



USAID
FROM THE AMERICAN PEOPLE

KOSOVO
CLUSTER AND BUSINESS SUPPORT PROJECT

Constraint Study

Contract #AFP-I-00-03-00030-00, TO# 800

Submitted to:
USAID/Kosovo
Cognizant Technical Officer: Timothy Hammann

Prepared by:
Richard O'Sullivan

Submitted by:
Chemonics International Inc.

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I. EXECUTIVE SUMMARY

The Goal

The purpose of this report is to serve as the foundation for a public-private dialog on crucial issues

No Shortage of Issues

The biggest problem faced by the Constraint Study team was not finding problems but narrowing the field. Also, we found that in the absence of hard macro- and microeconomic data, it was all but impossible to determine quantitatively which constraints had the most severe impact. Therefore, in many cases we were unable to separate fact from opinion. We noted in this report when we were depending on a professional's opinion or conventional wisdom.

The Criteria for Targeting

Therefore to narrow the scope of a public-private dialog and provide some focus for policymakers, we selected five criteria by which a constraint was targeted:

1. It was deemed to have significant impact on business formation or expansion;
2. In the spirit of the Bulldozer model, it lent itself to practical resolutions that could be enacted within nine months;
3. It could be addressed directly by the business community with little or no dependence on governmental action;
4. Extensive additional funding was not required for practical resolution; and
5. Potential solutions were not in conflict with the Kosovar political environment.

The Top Five

Given those selection criteria, the Constraint Study team identified five key targets:

1. A lack of clear and protected product standards
2. Inadequate access to financing
3. Tax and trade policies inconsistent with development objectives
4. Common lack of experience and practical know-how
5. Weak business and professional associations

All of these can be addressed, at least in part, in a short period of time, without major expenditures or government involvement. In fact, most of the policies needed to effect positive changes in these areas require a scaling back of government activity.

The Cutting Room Floor

These, of course, were not the only constraints we studied. Several were studied in detail, yet did not meet the criteria listed above. This in no way is intended to minimize their importance or economic impact.

Of these we found eight that were important enough to include in this report anyway:

1. Inadequate physical infrastructure, especially power supply
2. Corruption, crime, and law enforcement
3. Legal/Justice system/courts/enforcement of judgments
4. Grey economy impact
5. Internal issues affecting business cooperation/competition
6. Weak professional infrastructure and limited management experience
7. Halted Privatization of Land/Uncertain Land Titles
8. Legal/Government/Final Status Uncertainty

Conclusions and Recommendations

Kosovo is struggling not only with a socialist past but also with continued ethnic stress from the civil war. The civil conflict of the 1990s has put Kosovo at a distinct disadvantage compared to most other European post-communist societies. Its condition today can best (and perhaps optimistically) be described as the twilight between its socialist past and its democratic future.

Trying to catch up quickly to the other transitional economies, particularly its neighbors and trading partners in Southeastern Europe, Kosovo is moving to develop more market-friendly institutions, practices, and infrastructure at a pace that may be faster than the society and its institutions can absorb. Leaders seem to know what needs to be done but often are not sure why. Associations and standards development are two of the five targeted constraints where this observation is most obvious. Without strong traditions of pluralistic, transparent decision-making and with a history of government directed fiat in most major business decisions, private sector and nonprofit sector led development is virtually unknown. Kosovar business and government leaders, in many cases, seem to be acting on donor advice more on faith than on conviction. Consequently there is no strong local commitment for many of the reforms enacted and institutions created to date. Nor is there native experience as to how to manage, lead, and capitalize on these institutions.

We also discovered that in some respects the very donors trying to help address these problems are often creating new problems and constraints in the process. Donor supported associations and business services have in many ways compromised their development by making the donors the largest economic player in the market. Efforts must be taken by donors to shift from directly providing these services to working through local organizations and businesses.

As a result, the recommendations proposed in this report focus on

- Consolidating the gains to date,
- Strengthening and, in some cases, reforming the organizations and institutions developed in the past 10 years,
- Rationalize and develop objectives and institutions by increasing coordination among local and international agencies,
- Switch to more long-term sustainability of existing institutions and away from immediate short-term institutional development.

II. BACKGROUND AND METHODOLOGY

The Kosovo Cluster & Business Support Project (KCBS) undertook an assessment of constraints to business formation and growth in the three business sectors that KCBS serves:

1. Livestock including dairy, beef, poultry and animal feed
2. Fruits and vegetables
3. Construction materials

These clusters were chosen in large part because there is a significant domestic demand for their products; there appear to be excellent opportunities for import substitution; and because USAID already has had some successful experience in working with farms and firms in these clusters and have identified interest and potential leadership in the clusters. UNMIK has identified the “unsustainably” high trade deficit as the single most significant threat to long-term economic stability in Kosovo. The challenge to the Kosovar economy is to create and expand domestic capacities to serve domestic demand so as to reduce its reliance on foreign suppliers.

This goal, however, has been undermined by multiple constraints to business formation and expansion. These constraints range from such seemingly mundane issues such as lack of accurate and timely economic statistics to the Damoclean Sword of “Final Status.” Some of these constraints could be addressed quickly and simply. Others may never be addressed at all. The purpose of this study was not to speak to ALL of the constraints but to identify and focus only on those constraints that threaten KCBS’ goals of increasing sales and employment in its targeted sectors. Therefore, USAID recommended that the Constraint Study team limit its focus on those constraints that affected businesses in those three clusters that can be addressed within the life of the project.

USAID anticipated that this study would serve as the foundation for a public-private dialogue, similar to the Bulldozer project in Bosnia, through which both business and government representatives can agreed upon and immediately implemented near-term strategies to eliminate or dull significant constraints to business formation and expansion. In the Bulldozer project, the prime minister set a goal for task groups of 50 constraints in 150 days.

To that end, the task of the Study was first to identify and review all of the many significant constraints to investment and growth which exist in those areas, and then to select as “targets” a limited number which are both very serious and can be affected by actions that KCBS can initiate immediately. A constraint was “targeted” if:

1. It was deemed to have significant impact on business formation or expansion;
2. In the spirit of the Bulldozer model, it lent itself to practical resolutions that could be enacted within nine months;
3. It could be addressed directly by the business community with little or no dependence on governmental action;
4. Extensive additional funding was not required for practical resolution; and
5. Potential solutions were not in conflict with the Kosovar political environment.

Methodology

The Constraint Study was carried out from February 7 through March 7 under the direction of Richard O’Sullivan, KCBS’ Senior Competitiveness Advisor. The Study team included two expatriate consultants from Crimson Capital working closely with senior KCBS personnel and Integra Consulting & Services, with the invaluable assistance of the entire KCBS staff and local government and private-sector counterparts.

The principal team members were:

| | |
|--|-----------------------------|
| Richard O’Sullivan, KCBS | Project Manager |
| Tom Jersild, Crimson Capital | Team Leader |
| Safo Musta, KCBS | Project Coordinator |
| Art Dimas, Crimson Capital | Financial Market Specialist |
| Avdullah Hoti, Integra Consulting & Services | Public Policy Economist |

The work itself had two parts. First, the team reviewed already-existing studies of the Kosovo business environment as well as relevant laws, regulations and related literature. Extensive research to make this possible was provided by the Integra team. Integra found that the Kosovo business environment has been the subject of literally scores of prior studies on business constraints. A copy of Integra’s complete report appears as Appendix A and a complete list of business constraint and business environment studies identified by this project is in Appendix B. That fact alone both supported our decision not to undertake extensive original research on the *causes* of business constraints and provided the team a head start in selecting and concentrating on the particular constraints most important to the KCBS clusters that met the criteria listed above. The team was able to focus on the *prescriptive solutions*.

In addition to this secondary research, the team interviewed numerous government officials, regulators, private businesspeople, association and industry representatives, donor representatives, lawyers and other local stakeholders and experts to gain perspective regarding various constraints and to assess their relevance and impact on business formation and expansion. All of those persons, including the government authorities, were generous with their time and lent full support to the Study effort. To assure confidentiality and candor, we did not identify by name the individuals interviewed in this report.

On February 22, 2005, upon completing the research and interviews, the Constraint Study Team presented its preliminary conclusions to a meeting at the USAID mission in Pristina to key industry and trade association persons who we anticipate will participate in the public-private dialogue. Many helpful reactions and comments were received at that meeting which aided in the preparation of the final report.

III. OVERVIEW OF THE CONSTRAINTS

When the Constraint Study began it immediately became apparent that the constraints of concern in the KCBS sectors are crosscutting and interdependent. They can be listed separately but, as they feed upon each other, none can be understood in isolation. As only one example, one of the selected “target” constraints, the absence of industry product standards, is aggravated by weak enforcement of intellectual property rights, dysfunctional business associations, and poor intra-industry collaboration, all constraints in their own right. Similarly, limited access to financing, another target constraint, is exacerbated by another constraint, the legal delays and difficulties in enforcing collateral rights.

This, of course, leads one to assess a possible hierarchy of constraints in which some constraints are the by-products of others. The Constraint Study team has concluded that low participation in the formal economy, which is perceived to be a constraint for legitimate businesses who, by paying taxes, face higher operating costs, is largely a symptom of other constraints such as limited access to credit, poor standards development, dysfunctional courts, inadequate public services and infrastructure, and irrational/contradictory fiscal policies. By addressing these other constraints the benefits to participation in the formal economy will become more pronounced and obvious, and firms will migrate out of the grey economy. Similarly limited access to credit is, in part, a function of low judicial capacity. To increase access to credit, Kosovo must streamline civil procedures, better train judges and other court officers, and reduce caseloads by introducing non-judicial redress.

Before addressing the target constraints, therefore, it will be useful to have an overview of all the major constraints that the Study team found to be of concern. It should be noted that most of these constraints affect other business sectors as well as the KCBS sectors. Most do not lend themselves to change through short-term actions by KCBS or other donor organizations. Nevertheless, they must be considered together for a full understanding of the obstacles with which the KCBS clusters must deal. One should not conclude that the Constraint Study Team excluded the constraints below from our targeted list because we believed them to be of less severity to the economy or less important to the business community. They were not included because we did not perceive that they met the five criteria selected to be appropriate for the public-private dialog.

Identified constraints that were not included in our recommended targeted list are:

- Inadequate physical infrastructure, especially power supply
- Corruption, crime, and law enforcement
- Legal/Justice system/courts/enforcement of judgments
- Grey economy impact
- Internal issues affecting business cooperation/competition
- Weak professional infrastructure and limited management experience
- Halted Privatization of Land/Uncertain Land Titles
- Legal/Government/Final Status Uncertainty

1. Inadequate electric power supply. Almost every person interviewed complained of frequent power outages, which may well be the single most severe constraint to business

growth in Kosovo. It seems clear that this problem is worse in Kosovo than in any of the neighboring countries. It affects all businesses, not only those in the KCBS clusters, by increasing cost, cutting production and in general reducing the competitiveness of Kosovo enterprise.

Kosovo faces a structural power deficit due to former mismanagement of the power grid and extraordinary post-war increases in demand. The Kosovo Electricity Corporation (KEK), a publicly owned enterprise (POE), has only two power stations and only one is running at close to capacity. The other requires an extensive overhaul and upgrading of equipment to effectively meet demand. German efforts to improve capacity at that power station using second-hand equipment proved most inadequate. Therefore, in the short-run KEK must import electricity. Given the inefficiency of importation, this is an extremely expensive source of power. Consequently, the cost of electricity in Kosovo is among the highest in the Balkans seriously undercutting its competitiveness for foreign direct investment.

This problem is made worse by a combination of:

- Widespread theft of power (by some estimates as much as 50 percent of electrical power consumption is illegally siphoned off the system),
- Non-payment of electric bills of those who do obtain power legitimately,
- Poor enforcement and collection (indeed, the courts are so clogged with slow-moving electric bill collection cases that this itself is a major constraint to the justice system).

These in turn drive up the prices for those who do pay and they are few and far between. In 2003, only 23 percent of receivables were collected. KEK, which came under new private management by ESBI Consultants in June 2004, estimates that owing to more aggressive collection from large firms and disconnects of whole neighborhoods where power is being siphoned off the grid, that figure may have reached 30 percent in 2004. Given that these figures exclude stolen power, the actual percentage of electricity that is actually paid for is probably closer to 10 percent in 2003 and less than 20 percent in 2004.

In the second of a three-phase strategy to address the power deficit KEK published a Financial Recovery Plan in February 2005 intended to more than double its collected receivables to 65 percent in two years. The first phase focused on reducing power outages and achieve consistent, if not constant, power. The goal of phase one was “5/1” for five hours on and one hour off on a rotating schedule across the energy grid. That has been achieved. KEK believes that now with normalized service it can justifiably become more aggressive in its collection efforts. With phase two, it will more aggressively pursue both non-payments and theft. It will publish the names of firms in default. It has also targeted 4,000 disconnects a week for April, May, and June. In addition, KEK is proposing that a special court, similar to a small claims or traffic court, be established to process the huge backlog of default claims. There are only eight laws that govern nonpayment of utilities. KEK proposes to train court officers to specialize in these and process the claims expeditiously. As noted earlier, this solution would also help to address problems of access to credit by freeing up the courts to enforce lending contracts and reduce risks to banks and non-depository financial lenders.

KEK also plans to raise revenue by selling off many of KEK's extensive holdings unrelated to energy such as scrap metal processing.

KEK must increase revenues and liquid assets to acquire the capital needed for Phase Three, overhauling the second power station. As KEK is under the auspices of the Kosovo Trust Agency, it cannot borrow against real estate or other fixed assets. Therefore it must have a steady stream of revenue against which it can borrow. By upgrading the station, KEK will finally be able to eliminate energy imports and reduce the price.

