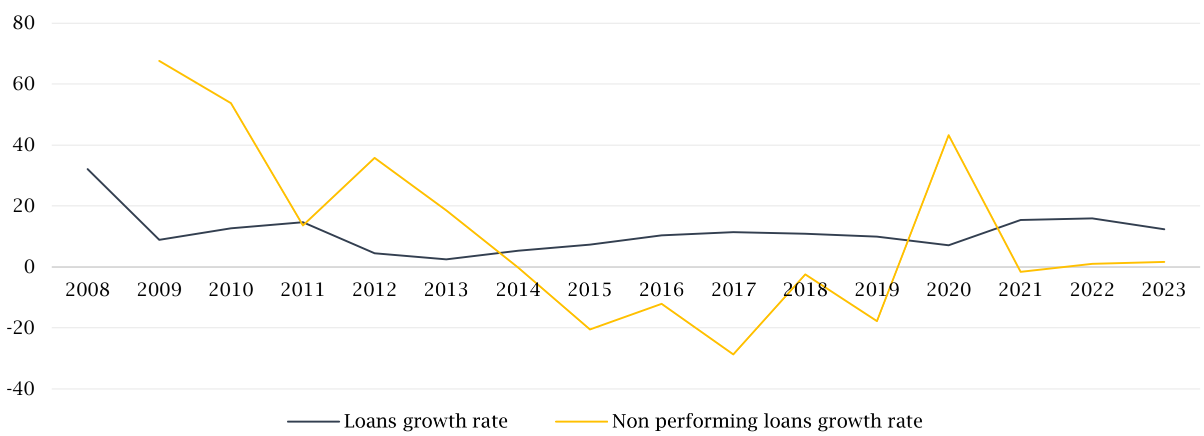


Source: Adapted from CBK annual reports 2008–2023 (https://bqk-kos.org/publications/cbk-annual-report/?lang=en).

The banking sector in Kosovo experienced gradual growth in both loans and deposits after the financial crisis, though at a slower pace. Interest rates fluctuated during this period, initially dropping from 16.1% to 14.11% in 2009, but then rising to 18% in 2010 and 2011, reflecting a shift towards more conservative lending. These higher rates led to a slowdown in lending, particularly affecting SMEs as banks became more cautious with loan approvals, impacting their ability to secure financing for working capital and investments. The crisis also led to a sharp increase in non-performing loans (NPLs), which reached 4.5% of total loans by June 2010. The CBK reported an average annual growth rate of NPLs at 26.8% from 2008 to 2012, outpacing the average credit growth rate of 22%. By June 2011, NPL growth had surged to 30.6%.

Despite these challenges, lending activity showed dynamic growth from 2013 onwards, with 2023 marking the highest growth rate in over a decade. However, this momentum slowed in the latter half of 2023 due to anticipated inflationary pressures and economic uncertainties. The bank credit survey indicated that while credit demand drove lending activity for most of 2022, credit supply tightened towards the end of the year due to a pessimistic economic outlook. The sector's favorable liquidity, competitive pressures, and support from the Kosovo Loan Guarantee Fund helped maintain the loan supply. Business loan demand surged due to the need for inventory financing, working capital, and fixed investments, while individual loan demand was driven by consumption and real estate expenses. However, expectations for 2023 suggest a decrease in loan demand, especially from individuals, due to economic uncertainties, leading to stricter credit analysis and tighter loan supply. New loan growth slowed to 6.5% in 2023, a sharp decline from the 22.9% increase in 2021, particularly in the fourth quarter. On the deposits side, the sector saw a rapid annual growth of 13.3% in 2022, reaching EUR 5.6 billion. Although growth in deposits from individuals and non-financial corporations slowed, substantial increases in deposits from financial corporations, public entities, and non-residents contributed to the overall growth. By the end of 2022, deposits accounted for 82.3% of the banking sector's financing sources (IMF, 2023).