The major problem with this strategy is that nonpayment of utility bills has become laced with political motives and incentives. Delinquent Albanian Kosovars defend their non-payment on the belief that non-payment in the Serbian enclaves goes unpunished. Small firms refuse to pay because they believe large firms do not pay. And large firms who refuse to pay claim that because no one else pays their bills, they are being overcharged. In this way theft of electrical power has essentially become institutionalized and will require years of draconian enforcement by KEK, major court reform, and a massive public education program to reverse the process. While the authors of this study endorse and encourage these actions, we do not believe that they will yield measurable results in the next six to nine months.

While electric power was the most-mentioned physical constraint, several interviewees also stated that their business was hurt by the inadequate state of the road system and difficulties in obtaining sufficient water. In the latter case, again we see blatant refusal to abide by rule of law is a factor as fresh water supplies are often contaminated by reckless and illegal actions by manufacturers and agribusinesses.

Corruption, crime and inconsistent law enforcement. Corruption was mentioned in almost every interview and is universally acknowledged to exist, although many interviewees made the point that they had never made any improper payments or personally witnessed them. One of the few specific cases cited as "seen" was bribe-taking by customs and tax officials at the border with Serbia, where (it is said) many or even most trucks crossing the border get special treatment on customs and VAT assessment and the border officials "look at the sky" when trucks cross. Again, practitioners and even some members of the general public rationalize, on political grounds, these behaviors by those who continue to harbor ethnic animosities on both sides.

Cases were also cited in which government tenders for building and road projects mysteriously went to builders who had no construction experience but were well connected. Corruption was also mentioned at the municipal level in connection with licenses and permits that are granted under local rules that are not always clear and often vary from town to town.

Some persons stated that favors or special relationships have been required for judges to decide cases promptly or to decide them at all. One person mentioned that the UNMIK border officials are often active in Kosovo politics and that an importer's domestic political affiliation can make a big difference in waiting lines and tax assessments at the border.

The issue of government corruption clearly has a place in the public-private dialog and the Constraint Study Team strongly urges the Prime Minister to form a Task Group to address this significant structural issue. However, we see no resolution that would benefit the business community in the next six months.

A related issue is crime. Cases were cited of common crime but also, in some cases, business crime such as window-breaking and property destruction at the behest of business competitors or by organized crime. Indeed, crime could be listed as a separate constraint in itself but, as with corruption, there was no practical way to quantify it in the interviews.

Inefficient court and commercial dispute resolution system. Surprisingly none of the interviewed businesspeople reported having been in a business lawsuit, although an efficient dispute resolution system is absolutely essential for investment and growth. Some interviewees did state that they would not look to the courts in a dispute and there was much anecdotal reference to delay, favors and “connections” when courts were being discussed, but the only first-hand criticism of the courts was in connection with the well-known difficulty of enforcing liens (discussed further below).

It is generally acknowledged that the Kosovo court system, which is largely governed by pre-1989 Yugoslav laws and is largely unchanged from former Yugoslav times, is slow to act and inefficient and badly needs reorganization. Recognizing this, the SRSG initiated a major study of the court system in 2002 that led to a set of highly detailed recommendations for reorganization sponsored by the Council of Europe and the US Department of Justice published in late 2004. (The complex system consists of 24 Municipal Courts, which handle a list of specific types of cases including cases involving property issues, leases, execution of judgments, and other business and non-business issues; five regional District Courts, which hear appeals from the municipal courts; one District Court in Pristina which is also a specially-designated “commercial court” which hears first-instance business cases in which all of the parties are registered business companies; and a Supreme Court which hears appeals from the District Courts including the specially-designated commercial court. The Council of Europe/DOJ report recommended that the separate commercial court be abolished, but a later 2004 report sponsored by USAID disagreed with this and recommended that the commercial court should be retained as a specialized business court and its jurisdiction should be expanded.¹)

¹ Actually the court system is still more complicated than stated above. The courts “as such” are enshrined as one of the four Kosovo PISGs (i.e., Provisional Institutions of Self-Government) in the 2001 Kosovo Constitutional Framework (the Constitutional Framework for Provisional Self-Government in Kosovo, UNMIK Regulation 2001/9). The other three PISGs are the Kosovo Assembly, the President and the Government. The Constitutional Framework gives the SRSG (the Special Representative of the UN Secretary General) the power to appoint judges from candidates proposed by the Kosovo Judicial and Prosecutorial Council (the KJPC) and endorsed by the Assembly, and states that decisions on promotion, transfer and dismissal of judges are to be made by the SRSG on recommendations by the KJPC. The Constitutional Framework also creates a “Special Chamber of the Supreme Court” with the job of deciding constitutional issues; this chamber is staffed by international judges, many from the US.

Beneath all this, the court system is as described in the text above and is governed by pre-1989 Yugoslav laws which were preserved in effect by UN Regulations 1999/24 and 2000/50

While its final form may still be debated, reorganization of the court system is impending and is a major subject of discussion within UNMIK and the PISG. For purposes of this Study the overly complex and docket-clogged system must be listed among the constraints to business investment and growth. However, aside from some remedial actions such as the creation of the utility court mentioned above or a small claims court that would offer some relief to businesses looking for civil redress, this problem clearly does not fit into the six to nine month range.

The problem is compounded because there is not an effective alternative dispute resolution (ADR) system in Kosovo such as arbitration or mediation.

The grey economy. The persistence of a grey economy results from several realities in Kosovo. While its actual size is, by definition, unknown, estimates as high as half of economic activity seem quite credible. There are even a large number of significant-sized Kosovo businesses that are not registered as companies at all (i.e. not registered as a partnership, limited liability company or joint stock company), demonstrating that there is at least tacit acceptance, if not approval, of these practices by government officials. The continued existence of grey economy can be accredited to the simple fact that, for many, there seems nothing to gain and much to lose by registering. Many of the incentives for registering a business elsewhere do not exist in Kosovo. Limiting personal liability for business owners through incorporation is not needed because there is little practical danger of lawsuits (see Commercial Dispute Resolution above). While banks insist that they lend only to registered businesses, restrictions on access to credit (see below) blunt that incentive. Conversely, not being registered helps a business stay off the radar screen of the tax and licensing authorities. Of course, even in the case of registered companies there is universally said to be non-payment or underpayment of taxes and noncompliance with licensing requirements.

The major consequence of the persistence of the grey economy is underpayment of taxes and in turn under-investment in public infrastructure and services. Such lawlessness also discourages much needed foreign direct investment.

Conventional wisdom in Kosovo also holds that unregistered firms have a competitive advantage over legitimate ones as tax evasion reduces their costs relative to their law-abiding competitors. This claim, however, should be challenged simply because the formal sector continues to grow year by year. Therefore, despite the limits of the court system and lending markets, there must be other competitive advantages to participating in the formal economy that are unrecognized or unappreciated by those still outside the law. If there were not, the informal economy would continue to gain market share. That it does not is very telling. For that reason, as well as those noted above, the Constraint Study Team concluded that the grey economy is largely a symptom of other constraints and that by addressing these participation in the formal economy will accelerate.

Ethnic region differences and relations with Serbia. Differences, discrimination and non-communication between the ethnic regions remain a huge constraint to Kosovo-wide business. Personal safety concern is usually mentioned first. Many people from one region will simply not travel to the other which, for one thing, has the double-edge consequences of cutting off businesses in Serbian enclaves from regulation by the government in Pristina and many of the benefits of government services. We were told that some businesses in the Serbian “enclaves” simply do not register as companies

simply because doing so means going to Pristina. Even registered businesses reported not collecting reimbursements from the government because of their concerns of traveling unaccompanied out of the perceived safety of the enclaves.

Persons in northern areas who were interviewed stated that they feel caught between two Chinese Walls – the Kosovo border to the North and the inter-region border to the South – and that there are no rules or government in between. It seemed clear from the interviews that law enforcement generally is more lax and less clear in those areas. Persons in the North also alleged that they are discriminated against by Pristina in getting VAT and customs refunds, and that in some cases Kosovo laws are not made available in the Serbian language.

On the other side it was pointed out by several interviewees that Kosovo land title and other legal records are held in Serbia are kept unavailable to Kosovo residents who need them for their normal business and personal purposes.

Adding to this is a legal limbo phenomenon – one businessperson in a KCBS cluster company stated that his company has been required to pay social security and employee health insurance double, once to Pristina and once to Belgrade, for the same employees.

Weak professional infrastructure. There is only a limited universe of experienced private lawyers, accountants, auditors and other professionals to whom growing businesses can turn for their professional services and as trusted advisers. The law faculty and legal education are overly theoretical and not transaction- or business law-oriented (which is characteristic of countries in the region) and the law school suffers from a ratio of students (about 3000) to faculty (about 47) of more than 63:1. The independent legal profession consists largely of sole practitioners or very small firms, which primarily serve individuals and are not widely used as business counselors, as lawyers commonly are in the US.

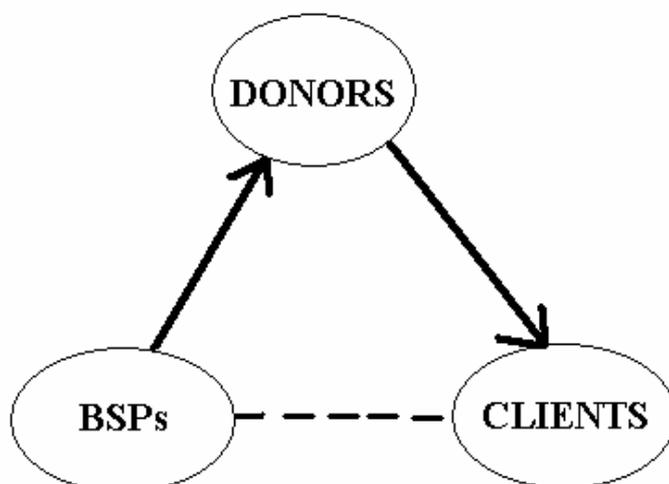
One company which was interviewed (one of the largest in Kosovo) stated that it had simply been unable to find a sophisticated outside lawyer when it recently needed legal advice. Some companies have skilled in-house lawyers; the banks, for example, have experienced attorneys to handle loan documentation, foreclosure and other matters. These, however, are obviously not available to represent small private businesses.

There is also not a cadre of experienced or certified appraisers for use in business transactions; some interviewees have said that a shortage of experts in property appraisal is hampering financing transactions. Additional training and education of the legal profession would clearly be helpful but to a large extent this may be a “chicken and egg” problem. Once more business develops, the professions may grow on their own to serve it.

The same can be said of most business service provider professions, especially in those areas needed to manage the business environment. The dominance of donor activity has played a major role in hampering the development of professional business service market. After over a decade of direct donor assistance of marketing, product development, market research, foreign trade assistance, business plan development, and lending, local business service providers have difficulty trying to sell services that the business community has now come to expect to be given for free. In fact, the business

service market is almost completely dependent on donor activity as service providers now see donor agencies as their primary market for whom they write proposals to provide services to donor projects that then provide free of charge to their client firms.

The Business Services Disconnect



Business service providers (BSPs) solicit, or are solicited by, donor organizations or contractors to provide services for a target group. The donor purchases the services of the BSP and then gives the services to the targeted firms. Consequently, prices for business services are quite artificial and inflated.

Few transactions directly between BSPs and local businesses take place because

1. As potential clients, local businesses cannot possibly compete with the prices paid by donors,
2. Local businesses have been trained to wait for donors to provide services for free or at heavily subsidized rates

As a result, the business service market is dysfunctional. Ironically, donors, trying to create business opportunities elsewhere, have become a primary barrier to business formation and creation in the business services sector.

The development of the association sector has been greatly compromised by this phenomenon. Associations depend on donor assistance for as much as 80 percent of their total revenues. In more mature markets, grants are seen as a distraction and should only be entertained as a marginal income source and should never account for more than 20 percent of total revenue. Even then, these funds and the programs they support should be kept separate from the basic running of the organization lest the association become financially dependent on the very government bodies it was formed to influence. But in Kosovo, associations lack this freedom because many of the traditional association revenue-generating activities such as workshops, trainings, business-to-business conferences and trade show promotion and attendance are the primary free services offered by donor programs. As will be seen later, this lack of independent revenue

streams has forced Kosovar associations to be almost exclusively dependent on volunteer labor and has prevented a cadre of professional association managers from emerging.

Halted privatization of agricultural land. It is acknowledged by all that privatization of agricultural land has been “horribly slow,” and has now come virtually to a stop. While socially-owned land is only a minority of total agricultural land, it includes many large contiguous parcels of great value. This applies also to agricultural service SOEs (socially-owned enterprises) that provide collection, storage facilities and other non-land assets. There are several reasons for the slowness. One is the complexity of the process, which requires establishing that the land in question is in fact an SOE asset (and not previously privatized), establishing title, and advertising in newspaper and preparing contract documents. In some cases ownership must be traced back 20-30 years and in some cases tracing is impossible because records are in Serbia and unavailable. There are cases where the land was registered in a municipality, not an SOE, and cases where workers’ council action was necessary. Also, the procedure for land registration and title search is different in different municipalities (which were referred to as “fiefdoms”) and many records are missing.

There is also criticism of foot dragging in the Ministry of Agriculture in forcing resolution on SOE management with municipalities, and of SOE boards of directors appointing different management teams leading to conflicting orders and confusion. This lack of clear leadership, let alone ownership, has significantly undermined investment in the SOEs themselves as well as in “downstream” agricultural processing, where supplies of raw materials are threatened by clear ownership and management of the producers and distribution networks.