Figure 4. Percentage of growth rates of loans in total and NPL for 2008–2023



Source: Adapted from CBK annual reports 2008–2023 (https://bqk-kos.org/publications/cbk-annual-report/?lang=en).

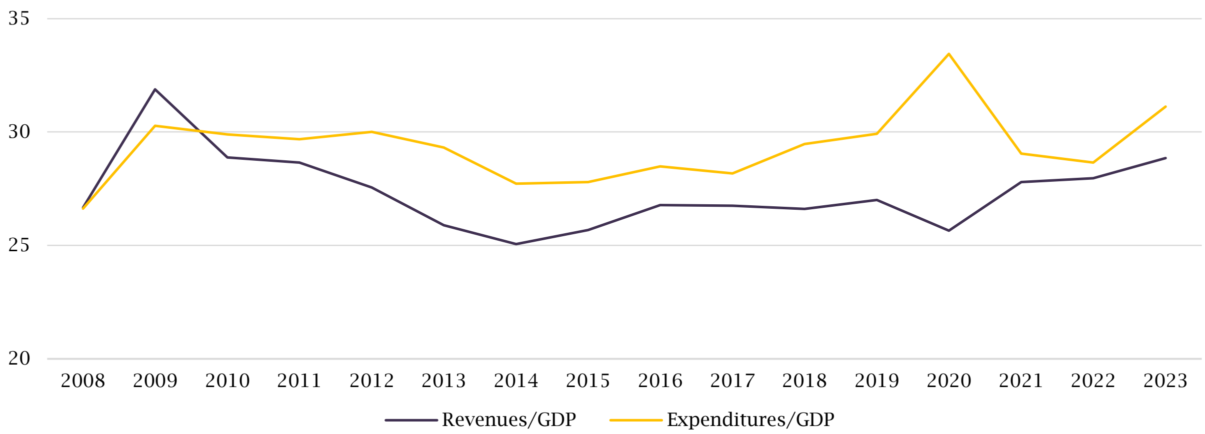
The graph in Figure 4 depicts the growth rates of NPLs, mirroring the growth rate of loans starting in early 2010. This overlap stemmed largely from banks adopting more conservative lending policies, particularly affecting sectors like SMEs, which struggled to secure financing amidst reduced economic activity and demand during the crisis. This trend led to a steady increase in NPLs until June 2013, peaking at 7.8% of the total. The rise in NPLs can be attributed partly to the construction sector, where a downturn in the property market, driven by decreased demand for new apartments, contributed significantly. This decline in demand was linked to reduced purchases by Kosovar immigrants. Additionally, decreased export demand from Kosovo may have impacted the manufacturing sector's ability to repay loans, further contributing to the NPL increase in this area.

Shifting the focus to the banking sector's assets, there was a notable annual increase of 13.5%, reaching EUR 6.76 billion. Credit activity saw its highest annual growth in 11 years, with interbank balances playing a significant role in this acceleration. However, growth in investment in securities slowed to 9.8%, driven by reduced domestic securities investments, while foreign securities surged by 30.6%. Cash and balances with the CBK also saw slower growth, indicating a move towards higher-yield financial instruments amid inflation concerns. Structurally, the banking sector's assets remained relatively stable over the years, except for securities, which began increasing in 2012 following the establishment of an internal securities market. In 2022, investments in Kosovo government securities decreased by 14.9% annually due to reduced supply. Deposits from households and non-financial corporations continued to be the primary source of financing for the banking sector, despite a slowdown in their growth rates. At the end of 2022, deposits constituted 82.3% of the sector's funding sources. Household deposits, the dominant component, grew by 8.3%, down from 14.6% the previous year, potentially influenced by increased consumer spending amid rising prices and wages.