Divided Government and Final Status Uncertainty. The division of government between UNMIK and the PISG has inevitably resulted in weak government and often in uncertain policies. This inevitably discourages investment. The instrument which controls the division is the 2001 Constitutional Framework for Provisional Self-Government in Kosovo (UNMIK Regulation 2001/9), in which UNMIK delegated law-making authority in several areas to the Assembly and Prime Minister of Kosovo – but still subject to ultimate approval by UNMIK.

In one area of great concern to KCBS sector companies, customs and tax policy, UNMIK retains full control under the Constitutional Framework, but it has adopted policies which harm KCBS businesses and which the PISG itself has urged UNMIK to change. Issues involving product standards are largely within the purview of the PISG but, since ultimate approval of new laws by UNMIK is required, both bodies must still be dealt with. This increases the complication and decreases the predictability of efforts to secure changes in laws that would benefit the KCBS business sectors. On top of this is the uncertainty of what the final status will be or when it will be determined, which further clouds all business and investment planning.

III. THE FIVE TARGET CONSTRAINTS

All the constraints described above hurt investment and growth in KCBS sector businesses. As indicated above, many are beyond any curative action that KCBS or its industry partners can take in the short term -- or ever, in some cases.

There are five more, however, which the Constraint Study Team selected as targets, using the five criteria on page 1 above, in the belief that they *can* be affected in the short term.

These five are:

1. A lack of clear and protected product standards
2. Inadequate access to financing
3. Tax and trade policies inconsistent with development objectives
4. Common lack of experience and practical know-how
5. Weak business and professional associations

Each of these will be discussed in turn.

Target Constraint 1: Lack of Clear and Protected Product Standards in the KCBS Sectors

A. The Constraint

The most-cited constraint. The constraint most often mentioned in interviews with businesspeople was the absence of clear and agreed standards to vouch for the quality of their products. This was cited as an obstacle in all three clusters and it was specifically mentioned in poultry, eggs, milk, fruits and vegetables, wood construction materials and steel beams and wire. For example, it was contended that fresh Kosovo eggs are competing in the marketplace with foreign eggs that, while labeled as “fresh,” may be 40-50 days old and have never been refrigerated; and that fresh Kosovo milk is competing with milk more than 10 days old with no way for the consumer to distinguish between them. There are no established standards for grading apples and no standard attractive method of packaging them, so Kosovo apples are simply not competing with imported apples in Kosovo supermarkets. The makers of prefabricated windows and doors state that they conform to established Western European norms but that there is no mechanism to certify this and without that they cannot sell into foreign markets even in contiguous countries such as Macedonia. Trading partners are taking advantage of this market gap. Montenegro, for example, has in recent years strengthened its reputation as a wine producer rebottling Kosovar wines while Kosovo itself has no clear market position.

These stories raise a host of detailed practical questions that KCBS and its industry partners are in a good position to answer and follow up on:

- Who should establish the standards in each sector?
- Who should do the testing and certification to show that they are met?
- Who should accredit the inspectors?
- How should standards be managed
 - By brand name, private label, or logo
 - By industry or profession certification (as France does with wines or the American Society of Travel Agents has done with the “ASTA” logo)
 - By government owned and enforced license.

Even if standards were established, there remains the very real challenge as to how they can be protected from copying and name theft. There is also the issue that the different sectors may call for different approaches.

Writing standards. Several of the businesspersons who were interviewed argued that new laws are needed under which the government would establish standards and then test and certify compliance. Some complained that they have met with government officials, of both the PISG and UNMIK, but found little or no interest or motivation on the officials' part. This should not be surprising as government officials rarely provide such impetus anywhere in the world. It should also be observed that Kosovo has a history of getting new laws passed (mostly written by foreign experts) which are good on paper but are not followed up or implemented – often they just sit there.

There are three ways that standards can develop:

1. Through market dominance such as Tetra Pak packaging for drinks or Lotus' menu system developed for its 1-2-3 worksheet and soon emulated by its rivals.
2. Through business cooperation (or collusion)
3. Through government fiat

Experience in other countries shows that the impetus for industry standards best comes from industry participants themselves. Even though in some of the Constraint Study interviews, the persons who expressed the need for standards most strongly were representatives of already-existing industry associations, Kosovo, as a post-socialist environment, lacks a tradition of pluralistic, consensus driven standards development. While these associations are undoubtedly the logical vehicle for establishing standards in at least some – perhaps most -- of the KCBS sector markets, the practice of moving ahead of government policies is very new. Therefore, government fiat, the standards setter of last resort in most market economies, is the one most likely to be turned to in Kosovo.

The needed new standards themselves can be very simple or highly complex depending on the specific product and need. However, given its small market and late-coming to most markets, Kosovo is a standards taker, not a standards setter. In many or most cases already-existing standards in European countries should be adopted with little or no change especially as the EU and its standards will continue to play a growing role in the region.

Implementing standards. Once standards are written there are practical issues of implementation, which should be expected to vary from product to product. This is a far greater problem for Kosovo as testing capacities are sorely lacking. In most cases a physical testing facility or laboratory is required with trained personnel. In some cases, especially with dairy and some perishable food, daily or weekly sampling is needed from the farmer or processor and there is a need for standards for sterile containers. Procedures for quickly communicating test results to the farmer, processor or manufacturer should also be specified, especially when failure to meet specifications means not being paid for the product or not being allowed to sell it on the market.

This leads to more questions including who should be responsible for testing and certification as between the market participants at various levels. Yet another issue is whether the government should be involved in testing and certification. There is little understanding of the power of the market to enforce standards and few illusions of the impotence of the courts to do so. In some cases, especially where the standards relate to health and safety, government supervision is perceived as preferred because the

government is seen as a disinterested outside party that will protect the public. In most cases, however, especially where the standards relate to matters of taste or consistency of quality, government involvement is not wanted and should not be invited.

Publicizing, enforcing and protecting standards. Once there are standards it is in everyone's interest to advertise that they are there and that they are being followed. In some KCBS product areas a trade name, logo, or distinctive label should be developed that will require public education programs. The question yet to be answered is, given the current low quality of many Kosovar products, will quality claims be credible and will these products actually become more competitive in the eyes of consumers. As many KCBS-sponsored associations are leaning in this direction, the effectiveness of this approach should be tested and any barriers to consumer confidence identified.

Finally, compliance and enforcement are critical if standards are to work. In some cases it is appropriate to require industry participants to agree by private contract to purchase or distribute only products that meet the standards. These should be drafted to be enforceable in court. In the case of some health and safety standards, criminal penalties are necessary and new laws may be needed for this purpose and laws that do exist need to be enforced. Currently, for example, despite laws against the retail sale of unprocessed milk, direct sales of raw milk to households is still common and accounts for the bulk of dairy farm output in some areas. Local authorities do not prevent such activities because they do not want to reduce farm incomes.

Worse than no law at all are laws that are intentionally unenforced. It is well known that enforcement of intellectual property rights is weak or non-existent at this point in Kosovo's history. That means that there is significant danger that any trade names or marks for quality standards could be copied or counterfeited without repercussion or recourse by the legitimate holder of the seal. Such practices would confuse the market and debase legitimate efforts to improve quality. The final item in the planning kit for new product standards is a strategy to protect intellectual property and education of local authorities why they should be aggressively enforced.

B. Specific Action Steps

The standards problem is not new news to Kosovo or KCBS, but the Constraint Study found beyond doubt that it is "Issue No. 1" to many and perhaps most industry participants. The interviews and the description of the issue above suggest the following.

1. First, educate industry participants, government, and the public on the choices and decisions to be made in developing standards, particularly the limits to government involvement and the benefits of private consensus-driven standards development. Efficient action is impossible without understanding the details of this – which are only outlined generally above. However, the better understood they are, the best choices for a specific market can be self-evident.
2. Form task groups of industry, ministry and consumer representatives for each cluster to discuss and then act on steps 3 and 4 below – and to revise and add to those steps as they see fit. The important thing is to maximize the hands-on involvement of those persons, guided and led by KCBS, but in such a way that those other persons are always the moving force in decisions.

The initial selection of people could be made immediately from present KCBS contacts. In some cases but not all they should be existing leaders in industry associations; in some cases, sub-clusters within a cluster would be more appropriate. Government people from the Ministries of Agriculture and Trade and Industry should be involved and kept aware but not be prime movers of standards development.

3. As preliminary tasks leading to Step 4 below:
 - (a) Identify separately and specifically each product segment for which standards are needed and wanted, both those where KCBS has already begun action and those where it has not.
 - (b) Become familiar with all the present and proposed Kosovo laws, administrative instructions, and other government activities relating to product standards including any existing standards themselves. (This can be a little complicated; we were told that there is a draft new Law on Quality Control of Food Goods in the Ministry of Labor and Social Welfare; there is also a proposed administrative instruction on construction materials standards and a new agency to administer it within the Ministry of Trade and Industry. We also learned that UNMIK is overseeing several dozen new laws on a crash basis for enactment by mid-2005.)
 - (c) Personally contact the persons working on proposed laws and submit comments or give other assistance where that would help this project. Whenever possible, government authorities should be encouraged to turn the actual crafting of standards over to the relevant business association.
 - (d) Harmonize any local standards development activity with the existing standards, standard-setting bodies, and standards laws in neighbor countries and the EU, and particularly with standards that competing exporters into Kosovo are now using.
4. Draft a customized “road map” with timetable for each segment identified from Step 1 covering specifically:
 - a. Writing the standards of adapting existing standards;
 - b. Implementing the standards by deciding on the best methods for testing, selection of personnel, certification, communication of results, periodic inspection;
 - c. Deciding the appropriate role (if any) for government and involving the proper government officials;
 - d. Publishing and advertising the standards; and
 - e. Enforcing the standards, which will be the most difficult task of all.

Then proceed to implement the plan.

5. Separately, create an enforcement strategy including possible contractual commitments to observe the standards, sanctions for violation, guidelines for enforcement by litigation, possible amendment of existing laws on intellectual property and court injunctive powers and penalties, and training of judges in intellectual property enforcement. One must be cautious in this act, however, as there are no anti-trust laws currently in Kosovo. These private means of enforcing standards could easily, and legally, be abused by the existing handful of dominant producers as barriers to entry and a means of locking in market share. This would cause the standards development process to reduce competition rather than enhance efficiency.

Target Constraint 2: Inadequate Access to Financing

A. The Constraint

The current financing market. The constraints in the current business financing market can be seen by reciting just a few facts:

- Almost all bank business lending is short term with loans for over three years being rare, over five years exceptional, and over seven years unheard of;
- Typical interest rates are a high 12-15 percent annually;
- There is essentially no lending to startup businesses;
- There is no unsecured business lending and banks generally require collateral-value coverage of 150-200 percent of the loan principal amount;
- Even the most established banks in Kosovo are less than seven years old. Consequently, experienced loan officers and account managers are in extremely short supply.
- Agricultural loans represent only about 2 percent of total loans compared with 20 percent of gross domestic product.

Another notable feature of the market is that lenders almost always require personal guaranties and personal real property as security for business loans, regardless of the stability of the business or the viability of the activity supported by the loan. This exemplifies more reliance by lenders on the personal character and stake of the business's owners (as opposed to reliance on the underlying business itself) than is typical in the West.

The shortage of long-term financing is a serious problem, especially in the manufacturing, processing and construction sectors where financing is needed for multi-year projects. We were told of several cases in which lack of long-term lending is currently inhibiting projects in KCBS sectors. (At the same time, the lack of long-term financing in the KCBS sectors should not be overemphasized since the greatest need in those businesses is probably for working capital.) In addition, the high interest rates and the absence of startup financing only add to the problems of many KCBS sector businesses.

Exacerbating this problem is a lack of an alternative to borrowing. Foreign direct investment is extremely rare in general and unheard of in the agricultural sector. Additionally, with no equity markets or venture capital mechanisms, what little long-term lending that may exist is often being committed to privatization activities, which in a

more mature finance market would be financed through venture capital or other third-party investors.

Reasons for the constraints. When asked why long-term loans are so scarce, the banks and the bank regulator point to a total lack of long-term deposits. This makes the banks hesitant to take on the risk of long term lending and it leads the regulator, the Banking and Payment Authority of Kosovo (BPK), to follow guidelines that discourage long term lending in the interest of safe and sound banking practice. They also cite a lack of support from civil courts to enact and enforce judgments that favor lenders, a lack of credit history or business experience among borrowers, and the erroneous perception that lending against non-real securities is frowned upon by BPK.

The market for long-term deposits. Bank deposits for terms of over three months are almost unknown in Kosovo (although such deposits, when made, are typically rolled over). Reasons for the absence of longer-term deposits are many. The banks quickly point out the obvious fact that international depositors consider Kosovo risky despite the much higher interest rates available compared to other Euro-based markets. With no currency conversion risk, Kosovo's high rates should be extremely competitive with Austria, Switzerland, and other foreign depositor havens.

Additionally, many local people have a cultural and historical preference for holding their assets in cash or their personal residence, always referred to as a "nonproductive" asset in our interviews with banks. This comes largely from past history including past political insecurity and bad experiences with the Yugoslav banking system.

Also cited is the supposition that many people see greater returns in the underground economy than in bank deposits. This is especially true since January 1, 2005 when bank interest became taxable income and, by definition, much harder to hide than cash-based transactions in the grey economy. Tax avoidance and blatant tax evasion, like refusal to pay utility bills, appear to be acceptable practices among the Kosovo public.

Finally, the fact that the current banking system is still young and the public has no long-term history with working with banks undermines the savings potential.