4.3. Government measures and responses to externalities amidst the global crisis

In response to externalities generated by the global crisis, governments worldwide have implemented a range of measures to mitigate the adverse impacts on their economies and societies. These measures typically encompass fiscal, monetary, and social policy interventions. On the fiscal front, governments have introduced stimulus packages to bolster economic activity, support businesses, and protect vulnerable populations. Central banks have deployed monetary tools, such as interest rate adjustments and quantitative easing, to maintain financial stability and ensure liquidity in the markets. Between 2008 and 2013, although the Government of Kosovo implemented market-based policies that included corrective taxes and subsidies to absorb externalities — taxing activities with negative externalities and subsidizing those with positive externalities, as argued by Mankiw (2012) — it did not immediately approve specific fiscal policies either intervene directly to prevent or respond to global crises.

Figure 5. Kosovo budget revenue and budget expenditure 2008–2023



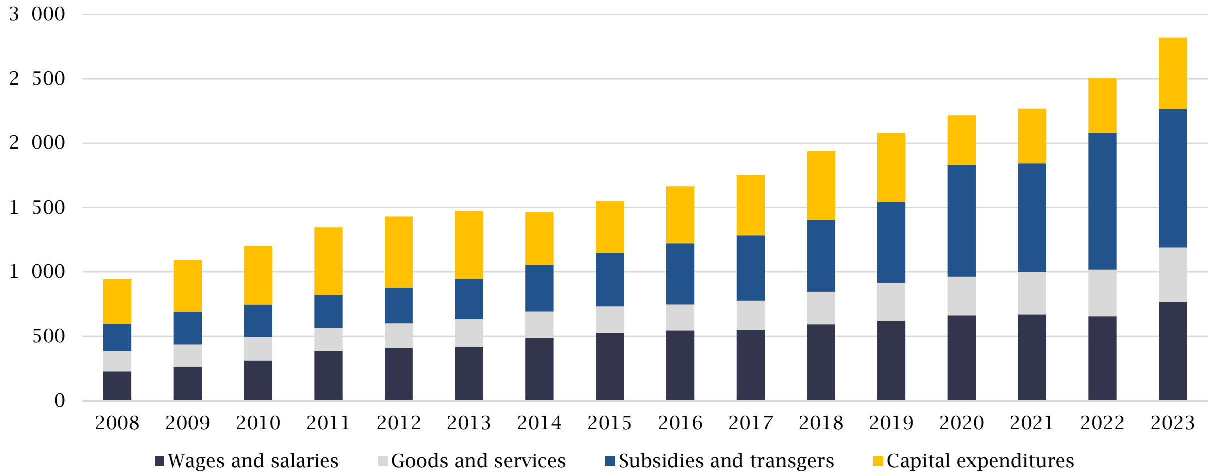
Source: Authors' elaboration.

Examining a nation's budget, encompassing both revenue and expenditure trends is fundamental in comprehending its economic well-being and policy priorities. In the case of Kosovo, a region marked by substantial economic and political transformations, the continuous scrutiny of the budget offers valuable insights into fiscal management, economic development, and governmental priorities. Positive trajectories in budget revenue, represented by an increase from EUR 662 million to EUR 1,411 million over the 2008–2023 period, may signal a burgeoning economy, effective tax policies, and enhanced revenue collection mechanisms. Simultaneously, a meticulous analysis of budgetary expenditure unveils the government's resource allocation strategy, emphasizing pivotal sectors like healthcare, education, infrastructure, and social services.

In evaluating budgetary trends, it is imperative to contextualize within the broader economic and geopolitical landscape. External factors, global economic conditions, and regional stability significantly impact Kosovo's fiscal performance. Furthermore, the assessment should delve into whether the budget aligns with long-term development goals and effectively addresses socio-economic challenges. The government's measured and indirect response was primarily influenced by the relatively minor impact of the crisis on Kosovo's economy, which was overshadowed by persistent internal economic issues in the region. Notably, the newly elected government adopted Keynesian fiscal policies (Schiller, 2008) in 2007, well before the economic crisis hit Kosovo, as depicted in Figure 5. These policies, characterized by substantial investments in public infrastructure, played a pivotal role in maintaining macro-fiscal stability and fostering growth in both revenue and expenditure. This, in turn, significantly influenced overall GDP growth in Kosovo.