These "facts of life" must be recognized in any analysis of the Kosovo business financing system. They hamper all of the banks, although in the case of long term funding there is one important exception. The exception is ProCredit Bank, which is a "development" bank that receives long-term subordinated debt funding from its non-profit shareholders (further described below). The availability of such funding recently led that particular bank to adopt a policy of allowing term loans up to five years to be made and approved at the local Kosovo level. Even at ProCredit, however, longer-term loans represent less than 5 percent of the total outstanding loans. However, ProCredit anticipates that longer term lending's share is likely to increase.

The inability to enforce judgments. Several other factors are also cited to account for the current market situation. One is the difficulty in Kosovo of seizing and selling collateral when there is a loan default. This applies both to mortgaged land and the case of pledged personal property. In the case of land, registration of mortgages was moved from the courts to the cadastre in January 2005 and one bank stated that the situation there is "atrocious," with registration of a mortgage on land taking a week and liens on residential

apartments being impossible. By contrast, in the case of personal property, there is an efficient pledge registry, which was established with USAID help. In both cases, however, repossession can be slow and expensive, sometimes taking months. This is put down to the fact that judges are unmotivated and unfamiliar with repossession and resale procedures, that their dockets are clogged, and that sometimes special favors are needed for them to act.² On top of this it is often difficult or impossible to sell land because the only potential buyers are neighbors (or potential neighbors of those buyers) who will not cooperate, especially in the case of residential real estate.

There is one important exception. That exception is Raiffeisen Bank, which relies on collateral more than any other Kosovo bank and “aggressively” enforces its legal repossession and sale rights when loans default. To help do this it has a staff of experienced lawyers who work closely with the judges, sometimes “showing them how” to do it hands-on. Raiffeisen reports success in this policy, which indicates that a given lender’s lien enforcement problems may be largely a matter of that individual lender’s policy and attitude.

Raiffeisen’s practice of maintaining a battery of lawyers to educate judges is an illustrative example of how high interest rates are driven by the costs and risks of lending, not lack of competition. Part of the solution to reducing loan costs is to address these structural costs and not offer preferential interest rates as is commonly proposed.

Structure of the financial sector. Kosovo’s financial sector has grown quickly during the short period of just a few years since the War. It now includes seven banks, eight insurance companies, seventeen microfinance lenders, and six pension funds. Two of the banks are “foreign” banks, and they account for about half of all bank loans. These two are the above-mentioned Raiffeisen Bank Kosovo, a subsidiary of Raiffeisen International, the Austrian commercial bank, which purchased the USAID-sponsored American Bank of Kosovo in 2003; and ProCredit Bank, which is owned equally by six shareholders of whom five are non-commercial financial institutions including the EBRD, IFC and IMI (International Microinvestment Company). The sixth shareholder is the German commercial bank Commerzbank. One of the five “local” banks one, Kasabank, which is the third largest commercial bank in Kosovo, is actually a subsidiary of a Slovenian bank. Despite foreign ownership, Kasabank has broad Kosovo contacts and close ties to KCBS. Its main shareholder, and President of the Board, is also the president of Lesna, a Kosovo wood processing company, and is an officer of the Association of Wood Processors in Kosovo (AWPK), which was created by the KCBS project.

Overall the banking system appears stable and adequately capitalized. It is closely monitored by the BPK, which has 20 bank inspectors and is headed by a former US state bank regulator who was interviewed at length for this report. Earnings have increased and liquidity in the total banking system is considered satisfactory by the BPK, representing 58 percent at the end of 2003. All banks are in compliance with the minimum capital requirement, which was recently increased to €4 million.

² That the Kosovo National Assembly would pass laws allowing alternative lending practices without training judges and other court officers on their enforcement is, in turn, symptomatic of a greater problem in Kosovo. The Government proposes and the Assembly regularly passes laws without a fiscal impact analysis that assesses how the law should be enforced and how much administration of the new law will cost. Consequently, markets that look quite sophisticated and advanced on paper are in fact quite dysfunctional.

While in the past few years the banking sector has grown and changed, it is still evolving. One bank interviewee expressed the view that there may be a shakeout leaving fewer banks a few years from now. The ratio of nonperforming loans (NPLs) to total loans was 2.5 percent as of December 31, 2004. However, in interviews especially with domestic banks, there appeared a lingering uncertainty that this low ratio of NPLs will be maintained. Some loans have been rescheduled, and since the banking sector in Kosovo is still young there is not much experience from which to draw conclusions. The delinquency rate is 6.9 percent for all banking sector and ranges bank to bank from 0.5 percent – 24 percent. Also, some small banks have relatively high ratios of NPLs to total loans -- over 4 percent. As banks' deposit base has expanded, they have started to lend more aggressively domestically. The loan to deposit ratio was 54 percent as of December 31, 2004, a level with which BPK expressed some discomfort.

As noted above, commercial banks along with various donor-sponsored micro-financing institutions (in the case of many small farms and other small businesses) are the only current outside sources of credit. The main source of funds for most businesses is their own resources, whereas loans from a family member, friends or other associates are not as important³.

Lending provided by the eleven microfinance institutions comprise about 10 percent of total outstanding loans at the time of this study. Total loans have reached the amount of 409 million euro, with 39 million euros from non-depository financial institutions and donors. The EU Agro Business Unit (ABU) had 10 million Euros in outstanding loans, and is providing long-term loans of up to 5 years.

Peculiarities of agricultural lending. Adding to the complexity in the KCBS agricultural sectors is the fact that agricultural lending has peculiarities about which lenders in Kosovo readily admit to not being educated. Consequently, existing products do not fit agribusinesses needs. The banks do not know how to assign risks such as agribusinesses' dependence on weather which can destroy crop value for an entire season or two. Lending against land is problematic because of the confused land registration system and the difficulty of foreclosure. Alternative forms of collateral such as crops or crop-purchase contracts are virtually unknown and only this year are starting to be used in the banks' more established markets. Farmers, generally, are less sophisticated in financial matters than other business borrowers.

Different lenders have different mentalities. As stated above, about half of bank business lending is done by two banks, Raiffeisen Bank and ProCredit Bank. Both Raiffeisen and ProCredit expressed interest in lending to businesses in the KCBS sectors and they have different types of policies each of which can offer particular opportunities for particular prospective borrowers. Raiffeisen relies more heavily on business collateral to support its loans and it actively exercises foreclosure rights when borrowers default -- and has a successful history in doing so. It has experienced in-house lawyers who work closely with the courts and judges to accomplish repossessions and sales of both land and

³ According to "Survey of 300 Enterprises in Kosovo", February 2003 funded by EAR and carried out by Eurecna: "Almost all (297 out of 300) use their own resources and 238 enterprises use their own funds to finance 70 percent or more of their financial needs. 82 enterprises use loans from financial institutions. For most (60 out of 82) loans from financial institutions account for less than 30 percent of their financial needs. Informal loans (from neighbors, extended family or others) are not an important source of funding -- only 33 respondents have informal loans. These informal loans usually account for only a small (less than 30 percent) portion of total funding requirements."

personal collateral. Raiffeisen finalized a new agricultural lending policy in February 2005 and is currently working with a group of farmers to get it started. Its customers already include several KCBS sector businesses including a potato, milk, mushroom, meat and fruit juice processors and a berry processor producing cosmetics. ProCredit has a long background in making micro-credit loans to farmers but it also is a substantial lender on a commercial basis to larger businesses, including many in the KCBS sectors. It especially emphasizes that it relies on in-depth analysis and close ongoing relationship monitoring of its borrowers.

B. Specific Action Steps

While the “facts of life” recited at the beginning of this discussion cannot be changed now, much can be done to help KCBS sector businesses exploit a knowledge of the market, to train some of them in how to apply for credit, and to help banks see the opportunities in areas such as agricultural credit and possibly new forms of financing. The discussion above suggests the following steps.

1. *Train sector businesses in the practical aspects of accessing financing.* KCBS itself can conduct such trainings but, to the extent possible, such trainings should be provided by industry associations and groups guided by KCBS. The less sophisticated business segments such as agriculture should be especially targeted. Aspects to be covered should include:

- When (and whether) a particular business really needs outside financing;
- Exactly what types of financing are available and what types the business needs – for example, the requirements to obtain working capital are different from those for longer term needs and how to differentiate between short- and long-term credit needs;
- What lenders themselves look for in a borrower and how different lenders look for different things;
- What the business itself should do, or should learn, to attract financing -- matters such as how to write a business plan and what a lender looks for in a business plan, what financial statements and disclosures should be offered; and how to make a realistic collateral valuation.

2. Complete a thorough survey and matrix of available business financing and actual demand for business financing in the KCBS sectors. This could start from the above general discussion and it would cover:

- Availability including sources (not only banks but others also), terms and conditions, types (not only loans but other types such as those in Step 4 below), purposes, different preferences and policies of specific lenders, lender attitudes toward agriculture, etc; and
- Demand including a realistic assessment of what the KCBS sector businesses actually need, and what they need that is missing.

Then, publish the survey and update it regularly to reflect the changing market.

3. Work directly with banks – to the extent possible through their association, the Kosovo Bankers Association – and the BPK to:

- Create a venue for communication among banks, the BPK and business customer representatives; and
- Bring the banks and the BPK together in a facilitated dialogue to clarify understanding and remove any misunderstanding of regulatory rules and interpretations to increase access of the KCBS sector customers to needed types of finance.

4. Survey and assess the many forms of financing which are well-known in other countries but are not, for one reason or another, available in Kosovo. These include equipment leasing, factoring, purchase order finance, credit card finance, agricultural finance secured by crop-purchase contracts or by crops in the ground, and others. For this purpose, survey the extent to which such forms are used in neighboring countries.

Then, if these are promising for KCBS sector businesses, introduce them to banks and the BPK and provide training and documentation for them.

5. Promote agricultural lending by meeting with banks to understand their attitudes and to help familiarize them with the problems and solutions. As stated above at least two banks are contemplating increasing agricultural loans, which means there must be profit in them, but overall agricultural lending is at an extremely low level. This is a very specific area and deserves special attention.

Target Constraint 3: Tax and Trade Policies Which are Inconsistent With Development Policy

A. The Constraint

Almost all interviewees stated that their business is being hurt by Kosovo customs and tax laws and the administration of those laws. The laws in question, which were established by UNMIK, are almost universally seen in Kosovo as being inconsistent with a development policy aimed at encouraging growth and development. This problem has many specific components; those most frequently mentioned are the following.

Customs duty on raw materials, production machinery and other manufacturing inputs. The most frequent complaint concerned the 10 percent Kosovo import tariff. This tariff is set by the Kosovo Customs Code (UNMIK Regulation 2004/1 as amended by Regulation 2004/13), which created a limited list of exempted products. The chief problem cited is that, prior to that amendment Kosovo was unique in the region for imposing a uniform tariff on both raw materials and manufactured goods.

This policy disadvantages manufacturers and fabricators, an example being KCBS-sector wood processors who must import their wood and glass as well as production machinery subject to the 10 percent tariff and then must compete with imports by trying to make

doors and windows at total labor and other costs comparable to those in neighboring countries who often have more abundant local raw materials – the glass and the lumber – as well as lower (or no) import tariff on raw materials for manufacturing. The Kosovo producers are also at a disadvantage in competing with Kosovo traders (resellers) who can import finished doors and windows whose materials have not previously been subject to an inside import tariff.

Relief from tariffs on raw materials has already been the subject of considerable debate including discussion in a current series of roundtables sponsored by the Kosovo Community Business Development Center (CBDC). One solution proposed at a roundtable in Pristina in February 2005 was to change the law to add raw materials and production machinery to the limited list of exempted under UNMIK Regulation 1004/13.

Full value added tax (VAT) is charged on raw milk, seeds, fertilizer and other agricultural inputs. This was also a frequently mentioned constraint. In the dairy sector, for example, the VAT – which is 15 percent -- is imposed on raw milk when it is bought from the farm for processing into fluid milk, cheese, yogurt and other dairy products. The result of the tax at this level can be to make the processed products uncompetitive with imports from other countries.

One should note that Kosovars enjoy the lowest VAT in the region. In Kosovo's two largest trading partners in the region, Serbia and Macedonia, the VAT is 20 percent and 19 percent respectively. In Albania, the country with which Kosovo has a free trade agreement the VAT is 20 percent. Also, while Kosovo is not a signatory to the WTO, it has a stated policy of acting as if it were, in preparation for recognition of nationhood. According to WTO regulations, domestic tax cuts made for competitive purposes must be met with offsetting cuts in tariffs. Therefore, allowing VAT exemptions would not necessarily provide the relief its proponents believe.

This argument appears to make little sense as taxes on inputs are reimbursed. However, there may be more to this than meets the eye. As already mentioned, tax avoidance and outright evasion are common. For farms to be reimbursed they must be registered. However, by registering they become subject to income taxes. Some of the experts we met speculated that the concern over the VAT was more an issue of avoiding income taxes than the competitive impact of the VAT itself.

KCBS was told that efforts to avoid the VAT has further encouraged the already existing practice of purchasing of raw milk in the grey market where the purchase it is simply not reported. Accordingly, for KCBS this is an issue.

Slow and discriminatory VAT refunds. This is not to say that the VAT is without economic impact. Here the problem is not the law itself but the policies and practices under which it is administered. One such policy is widely believed to be to slow down reimbursement so that the government will have the benefit of the "float" on the VAT for as long as possible. Delays of six months to a year were cited in the interviews, and the owner of one business in the northern ("Serbian") area stated that he does not receive refunds at all. This can be especially painful considering that most businesses are cash-based, which means that the business has made a cash outlay that is not-credit financed but comes out of its cash flow directly. It was also stated that many of the tax officials

are also locally politically connected and that a company's political connections may count in determining the time for reimbursement.