Figure 5 illustrates a notable transformation in government spending from 2008 to 2023. Over a five-year period, capital spending surged by 269%, with more than 70% allocated to financing infrastructure development, particularly in roads and education. Expenditure on goods and services rose by 27%, predominantly sourced from local companies. Subsidies and transfers experienced a marked increase of 78%, while wages and allowances witnessed an 83% rise, injecting additional liquidity into the market and influencing consumption positively. Overall, government spending's remarkable increase of 113% from EUR 662 million to EUR 1,411 million made a substantial and impactful contribution to Kosovo's economy and GDP growth.

Figure 6. Government expenditures during 2008–2023



Source: Authors' elaboration.

The sustained increase in budget revenues in Kosovo can be attributed to multiple factors, with the improved performance of collection agencies like the Kosovo Tax Administration (TAK) and customs playing a pivotal role. These agencies enhanced budgetary inflows through significant reforms and the implementation of new information systems, focusing on inclusive fiscal functions to combat the informal economy. Additionally, the government's use of soft loans from the IMF under the Association Stabilization Agreement (IMF, 2020) and the introduction of government treasury bonds as long-term debt instruments in 2012 were crucial contributors. Tax system reforms in 2009 also facilitated annual revenue growth by increasing tax collection. This revenue growth, alongside adequate budget reserves from 2007, new financing sources, and the expanding tax base driven by economic growth, enabled the government to implement fiscal policies that supported economic stability and growth from 2007 to 2012. From 2008 to 2023, government expenditures exhibited dynamic trends and shifts in fiscal priorities. Between 2008 and 2013, spending focused on stabilizing the economy, with emphasis on healthcare, education, and infrastructure, despite the challenges posed by the 2008 global economic crisis. Prudent fiscal measures were prioritized during this period. From 2014 to 2018, there was a notable increase in overall government expenditures, particularly in capital spending on infrastructure projects such as road construction and educational facilities. Expenditure on goods and services also grew, reflecting increased reliance on local companies for public projects. In the most recent period, from 2019 to 2023, government spending continued to rise, with a significant boost in capital expenditures, furthering infrastructure development. There was also continued growth in spending on goods and services, along with a marked increase in subsidies and transfers, indicating greater support for various economic sectors. Throughout this entire period, wages and allowances consistently increased, demonstrating the government's commitment to its workforce. This strategic approach to government expenditures, with investments in infrastructure, support for local businesses, and sustained focus on key sectors, has been instrumental in driving Kosovo's economic growth and development.

4.4. Imperative future reforms for the financial sector in the aftermath of the global crisis

Kosovo's banking sector has largely avoided severe impacts from global crises, primarily due to its limited exposure to external borrowing and low financial integration, which insulated it from significant financial outflows. However, the sector still faces challenges that require strategic reforms to enhance its resilience and support economic development. One major issue is the high concentration within the banking sector, where about 80% of assets are controlled by three large banks, despite the presence of nine banks overall. Although new mergers have emerged since 2012, reducing this concentration slightly, the dominance of these few banks has led to uncompetitive interest rates. This situation is exacerbated by limited competition and potential collusion among key industry players, which restricts the availability of competitive banking products. Another concern is the high level of foreign ownership in the sector, particularly in the three largest commercial banks, which are entirely foreign-owned. This reliance on foreign ownership introduces vulnerabilities, as economic crises abroad could potentially transmit adverse effects to Kosovo's financial system. Therefore, it is crucial to reassess the ownership structure to ensure greater stability. Additionally, the ratio of banks' assets and liabilities to GDP — an indicator of financial integration — is relatively low in Kosovo compared to the Southeast European average. While this low integration has shielded Kosovo from the worst effects of global financial turbulence, it also hinders economic development. Increasing financial integration is essential for fostering growth, as seen in other underdeveloped regions. Developing Kosovo's financial market, particularly by promoting investments in securities, would be a key step in enhancing financial integration. This would enable companies, governments, and other organizations to raise long-term funds, driving economic growth. The pension fund sector, a vital part of Kosovo's financial system, also requires attention. Investing or depositing pension assets within Kosovo's economy, as opposed to foreign markets, could be safer and more profitable. This approach would reduce exposure to global financial crises, increase the inflow of capital into the local economy, and ultimately lower interest rates. The KPST has already begun this practice, gradually depositing funds in domestic banks since 2010, which could serve as a model for future strategies. While Kosovo's financial sector has demonstrated resilience, especially in the banking sector, future reforms should focus on reducing concentration, reassessing foreign ownership, and enhancing financial integration to foster sustainable economic growth and stability.