Artificial base prices for customs and VAT. Other major constraints in the administration of the taxes were cited. One often mentioned is that customs officials do not necessarily use the actual sale price as the basis for calculating the 10 percent import tariff. (The 10 percent tariff is calculated on the sum of the price plus additional expenses such as transportation, and the 15 percent VAT is calculated on that sum plus the tariff.) In many cases importers have grossly understated their purchase price on fraudulent invoices. Also in many cases the tax authorities use their own index prices instead of actual sale prices. This can result in under-invoicing of imports and underpayment of both tariff and VAT, which creates unfair price competition for importers who pay based on the actual sale price.

The Kosovo tax structure hurts KCBS-sector businesses compared to similar businesses in neighboring countries. Many reasons were cited for this. First, the 10 percent Kosovo customs duty is considerably lower than those of neighboring countries on agricultural products. Serbian, Macedonian and Croatian duties range from 26-30 percent on poultry, dairy, fruit and vegetable products and meat. The mismatch is exacerbated in the case of Serbia and Macedonia because goods from those countries come in duty free. That is because Kosovo's trade with Serbia is classified as "internal" under Kosovo's current status and Macedonia is covered by a former Yugoslav trade agreement that is renewed annually.

Another problem cited is that Serbia, Macedonia and Albania impose a 5 percent transit tax on goods traveling through their countries from other countries to Kosovo, which raises the price those products when they arrive in Kosovo. That tax is not payable, however, on goods originating in Serbia or Macedonia, giving those goods a cost advantage in Kosovo.

In addition Kosovo's neighbors subsidize many types of agricultural production, while Kosovo has no agricultural subsidies. Subsidies in Serbia, Macedonia and Croatia are as high as 6 eurocents per liter for milk (Serbia). Subsidies are also paid for beef, sheep and orchard output. Kosovo on the other hand imposes an excise tax on fuel used by farmers, which in effect is a *negative* subsidy to agriculture.

B. Action Steps

The above taxes and policies are both a major and a much remarked-on constraint for the KCBS sector businesses.⁴ Even minor changes such as reduction in a percentage tax, or exemption of specific products from the tax, could have major effects on some of those businesses. However, as noted, cutting the VAT may have the perverse affect of actually discouraging participation in the formal economy for it would eliminate a reason for businesses to register.

⁴ The problem is yet more detailed and extensive than stated in the above discussion. A more thorough summary of the Kosovo tax and trade policies as they affect agriculture can be found in a working paper of the Ministry of Agriculture, Forestry and Rural Development (MAFRD) entitled "Measures to improve fiscal and trade policies in Kosovo agriculture" dated February, 2004. That paper is one of the studies found by Integra for this Constraint Study.

Therefore, before deciding on appropriate action steps, it is helpful to list and suggest some “piecemeal” solutions for consideration:

- Eliminating or reducing the customs duty on raw materials and production equipment for manufacturing or, alternatively, on specific named items such as seed, fertilizer, lumber or other inputs or capital goods for specific industries such as agriculture;
- Eliminating or reducing VAT on agricultural inputs or, alternatively, on specific named items; and
- Imposing countervailing duties on directly subsidized agricultural products such as the subsidy of 6 eurocents per liter to dairies as is paid in Serbia.

Such measures could affect different KCBS sector businesses differently and would impact differently on whatever policy objectives UNMIK or the PISG may favor. Moreover, the PISG should first evaluate the different financial and government-revenue impacts of such actions. For those reasons it does not seem advisable, at least for now, to advocate such specific solutions.

Thus the following action steps are proposed.

1. Stop working piecemeal on customs and VAT exemptions and develop a rational overall tax policy for the benefit of the KCBS sectors. To the extent possible, the industry players, through their associations, should take the lead and not wait for donor or government policies to which the private sector only responds. This effort should include among other things:

- Assessing the different impacts of specific policy alternatives on specific KCBS sectors, encouraging them to work together to identify any differences or conflicts and work those out;
- Working with both UNMIK and PISG to understand their objectives and also to keep them apprised and, in this connection, contacting MAFRD (identified in the footnote);
- Encourage the business community to develop through large cross-sectoral coalitions instead of each sector individually asking for its exemption;
- Assessing the financial and government-revenue impact of the policy alternatives with expert help; and
- Harmonizing Kosovar customs and tax policies with the trade laws and fiscal practices in the neighboring countries.

2. Create an intergovernmental standing committee of Pillar IV and MEF to develop and promote fiscal policy that is consistent with development objectives.

3. Contact and engage other donors to coordinate their efforts both with KCBS' and with the intergovernmental committee. Consider organizing a donor conference in the near future for this purpose.

Target Constraint 4: The Common Lack of Experience and Practical Know-How in the KCBS Business Sectors

A. The Constraint

In the course of the Study many instances were found where persons in the KCBS sectors are simply without basic experience and knowledge of the kinds taken for granted elsewhere. In many ways these examples are unique to Kosovo having experienced two successive diasporas from two different populations; first the Albanian Kosovars and then their Serbian counterparts. The resultant brain drain of these two historic events severely depleted Kosovo of its indigenous expertise, which was often intergenerational in scope. With property left abandoned, ownership unclear, and donors providing extremely cheap or free funds for start-up businesses to fill the void, neophytes have found their ways into practically every business segment in Kosovo.

The consequences of this phenomenon are serious and important enough to be deserving of being listed as a constraint in their own right. With few experienced practitioners in the market, start-ups and businesses capable of expanding are denied the traditional informal networking and human capital that help drive business development elsewhere.

Examples found in our research include:

- Farmers who customarily do not mow hay until it has almost gone to seed, at which point the protein content of the grass is greatly reduced. By mowing earlier, and following mowing schedules of farmers in other countries, the nutritional content can be greatly increased.
- Dairy farmers customarily build cattle barns that are too large and expensive and they heat them to temperatures that are too high for optimum production.
- Dairy farmers customarily buy low-quality semen to save money when spending only a little more would produce cows with greatly increased milk production over their 3-5 year milking lives.
- Sheep farmers customarily raise lambs to a weight of 30 kg and sell them locally, when they could get twice the price by growing them to only 10-15 kg and selling them into the export market in Greece.
- Apple growers are unable to sell in local stores because they simply do not package their products well.
- Potato processors do not buy locally grown potatoes because local growers are simply not growing the varieties that are best for potato chips, French fries and other processed products.

B. Specific Action Steps

Needs of this kind can be attacked quickly and at little cost.

1. Design targeted training and education of farmers and others through emerging trade and professional associations using the foreign experts working through donors. These trainings should be created as fee-for-service opportunities to assure their sustainability.
2. Create an extension service working with the Ministry of Agriculture and the University's Agriculture Faculty which would provide advice and know-how through printed materials and a website, using as a model the State University agricultural extension services in the United States. A review of the websites of those services produces very practical ideas.

Target Constraint 5: Weak Trade Associations

A. The Constraint

Most of the Action Steps under Constraints 1-4 call for action by industry participants working together -- and for them to do so, whenever possible, through their trade associations. But for the most part those associations are not now prepared for the task. They need strengthening, reorganization and refocus.

The problems of the existing associations are many and are interrelated but they can largely be traced to a lack of independence, particularly financial independence at the association level. The associations both in and outside of the KCBS sectors are heavily dependent of donor support. This has resulted an environment in which it is donors, not the associations, who set priorities and planning. As a consequence there is no understanding as to how, when, who, or even why associations should charge for the goods and services they provide. Many associations were created as tools to deliver the services or capacities of a given donor project. When that project was done, or when donor assistance was withdrawn, the association collapsed.

Without a steady stream of income, associations cannot afford to hire long-term staff. Consequently, most or all work of associations is done by volunteer labor. This means that it is done by persons who have their own separate businesses and may not be in a position (or have time) to give attention, to or serve the interests of, the membership as a whole. The associations charge dues to members but they rarely if ever charge on an economic basis for services provided to the members. Yet doing that would be conducive to both financial and policy independence.

Consequently, as no professional association management profession has emerged, advocacy in Kosovo is also at a primitive stage of development in which personal contacts with leaders is more important than managing public opinion. This advocacy of cronyism is also attributed to the lack of public relations professionals and also a lack of more sophisticated advocacy methods and capacity that emphasize consumer and market impacts rather than the limited self-interests of members. As a result, associations in

Kosovo do not demand the more detailed statistics on their industries and markets as they do in other countries. The lack of this information leads to inefficient public policies based on opinion, conjecture, and influence. It also prevents banks and other suppliers from making more informed decisions about serving the markets.

The results of this lack of fiscal accountability are:

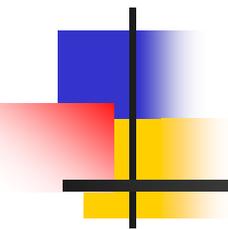
- Overall goal and strategy setting – long term planning -- has often not occurred or been possible;
- Financial budgeting and realistic step-by-step action plans are unknown;
- A lack of prioritizing of members' separate needs and identifying trade-offs when necessary;
- An overdependence on donors and a small number of large firms that currently dominate the Kosovar economy; and
- A cadre of association management professionals has not developed.

This lack of effective, independent trade associations must be viewed as a major constraint, and especially so because joint industry action is critical for dealing with the other constraints described above.

B. Specific Action Steps

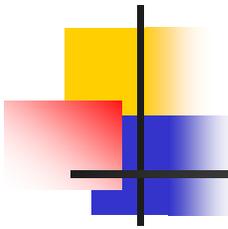
There is much that can be done to help strengthen the associations in the short term and at little cost.

1. Help associations achieve financial and management independence. Among other things:
 - Convene a conference of donors to get them out of the business of controlling association goals and priorities (whether deliberately or by default);
 - Help associations design mission-related fee-for service activities; and
 - Provide a mentor to work directly with the umbrella associations' key staff and officers as soon as possible to provide direction for action plans for 2005.
2. Educate government ministers and parliament members on the role and importance of associations in standards development and enforcement and service delivery.
 - Train government and association decision-makers on the development and use of industry statistics for policymaking.
3. Guide specific associations in drafting advocacy plans for Constraints 1 and 3 above, Product Standards and Trade and Tax Policies, which serve the members as a whole and take account of differences among them where those exist.



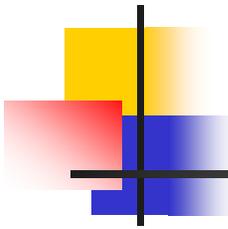
KCBS CONSTRAINTS STUDY

**CONSTRAINTS TO
INVESTMENT AND GROWTH
IN THE KCBS SECTORS**



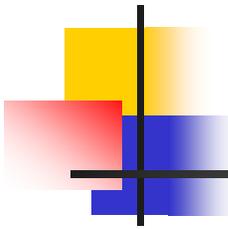
The Study

- **Methodology**
 - Preliminary Research – review of current laws, practices, studies
 - Interviews with key stakeholders – Bank officers, association/business leaders, government officials
- **Identify/Review Relevant Constraints**
- **Determine Targeted Constraints**
- **Formulate Specific Action Steps**



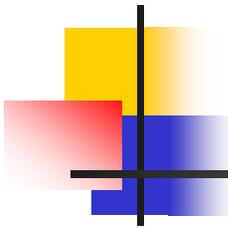
Review of Ten Relevant Constraints

- **Inadequate Physical Infrastructure, Especially Power Supply but Others Too**
- **Corruption, Crime, Law Enforcement Problems**
- **Unfair Competition/Grey Economy Impact**
- **Internal Issues affecting business cooperation/competition**
- **Legal/Justice System/Courts/Enforcement of Judgments**
- **Halted Privatization of Land/Uncertain Land Titles**
- **Limited Management Experience**
- **Limited Professional Infrastructure (Lawyers, Accountants, Appraisers, Etc.)**
- **Strong Foreign Competition/Imports**
- **Legal/Government/Final Status Uncertainty**



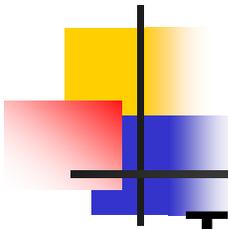
Criteria to Select Targeted Constraints

1. It was deemed to have significant impact on business formation or expansion,
2. In the spirit of the “Bulldozer model,” it lent itself to practical resolutions that could be enacted within six months,
3. It could be addressed directly by the business community with little or no dependence on government action,
4. Extensive additional funding was not required for practical resolution
5. Potential solutions were not in conflict with the realities of the Kosovar political environment.