5. CONCLUSION

This paper has provided a comprehensive analysis of the impacts of the global financial crisis and the subsequent COVID-19 pandemic on Kosovo's economy, with a specific focus on the financial system and key macroeconomic indicators. The global financial crisis, originating in the USA in 2007, disrupted Kosovo's economic trajectory, albeit with a delayed transmission compared to more integrated European economies. This disruption was reflected in reduced private sector investment, consumption, and trade volumes, as well as declines in essential economic indicators such as GDP growth, remittances, FDI, and corporate lending. The analysis revealed that Kosovo's financial system, despite its relative isolation from global financial markets, faced vulnerabilities that were exacerbated by the crisis. The banking sector, however, managed to maintain stability through prudent risk management practices and conservative credit policies, although challenges such as increased NPLs highlighted the need for ongoing vigilance and strategic reforms. The COVID-19 pandemic further compounded the economic difficulties in Kosovo, leading to widespread job losses and disruptions across various sectors, including mining, manufacturing, and agriculture. Government interventions, including fiscal support measures, played a crucial role in mitigating some of the immediate socio-economic impacts, supporting household consumption, and maintaining a degree of economic stability amidst global uncertainties.

Based on the findings of this study, several recommendations are proposed to enhance Kosovo's economic resilience and stability. These include prioritizing deeper integration into global and regional economic frameworks, strengthening the resilience of the financial sector through improved risk management practices, and promoting sustainable economic policies that support long-term growth, innovation, and competitiveness. Additionally, addressing the issue of NPLs through effective strategies such as loan restructuring and credit risk management improvements is critical for maintaining financial stability. Investing in digital infrastructure to enhance the efficiency of financial services and promote financial inclusion is also essential for fostering economic development in the digital age. Furthermore, aligning Kosovo's economic development strategies with sustainable development goals (SDGs) will promote environmental sustainability and social inclusivity, ensuring that economic growth benefits all segments of society.

Finally, continuous monitoring of global economic trends and enhancing crisis preparedness through robust institutional frameworks will be vital in safeguarding Kosovo's economy against future shocks. Implementing these recommendations will support Kosovo in building a resilient and sustainable economic future, fostering prosperity and stability for its citizens and businesses. The findings of this study underscore the importance of enhancing Kosovo's economic integration and resilience to external shocks. Future research should focus on specific sectors and policies that can bolster economic stability and growth. Addressing NPLs, promoting digitalization in financial services, and aligning economic policies with SDGs are critical areas for future exploration. Additionally, understanding the socio-economic impacts of crises on vulnerable populations and enhancing crisis preparedness measures should be prioritized to ensure a more comprehensive approach to economic resilience.

While this study offers important insights into the economic impacts of the global financial crisis and the COVID-19 pandemic on Kosovo, several limitations should be recognized. One significant challenge is the lack of detailed and comprehensive studies that could serve as a robust foundation for analysis. Additionally, the data gathered for this research are often dispersed across various institutions, making it difficult to access and compile in a centralized manner. This fragmentation of data, combined with the limited time available for data collection and analysis, further constrains the study. Future research could address these limitations by seeking out more cohesive and detailed datasets, which would allow for a more thorough and nuanced exploration of Kosovo's economic resilience and recovery.