Five Targeted Constraints

- 1. No Clear and Protected Product Standards**
- 2. Inadequate Access to Financing**
- 3. Tax and Trade Policies Which Are Inconsistent With Development Policy**
- 4. The Common Lack of Experience and Practical Know-How in the KCBS Business**
- 5. Inadequate Initiative and Collaboration Among Industry Participants (Including Weak Trade Associations)**



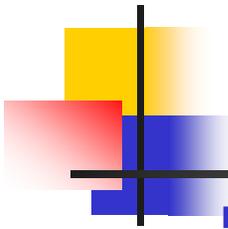
Five Selected Target Restraints

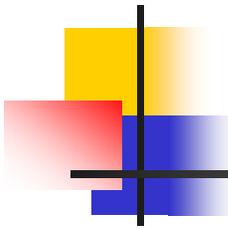
Target 1: No Clear and Protected Product Standards (Part I)

- Why This Matters – How it is Hurting
- Examples, Sector by Sector
- What Should Go Into Standards – Nuts and Bolts
- Who Should Write Them – Develop a KCBS View on Role of:
 - Government
 - Industry Leader(s)
 - Industry Association
- Whose Standards: Local, Regional, International

Note: Different Mixes of the Above May be Right for Different Products and Sectors

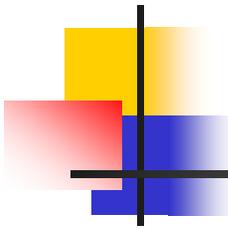
Target 1: No Clear and Protected Product Standards (Part II)

- 
- Testing/Sampling/Inspection/Implementation Issues to be Decided for Each Product
 - Different Types
 - Protect the public
 - Satisfy the Consumer
 - Who Pays and for What?
 - Enforcement Alternatives – Types of Private Contracts/Lawsuits/Criminal Penalties for Health Standards
 - How to Publicize – Logo? Stamp? Public Education Program?
 - Intellectual Property Legal Protection



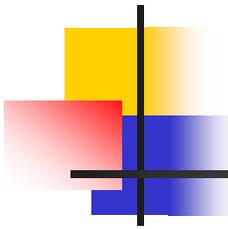
Specific Action Steps

- Educate government, industry, and public on choices when developing standards
- Form Task Groups of industry, ministry, and consumer representatives for each cluster
 - Identify existing standards and gaps
 - Draft customized roadmap and timetable to address market failures
 - Create enforcement strategy including training of court officers and means to financial means for enforcement



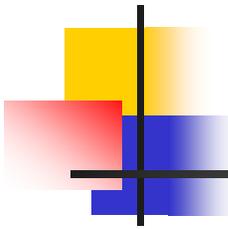
Target 2: Inadequate Access to Financing

- What's Actually Available in the Market Now
- How is This Hurting KCBS Businesses – Examples, Please
- The Causes – Infrastructure and Attitudinal
- Detailed Review of the Kosovo Finance Sector – Structure and Individual Players
- Different Lenders Have Different Policies and Mentalities – Get to Know Them
- Peculiarities of Agricultural Financing
- Alternatives to Loan Finance – Any Available?



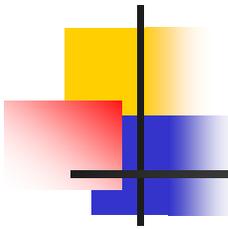
Specific Action Steps

- Assist associations in training members on practical aspects of getting financing
- Create complete inventory of financing practices now offered in market
- Assist KBA to create venue for communication among BPK, banks, and business consumer representatives
- Bring BPK and bank representatives together to improve communication and correct misconceptions of the role of each.



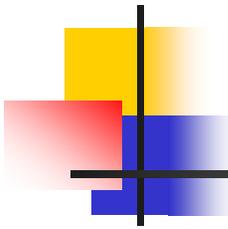
Target 3: Tax and Trade Policies Which Are Inconsistent With Development Policy (Part I)

- Overview of the Subject (It's Complicated)
 - Role of UNMIK vs. PISG
- The Tax and Duty Laws Hurt KCBS Businesses – and What is the Rationale for the Present Policies Anyway?
- Full Customs Duty and VAT on Raw Material and Production Inputs Contradicts Development Targets
- Slow and Inconsistent Customs and VAT Administration - Delayed Refunds/Unreal Base Prices, Etc.
- Discrepancies With Neighboring Countries' Tax Levels Which Hurt Here



Target 3: Tax and Trade Policies Which Are Inconsistent With Development Policy (Part II)

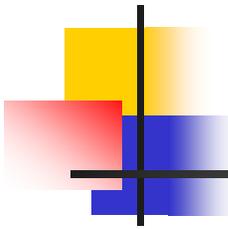
- Subsidies, Quotas, Transit Taxes, and Movement Limits in Neighboring Countries Which Hurt Here
 - Free Trade Agreements will exacerbate these problems
- Other Groups Which are Lobbying
- Positions Taken by KCBS Sector Companies or Associations



Specific Action Steps

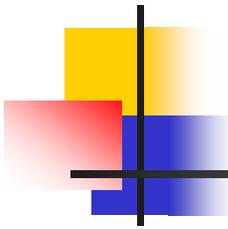
- Focus on a rational tax policy
 - Not just piecemeal on VAT exemptions
- Review tariffs for regional parity.
- Create better economic data to measure tax impact
- Help associations engage in inter-sector debates on tax policies and priorities
- Create Intergovernmental standing committee of Pillar IV and MEF to develop fiscal policy consistent with development objectives.
- Engage donors to coordinate their efforts with Intergovernmental committee policies.

Target 4: The Common Lack of Experience and Practical Know-How in the KCBS Business



Sectors

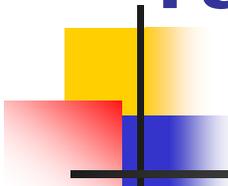
- The Unique Situation in Kosovo – Owing to Historical, Traditional and Other Reasons
- Examples and Anecdotes of Where Common Know-How is Not There



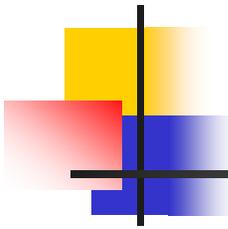
Specific Action Steps

- Improve domestic expertise in private sector
 - Create extension service independent of donor support
 - Improve post-graduate and continuing education programs in targeted sectors
 - Encourage immigration of qualified experts

Target 5: Weak Trade Associations

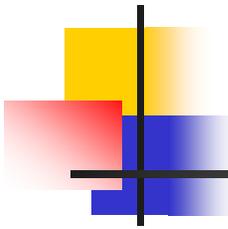


- Overly dependent on donor assistance
 - Project focused – not process focused
 - No long-term planning
- Donors have taken traditional forms of revenue – training, financing, trade missions, standards development
 - No rational pricing of products
 - Too dependent on dues
- No financial independence
 - Dependent on volunteer labor
 - No association professional cadre emerging
 - Advocacy relationship turned upside-down



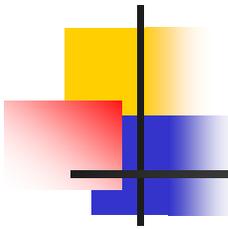
Specific Action Steps

- Help associations achieve fiscal independence
 - Hold donor conference to get them out of the business
 - Help associations create mission-related fee-for-service activities
- Educate ministers and parliamentarians on role of NPOs in
 - Standards development and enforcement
 - Service delivery
- Move advocacy from personal contacts to social welfare defense



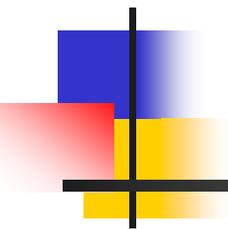
What Next?

- Create a Public-Private Dialog with a diverse cross-section of
 - Central and local authorities
 - Associations, Civil Society, and other private sector representatives
- Engage in an open and transparent deliberation that identifies specific actions for both the public and nonprofit sectors to undertake to eliminate or reduce targeted constraints



Discussion Points

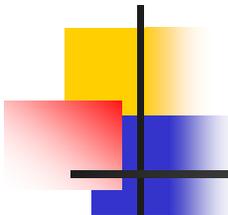
- Given the selection criteria, do you agree with the “Top 5” or would you pick others?
- What are the key short-term steps do you see that can be taken to address these issues?
- What role do you see KCC playing in a diverse Public-Private Dialog?



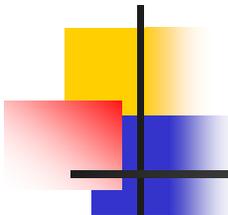
STUDIMI I KCBS-it PËR BARRIERAT

**BARRIERAT PËR INVESTIME
DHE RRYTJE NË SEKTORËT E
KCBS-it**

Studimi

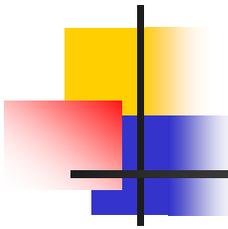


- **Metodologjia**
 - Hulumtime paraprake - rishikimi i ligjeve ekzistuese, praktikave, studimeve
 - Intervista me akterët kryesorë- zyrëtarë të bankave, drejtues të shoqatave, bizneseve, zyrëtarë të qeverisë
- **Identifikimi/rishikimi i barrierave relevante**
- **Përcaktimi i barrierave të targetuara.**
- **Formulimi i masave specifike të veprimit**



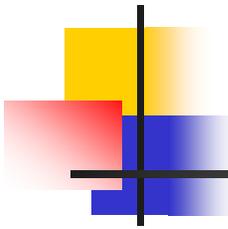
Rishikimi i Dhjetë Barrierave Relevante

- **Infrastrukturë fizike e papërshtatshme, sidomos furnizimi me energji, por edhe të tjera**
- **Korrupsioni, krimi, probleme të zbatimit të ligjit**
- **Konkurrenca e padrejtë/ndikimi i ekonomisë joformale**
- **Cështjet e brendshme që ndikojnë në bashëpunimin/konkurrencën mes bizneseve**
- **Ligji/sistemi i drejtësisë/gjykatat/zbatimi i vendimeve gjyqsore**
- **Ndalimi i privatizimit të tokës/pronësia mbi tokën e padefinuar**
- **Eksperiencë menaxheriale e kufizuar**
- **Infrastrukturë profesionale e kufizuar (juristë, kontabilistë, vlerësues të pasurive, etj.)**
- **Konkurrencë e madhe nga jashtë/importet**
- **Pasiguri ligjore/fiskale/dhe e statusit final**



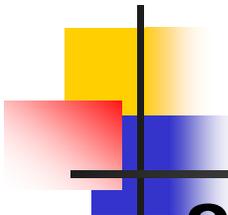
Kriteret për përzgjedhjen e barrierava të targetuara

1. Janë konsideruar që kanë ndikim të rëndësishëm në formimin apo rritjen e bizneseve,
2. Në kuadër të “Modelit Bulldozer” krijojnë mundësi për zgjidhje praktike që mund të implementohen brenda 6 muajve,
3. Mund të adresohen direkt nga komuniteti i biznesit me pak ose aspak vartësi nga masat qeveritare,
4. Nuk nevojiten fonde të konsiderueshme shtesë për zgjidhjet praktike,
5. Zgjidhjet e mundëshme nuk qenë në konflikt me realitetin e ambjentit politik kosovar.



Pesë barrierat e targetuara

- 1. Mungesa e Standardeve të Qarta dhe të Mbrojtura për Produktet**
- 2. Qasje e Pamjaftueshme në Kredi**
- 3. Politika Tatimore e Tregtare në Papajtueshmëri me Politikat Zhvillimore**
- 4. Mungesa e Përgjithshme e Eksperiencës dhe Diqeve Praktike (Know-How) në Sektorët e Biznesit të KCBS-it**
- 5. Mungesa e Iniciativës dhe e Bashkëpunimit të Duhur mes Pjesëtarëve të Industrisë (Përfshi Shoqata Jo të Forta të Biznesit)**

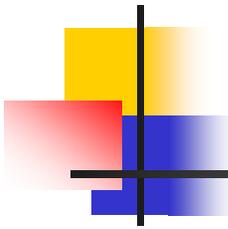


Pesë Barrierat e Përzgjedhura

Shënjestra 1: Mungesa e Standardeve të Qarta dhe të Mbrojtura për Produktet (Pjesa I)

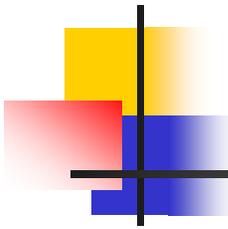
- Pse ka rëndësi kjo? – Si dëmton?
- Shembuj, sektor për sektor
- Cfarë duhet të përfshihet tek standardet– detajet
- Kush duhet t'i përgatisë ato – Këndvështrimi i KCBS për rolin e:
 - Qeverisë
 - Udhëheqësve të industrisë
 - Shoqatave të industrisë
- Standardet e kujt: lokale, rajonale, ndërkombëtare

Shënim: Kombinimi i ndryshëm i faktorëve të mësipërm mund të funksionojë për produkte dhe sektorë të ndryshëm



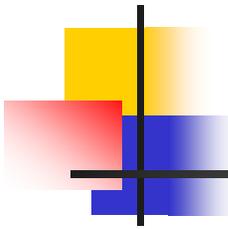
Shënjestra 1: Mungesa e Standardeve të Qarta dhe të Mbrojtura për Produktet (Pjesa II)

- Rregullimi për çdo produkt i cështje të testimit/mostrës/inspektimit/implementimit
- Lloje të ndryshme:
 - Mbrojta e shëndetit
 - Siguria e konsumatorëve
- Kush paguan dhe për çfarë?
- Alternativa për implementim – Llojet e kontratave private/padi/vepra penale për standardet e shëndetit
- Si të publikohen – Logo? Pulla? Program për edukimin e publikut?
- Mbrojtje juridike për pronësinë intelektuale



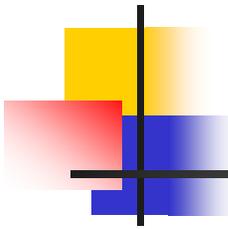
Masa Specifike Veprimi

- Edukimi i qeverisë, industrive dhe publikut për zgjedhjet kur përgatiten standarde
- Krijimi i grupeve të punës të industrisë, ministrisë dhe përfaqësuesve të konsumatorëve për secilin kllaster
 - Identifikimi i standardeve dhe hapsirave të pambuluara
 - Hartimi i modeleve dhe axhendave për adresimin e dështimeve të tregut
 - Krijimi i strategjive implementuese përfshi trajnimin e gjyqtarëve dhe mënyrat për mjetet financiare për implementim



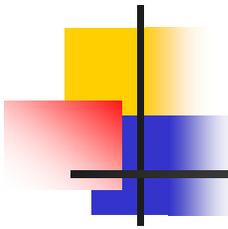
Shënjestra 2: Qasje e Pamjaftueshme në Kredi

- Çfarë ka tani në treg
- Si po i dëmton kjo bizneset e KCBS– Shembuj
- Shkaqet – Infrastruktura dhe sjellja
- Rishikimi i detajuar i tregut financiar të Kosovës– Struktura dhe aktorët individual
- Krediofruesit e ndryshëm kanë politika dhe mentalitete të ndryshme– Njihini ata
- Të veçantat e kredimit të bujqësisë
- Alternativat e financimit me kredi – A ka ndonjë?



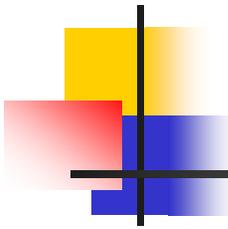
Masa Specifike Veprimi

- Ndiurma ndaj shoqatave për trajnimin e anëtarëve për aspekte praktike të marrjes së kredive
- Krijimi i një inventari të plotë të praktikave financiare që ofrohen tani në treg
- Ndiurma ndaj Shoqatës së Bankave të Kosovës për krijimin e ambjentit për komunikim mes BPK-së, bankave, përfaqësuesve të biznesit
- Afrimi i BPK-së me përfaqësuesit e bankave me qëllim përmirësimin e komunikimit dhe ndreqjen e keqkuptimeve në lidhje me rolin e secilës palë.



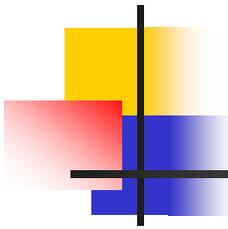
Shënjestra 3: Politika Tatimore e Tregtare në Papajtueshmëri me Politikat Zhvillimore (Pj. I)

- Shikimi i përgjithshëm i lëndës (i vështirë)
 - Roli i UNMIK vs. IVQP
- Ligjet për tatimet dhe ngarkesat dëmtojnë bizneset e KCBS– dhe cila është logjika për politikat aktuale?
- Ngarkesë e plotë doganore për lëndën e parë dhe inputet për prodhim
- Vlerë e plotë e TVSH-së për lëndën e parë dhe inputet për prodhim
- Administratë doganore dhe tatimore e ngadaltë dhe jo uniforme- Vonesat në kthimin e pagesave/bazë joreale e çmimeve, etj.
- Mospërputhje me nivelet e taksave në vendet fqinje, të cilat dëmtojnë



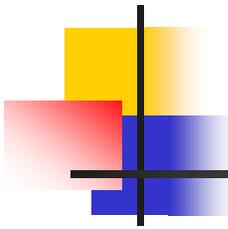
Shënjestra 3: Politika Tatimore e Tregtare në Papajtueshmëri me Politikën Zhvillimore (Pj. II)

- Suvencionet, kuotat, taksat tranzit dhe kufizimet e lëvizjes në vendet fqinje që dëmtojnë
 - Marrëveshjet e Tregtisë së Lirë do t'i vështirësojnë këto probleme
- Grupe të tjera që bëjnë lobim
- Pozicionet e kompanive dhe shoqatave në sektorët e KCBS-it



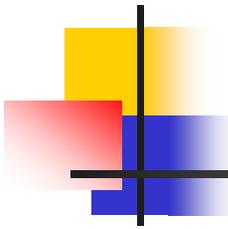
Masa specifike veprimi

- Fokusimi në politika racionale tatimore
 - Jo thjeshtë përjashtime individuale nga TVSH-ja
- Rishikimi i tarifave të reciprocitetit rajonal.
- Krijimi i të dhënave ekonomike më të mira për matjen e efektit të tatimeve
- Ndhurma ndaj shoqatave për t'u përfshirë në debate ndërsektoriale për politikat tatimore dhe prioritetet
- Krijimi i komitetit ndërqeveritar i Shtyllës IV dhe MEF-it për krijimin e politikave fiskale të pajtim me objektivat zhvillimore.
- Të nxiten donatorët të koordinojnë përpjekjet e tyre me politikat e komisionit ndërqeveritar.



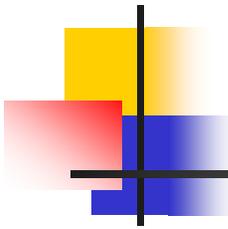
Shënjestra 4: Mungesa e Përgjithshme e Eksperiencës dhe Dijeve Praktike (Know-How) në Sektorët e Biznesit të KCBS-it

- Situata unike në Kosovë – Arsyë historike, tradicionale dhe të tjera
- Shembuj dhe raste ku dijet e thjeshta praktike (know-how) mungojnë



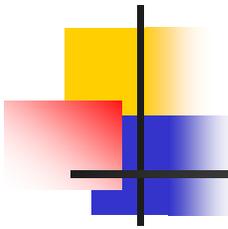
Masa specifike veprimi

- Përmirësimi i ekspertizës vendase në sektorin privat
 - Krijimi i shërbimeve të pavarura nga mbështetja e donatorëve
 - Përmirësimi i studimeve post-diplomike dhe programeve të edukimit të vazhdueshëm në sektorët e targetuar
 - Inkurajimi i ardhjes së ekspertëve të kualifikuar



Shënjestra 5: Shoqata Jo të Forta të Biznesit

- Kryesisht varen nga ndihma e donatorëve
 - Të fokusuara në projekte – jo në proces
 - Nuk ka planifikim afat-gjatë
- Donatorët kanë përdorur format tradicionale të të hyrave- trajnime, financime, misione tregtare, zhvillimi i standardeve
 - Vendosja jo racionale e çmimeve të produkteve
 - Varen nga kuotat e anëtarësisë
- Nuk ka pavarësi financiare
 - Varen në punë vullnetare
 - Nuk ka grupe të profesionistëve të shoqatave
 - Marrëdhënia e avokimit e kthyer në të kundërt



Masa specifike veprimi

- Ndiurma ndaj shoqatave që të arrijnë pavarësi financiare
 - Mbajta e një konference të donatorëve për t'i larguar ata nga veprimtaria
 - Ndiurma ndaj shoqatave të krijojnë aktivitete/shërbime kundrejt pagesës
- Edukimi i ministrave dhe deputetëve me rolin e organizatave jofitimprurëse në
 - Zhvillimin e standardeve dhe implementim
 - Ofrimin e shërbimeve
- Të zhvendoset avokimi nga niveli i kontakteve personale tek mbrojtja e mirëqënies sociale

KOSOVO
CLUSTER AND BUSINESS SUPPORT PROJECT

Constraint Study

Appendix “A”

Report by Integra Consulting and Services



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A Study on the Constraints to Business Creation and Growth in Kosovo

Prepared by: Integra Consulting

February 2005

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Acronyms

| | |
|--------|---|
| ASPAUK | Agricultural Statistics and Policy Advisory Unit Kosovo |
| BPK | Banking and Payments Authority of Kosovo |
| DFID | Department for International Development |
| ESI | European Stability Initiative |
| EU | European Union |
| FTA | Free Trade Agreement |
| ICG | International Crises Group |
| IMF | International Monetary Fund |
| KBS | Kosovo Business Support |
| KCBS | Kosovo Cluster and Business Support |
| LSMS | Living Standard Measurement Survey |
| MAFRD | Ministry of Agriculture, Forestry and Rural Development |
| MFE | Ministry of Finance and Economy |
| MTI | Ministry of Trade and Industry |
| NGO | Non-Governmental Organization |
| PISG | Provisional Institutions of Self-Government |
| S&M | Serbia and Montenegro |
| SME | Small and medium enterprises |
| SOE | Socially-owned enterprises |
| SOK | Statistical Office of Kosovo |
| UNDP | United Nations Development Program |
| UNMIK | United Nations Mission in Kosovo |
| USAID | United States Agency for International Development |
| WIIW | Vienna Institute for International Economic Studies |
| WB | World Bank |

Executive Summary

Kosovo has moved rapidly towards adopting legal and institutional reforms geared towards establishing an open market economy, with the ultimate objective of integration in EU in the coming years. Emerging from a military conflict and a more than ten years of disinvestment, Kosovo's economy experienced a rapid economic growth which is mainly attributed to immense international donor support. UNMIK and the Kosovar Government made significant progress in creating policies oriented towards creating a stable and sustainable environment to ensure economic development and freedom and welfare of the society.

As in many countries in transition, the path of Kosovo's transition was and continues to be not an easy one. In a complex and unique political situation in which Kosovo finds itself, it is a general impression that a lot has been achieved as far as creating institutions and policies that support private sector-led economic growth are concerned.

However, there is still a long way to go. Institutions should ensure a level playing field for all participants in the market. Legislation should prevent possibilities for monopolistic behavior based on favoritism and corruptive behavior. Public officials and particularly customs and tax administration staff should get proper training in order to maximize their efficiency and facilitate business operations.

In this report, numerous barriers to business in Kosovo were identified, and grouped into some categories, which are thought to be the severest ones and having the largest impact on business activities. Without attempting to provide an order of priority according to their severity, it is almost a consensual conclusion in all reviewed studies that the ultimate constraint for business development in Kosovo is the unresolved political status and political instability related to it.

Our review of available studies on Kosovo and its economic development identified the following major constraint categories that hinder business development: (i) unstable political environment; (ii) constraints related to trade regime; (iii) poor infrastructure; (iv) limited access to finance; (v) incomplete legal framework and lack of law enforcement; (vi) corruption and unfair competition; (vii) unskilled labor force; and (viii) constraints related to agricultural development.

It is obvious that most of these barriers to doing business are not specific only to Kosovo. In terms of regional comparison, there are several common issues and obstacles that most countries in the Balkans need to address: trade and customs related obstacles, infrastructure, business financing, and privatization are only some of the common issues. Therefore, it is unrealistic to expect that a country will work on its own to solve all these problems. Economic interdependence and regional cooperation are crucial to development of the Balkans as a region and of individual countries, too. The ability of these countries to attract foreign capital depends to a great extent on their being perceived as a part of a larger market – and functioning as such (Barrett, 2002).

1. Introduction

As Kosovo's economy is trying to develop local capacities to compete in both domestic and foreign markets, it is critically important to quickly identify and remediate constraints to business creation and growth facing the private sector development in Kosovo. At the request of Kosovo Clusters and Business Support (KCBS), Integra has undertaken this *Constraints Study* with the objective of identifying the constraints to business creation and growth. This report summarizes findings from the review of some selected studies, reports and publications on constraints to business creation and growth in Kosovo.

As such, this report will help to develop a clear understanding of problems related to business creation and growth. More specifically, *the goal of the Constraint Study is to create a body of knowledge on which a public-private dialog can be built to identify, prioritize, and select the most important constraints and develop immediate and practical solutions to overcome them.*

The study was carried out between February 8 – 22, 2005.

The report is structured as follows: After the executive summary provided in the very beginning and followed by this introduction, in Section 2 the methodology of this study is presented. In Section 3, an overview of economic development in post-war Kosovo is provided which helps to understand the constraints to business creation and growth in a wider context. In Section 4, we discuss the availability of studies related to constraints to business creation and growth in Kosovo. In Section 5, we discuss in detail constraints identified from the review of these studies. In Section 6, the intensity of constraints and their evolution during the last three years are examined. This section provides a dynamic analysis of constraints. Finally, in Section 7 policy recommendations related to the constraints identified above are addressed. In the annex of this report, a list of recommendations regarding policy prescription and a list of reviewed studies that relate to constraints to business creation and growth in Kosovo are presented.

2. Methodology

The lack of data poses a real constraint on analyzing almost every aspect of economic life in Kosovo. The existing data is at worst unreliable and at best incomplete. Therefore, one should consider all available data sources in order to draw conclusions that would stand. This was among the reasons why we reviewed the most relevant available studies related to constraints to business development. The studies were reviewed to identify consensual issues, major differences in assessments and the evolution of opinions and perceptions over time regarding constraints to business creation and growth in Kosovo.

More specifically, Integra carried out the following tasks in order to complete this constraints study:

- Identification and collection of the most relevant available studies that relate to constraints to business creation and growth,
- Review of these studies and identification of commonly cited constraints,
- Provide an economic analysis regarding the impact of these constraints on businesses, and
- Summarize proposed actions and recommendations.

The methodology went through the following steps: First, during an initial meeting with the project team, the action plan was discussed and tasks were allocated. A list of all institutions that have produced/published any document related to constraints to business creation and growth was compiled. In addition, a common framework was agreed upon as how to approach analyzing these studies. Second, relevant institutions identified during the initial meeting were contacted and their studies were obtained. Third, the project team continued with reviewing the studies. A meeting with KCBS Constraints Study team helped to come to a common understanding on how to review the studies and produce the final report. Fourth, the work produced by all members of the project team was reviewed, edited and the final report was produced. In the end, the final report is to include suggestions and recommendations from a meeting at the USAID Office in Prishtina on March the 22nd.

3. An overview of developments in post-war Kosovo

3.1. Political developments

Since the war ended in June 1999, great efforts have been made in trying to establish institutions and enact regulations that would provide the necessary conditions for a secure life and prosperity for everyone in Kosovo. Initially, UNMIK had most of decision making power, but recently there has been a remarkable progress in handing over some power to the Government of Kosovo. This process is to continue until the final status of Kosovo is determined.

Now, the Government and the Assembly of Kosovo have the power to exercise their role and decide for many aspects of social and economic life in Kosovo. The Government of Kosovo has the decision making authority over education, health services, basic employment services and other areas, though the SRSG has the final say in the laws passed by the Assembly as well as the complete power on foreign relations, justice, and some other related areas.