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APPENDIX

Table A.1. Kosovo's main economic indicators 2008–2023

Indicators	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*	*2016*	*2017*	*2018*	*2019*	*2020*	*2021*	*2022*	*2023*
GDP (M EUR)	4,1610.00	4,370.00	4,586.00	4,876.00	4,959.00	5,224.00	5,399.00	5,719.00	6,037.00	6,329.00	6,544.00	6,855.00	6,489.00	7,187.00	7,439.00	7,722.00
GDP (in %)	1.8	5	4.9	6.3	1.7	5.3	3.3	5.9	5.6	4.8	3.4	4.8	-5.3	10.7	3.5	3.8
CPI, period average (in %)	9.3	-2.4	3.5	7.3	2.5	1.8	0.4	-0.5	0.2	1.5	1.1	2.7	0.2	3.3	11.7	4.7
Revenues, incl. int. in % of GDP	26.7	31.9	28.9	28.6	27.6	25.9	25.1	25.7	26.8	26.7	26.6	27	25.6	27.8	28	28.9
Primary expenditures in % of GDP	26.6	30.3	29.9	29.7	30	29.3	27.7	27.8	28.5	28.2	29.5	29.9	33.5	29	28.6	31.1
The overall balance in % of GDP	0.4	-1.1	-2.8	-1.6	-2.6	-2.8	-2.7	-1.9	-1.4	-1.2	-2.9	-2.9	-7.6	-1.2	-0.5	-0.2
Exports (M EUR)	608.1	694.2	873.5	1,136.80	1,176.40	1,166.60	1,252.80	1,274.00	1,438.50	1,737.10	1,938.30	2,068.30	1,470.00	2,658.70	3,436.00	3,321.40
Goods (M EUR)	211.3	172.5	299.2	316.5	281.9	291.5	324.3	322.5	307.9	378.4	376.7	393.2	475.1	752.7	931.5	726.9
Services (M EUR)	396.9	521.7	574.3	820.3	894.5	875.1	928.6	951.5	1,130.60	1,358.80	1,561.60	1,675.10	994.9	1,906.00	2,504.50	2,594.60
Imports (M EUR)	2,106.30	2,113.10	2,439.10	2,788.20	2,726.90	2,642.10	2,851.50	2,926.20	3,090.60	3,374.10	3,820.20	3,982.60	3,651.60	5,190.90	6,350.30	5,539.80
Goods (M EUR)	1,856.00	1,818.80	2,040.80	2,363.70	2,332.00	2,287.00	2,382.90	2,431.80	2,598.70	2,842.60	3,114.50	3,233.50	3,048.30	4,319.70	5,218.70	4,423.80
Services (M EUR)	250.3	294.3	398.3	424.5	394.8	355.1	468.7	494.4	491.8	531.5	705.8	749.1	603.3	871.1	1,131.60	1,115.90
Trade balance (M EUR)	-1,644.70	-1,646.30	-1,741.60	-2,047.10	-2,050.10	-1,995.60	-2,058.60	-2,109.30	-2,290.80	-2,464.20	-2,737.70	-2,840.20	-2,573.20	-3,567.00	-4,287.20	-3,697.00
FDI, net (M EUR)	369.9	287.4	368.5	384.4	229.1	280.2	151.2	308.8	220	255.4	272.1	254.6	345.7	420.7	732	700.6
C/A balance (% of GDP)	-13	-10.4	-12.8	-13.4	-6.1	-3.5	-7.2	-8.8	-8	-5.5	-7.6	-5.7	-7	-8.7	-10.5	-8.1
Worker remittances (M EUR)	608.7	585.7	584.3	492.5	516.4	573.4	622.3	665.5	691	759.2	800.6	851.5	980	1,153.40	1,222.80	1,119.70
Official transfers (M EUR)	223.5	322.9	319.5	322.2	401.6	369.7	291.9	202.9	207.2	199.7	226.1	236.6	276.6	233.6	295.8	217.5

Source: IMF (n.d.).