Given the progress made so far, it is necessary to transfer more power to the Government of Kosovo and other local institutions. The power transfer is one of the major objectives of

the ‘standards for Kosovo’. The aim of these “standards” is to ensure that Kosovo’s institutions are capable to run democratic processes and achieve a certain level of required progress as a basis for the resolution of the final political status.¹

3.2. Economic development

Kosovo was the poorest region of the former Yugoslavia with a per capita social product of a quarter of the national average in 1989. Now, it is one of the last countries to embark on the road of transition to a market economy. The reason is twofold. First, the occupation by Serbia during the period 1989-1999, which started with the abolishment of Kosovo’s Autonomy in 1989.² The international isolation of Serbia together with that of Kosovo aggravated the economic situation furthermore. During the period 1990-1995, GDP contracted by 50%, falling to less than \$400 per capita. Some 145,000 Kosovar Albanian employees in social and public sector (primarily the managerial staff of SOEs, teachers and university professors) were dismissed from their jobs. Consequently, unemployment, being at 38% in 1989, reached the level of approximately 68% just before the war (Riinvest, 1998).

In addition, the war in 1999 displaced some 800,000 people to neighboring countries and to the Western Europe. GDP is recovering and has increased significantly during 2001 and 2002, reaching the level of approximately US\$ 1.7 billion according to the latest IMF estimation (IMF, 2004). The reconstruction process absorbed a considerable number of unemployed people. Some 72,000 people are working in public sector (education, health etc.). The table below shows some of macroeconomic trends over the last four years.

Table 1: Basic macroeconomic indicators

| | 2002 | 2003 | 2004 | 2005 * |
|-------------------------------------|------------------|------------------|------------------|--------|
| GDP in mil € ¹ | 1,735 | 1,797 | 1,895 | 1,999 |
| GDP growth (annual), % ¹ | 1.2 | 3.1 | 3.2 | 1.7 |
| Consumer Price Index ¹ | 3.6 | 1.0 | 1.5 | 2.0 |
| GDP per capita, in € ¹ | 913 | 930 | 964 | 1,000 |
| Gov. revenues (% of GDP) | 28.8 | 32.8 | 31.9 | 30.8 |
| Bank deposits, mil.€ ² | 413 | 501 | 677 (Nov) | - |
| Registered job-seekers | 257,505 (Dec) | 280,923 (Nov) | 298,036 (Jul) | - |

Source: ¹ – IMF estimates, ² – Banking and Payment Authority of Kosovo, * IMF projections

Based on some estimations made by the World Bank, poverty in Kosovo is widespread. According to LSMS survey around 11% of the Kosovo population live in extreme poverty,

¹ The areas concerned under the ‘standards for Kosovo’ include: (i) functioning democratic institutions; (ii) rule of law; (iii) freedom of movement; (iv) sustainable returns and the rights of communities and their members; (v) economy; (vi) property rights; (vii) dialogue; and (viii) Kosovo Protection Corps.

² During this period, the Kosovo Albanians established their own parallel institutions, including a government at central and municipal level, which did function until 1999.

while 50% are below the poverty line of \$1.534 per adult per day, including expenditures on food and non-food items. One of the main sources of income for a Kosovo household are remittances from relatives in Western Europe. Remittances are estimated at the level of a quarter of GDP.

Given all these reasons (high unemployment, low job creation, political constraints etc.), policies that will boost a private sector-led economic growth are urgently needed. This study will help to identify the constraints to business creation and growth and to properly address them in the future.

3.3. Private sector development

The number of private enterprises in Kosovo increased significantly during the 1990s, when over 16 thousands of them were registered.³ After the military conflict, most of these enterprises were consolidated and the number of new ones increased sharply.

Currently, it is difficult to know the exact number of enterprises operating in Kosovo. The data from the Business Registry differ substantially from that of Tax Administration. A Macroeconomic Monitor of MFE (October 2004) shows that the number of businesses is around 39 thousand, though a considerable number of these businesses are not active. Most of them are operating in trade sector (57%) followed by enterprises in transport sector (14%). Around 90% are individual businesses; some 6% are partnerships with the remaining that include other forms. A proportion of businesses (some 25% of the total) are involved in production activities but their share still remains very low and insufficient to lower huge demand for products that are imported by trade/importing companies.

Prospects and the challenges for economic and private sector development during emerging transition in Kosovo were identified by the World Bank (2000) report as consisting of three components: (i) private businesses, mostly in trade sector and to a large extent operating on informal basis; (ii) SOEs and their privatization; and (iii) public sector (the part involved in economic activities). It was recommended that the first component be brought into formal economy through a number of policy reforms, then promote private sector growth. This would be expanded by privatization of SOEs and performance improvements of public enterprises in support of that growth. While the progress with the first component is made and is still underway, privatization is not proceeding as expected and the process so far has been sluggish. The performance of the third component to provide services for the first two in general has improved, but there still remains much to be done.

³ There was also a considerable number of businesses in the informal sector. Their approximate number and the scope of informal economy are not known.

4. Available information on constraint to business and growth

In general, there is a considerable number of studies available regarding constraints to business creation and growth in Kosovo. But, most of the studies identify only a set of constraints. We have reviewed some studies, reports and publications, among others, by: the Ministry of Trade and Industry, Ministry of Economy and Finance, World Bank, USAID, DFID, UNMIK, EURECNA/EAR, Riinvest, ICG, IMF, KBS, MAFRD, OECD, EU, The Balkan Network, UNDP, WIIW, SOK, ESI, BPK etc (see Annex 2 for a list of studies).

Although most of these organizations have published studies that deal with business constraints, only few of them are very focused and provide recommendations as to what are the necessary steps to improve business environment and boost job creation and business growth. These are studies that come mainly from donor organizations, although government entities (such as MTI) have tried to work on this area, too.

5. An analysis of constraints to business

5.1. Unstable political environment

Kosovo's macroeconomic performance is largely dependent upon the settlement of its final political status. Its macroeconomic situation remains a challenge for policymakers, especially as the time for deciding about the final status is approaching. The economy suffered a heavy damage during the military conflict and with the substantial support of international community, it emerged as a new market-oriented economy. Significant donor inflows supported the reconstruction of Kosovar economy since 1999. However, despite the achievements in all aspects of economic and institutional reform, the macroeconomic performance faces serious challenges as donor inflows and diaspora remittances have declined. In order to maintain macroeconomic stability, Kosovo needs to replace this decline with foreign investment and increased exports. Foreign investments in Kosovo are marginal mainly due to the unclear political status and exports are at a low level mainly due to various trade-related barriers (and many of them are linked to political issues, too). However, a certain degree of macroeconomic stability has been achieved through adopting Euro as official currency and the inability of the Kosovo budget to run deficit. In one word, Kosovo's economic growth and macroeconomic stability will be maintained only if the conditions are created for the mobilization of private capital.

Privatization process is considered to be an important factor for attracting foreign fresh capital which would boost economic development. It was expected to provide for an important source for increase in exports thus improving trade balance. Despite the readiness and full support on the part of the Kosovar government and the society as a

whole, the progress in privatization has been slow due to political impediments. Initially, the privatization of over 500 SOEs in Kosovo was anticipated to be completed by end of 2005, whereas to date (February 2005) only 30 or so SOEs have been privatized. Many studies and publications have argued that privatization has been delayed mainly because of political reasons. A recent USAID evaluation study of the USAID Commercial Law support to Kosovo argues that ‘the resolution of Kosovo’s political status is the most important factor in increasing foreign investment’. Similarly, the World Bank study on Kosovo Business Environment carried out in June 2004 argues that the ‘prospects for economic growth depend upon the success of two overarching factors: (i) a resolution of the political status and the maintenance of peace and security in the region, and (ii) implementation of a policy program that promotes private sector-led growth, including completion of the reconstruction effort’⁴.

5.2. Constraints related to trade regime

Kosovo’s customs regime is unique in many respects – Kosovo is an independent customs administration unit, while based on UN Security Council resolution 1244 it is considered to be part of the Serbia & Montenegro. This has an effect on how foreign investors perceive trade possibilities and the risk in investing in Kosovo. As a World Bank report (2004) states, from a considerably protected regime as part of the former Yugoslavia, the trade regime in Kosovo has become one of most liberal in the region. The situation regarding the trade balance has improved over the last years, though there is still a large trade imbalance (see Table 2). The main trading partner is the EU (including Switzerland), while in the region Macedonia and Serbia. Kosovo is granted duty-free access to EU markets (though not much is made used of) as the EU established the Autonomous Trade Preference scheme, which provides duty and quota free access for all exports, not only of Kosovo.

Table 2: Exports and Imports (2000 – 2003)

| | Exports | | | | Imports | | | |
|------------|--------------|--------------|--------------|-------------|--------------|--------------|--------------|--------------|
| | 2000 | 2001 | 2002 | 2003 | 2000 | 2001 | 2002 | 2003 |
| Total (€m) | 18.88 | 10.65 | 27.32 | 36.2 | 635.2 | 874.4 | 988.7 | 968.5 |
| Of which % | | | | | | | | |
| EU | 30 | 45.5 | 43.2 | 38.4 | 27 | 20.3 | 23.6 | 25.9 |
| Macedonia | 26.7 | 18.7 | 12.4 | 19.2 | 25.6 | 20.1 | 15.4 | 14.6 |
| Serbia | 0.1 | 3.7 | 16.4 | 16.5 | 2.4 | 20.2 | 18 | 14.7 |
| Albania | 20.8 | 12 | 5 | 5.2 | 1.6 | 3.5 | 4.9 | 0.8 |
| Croatia | 0.3 | 1.3 | 7 | 5 | 0.4 | 1.1 | 1.6 | 3.3 |
| Turkey | 8.1 | 2.4 | 4.2 | 4.8 | 5.2 | 8.9 | 7.9 | 9.5 |
| Montenegro | 1.6 | 6.2 | 0.5 | 2.8 | 16.9 | 7.1 | 6.4 | 1.1 |
| B & H | 0.9 | 2.6 | 5.1 | 2.4 | 4.1 | 2.6 | 2.2 | 2.4 |
| Bulgaria | 1.5 | 0.8 | 0.6 | 0.5 | 6.7 | 5.7 | 5.7 | 4.3 |
| Others | 9.9 | 6.7 | 5.6 | 5.2 | 10.2 | 10.5 | 14.3 | 23.5 |

Source: World Bank (2004)

⁴ By ‘reconstruction effort’ the report refers to the reconstruction of the houses and other religious sites damaged during the March 2004 ethnically motivated violence.

Current trade regime arrangements in Kosovo are considered to hamper businesses in many aspects. These constraints can be categorized as tariff barriers and non-tariff barriers. This distinction has implications regarding the necessary steps to target them.

Until just recently, there was a uniform 10 percent tariff rate on all imports, except for wheat and wheat flour, pharmaceutical products, medical and surgical instruments, stamps and valuable papers, and fertilizers. As such, Kosovo's tariff regime made no distinction between goods for consumption and goods that are production inputs. The rationale behind this policy was to establish a simple trade regime which would be easily administered and enforced, and is also grounded on the argument of protecting the markets from distortions that would result through a differentiated tax system which favors one sector versus another.

Although VAT rate is only 15% and is lower than in other countries, its administration appears to be a burden to the development of local capacities and to their competitiveness even in the local market. For the sake of comparison, VAT in Albania is 20%, in Macedonia 19%, in Serbia 20% sale tax, Croatia 22%, Poland 22% etc. Nevertheless, a World Bank survey with SMEs showed that many firms expressed dissatisfaction with excessive delays in processing VAT refunds, and improper reference pricing. VAT refunds frequently require three months or longer to process. Efforts have intensified to deal with this issue, which is also one of the points referred in the "Standards for Kosovo".

Even though a FTA is concluded with Albania and initiated with some other countries, trade with Serbia and Montenegro is not subject to customs duties, while with Macedonia is subject to the agreement signed between S&M and Macedonia. This puts Kosovar producers on a disadvantaged position, since the largest share of Kosovo's imports comes from its neighbouring countries. The application of the trade agreement between S&M and Macedonia regarding the trade relations between Kosovo and Macedonia (this agreement was signed in 1999 between Skopje and Belgrade, and it came into effect in January 1, 1999) is undermining the ability of domestic producers to compete even in the local market. Based on this agreement, all goods originating from Macedonia are exempt of customs duty of 10%. Since around 15% of Kosovo's imports come from Macedonia (while a third of the imported goods come from countries of the former Yugoslavia), this measure is having a negative effect on the capacity of local producers to compete even in the domestic market. This trade agreement and the benefits that producers from Macedonia can get is an incentive for businesses to get involved in falsification of documents on the origin of goods, which in fact is quite a frequent phenomenon.

Transport incurs considerable cost on Kosovar exporters and importers. They pay a 4% to 5% tariff tax on goods shipped through Serbia and Montenegro. Montenegro does not grant reciprocal treatment (duty free access) to Kosovar exports to Montenegro regardless of the fact that goods with Montenegrin origin are not subject to any tariff as Montenegro is

considered to be part of S&M. The asymmetrical application of the trade regime with the trade partners puts Kosovar exporter in an unequal position.

Kosovar producers face also other non-tariff barriers. Until recently, Kosovars were faced with non-recognition of personal documents abroad (though this is being addressed and solved lately). Macedonian customs refused until recently to recognise UNMIK certificates of origin for Kosovar exports to Macedonia. Trucks bearing Kosovo licence plates have difficulties to travel to neighbouring countries. This increases the costs of transportation. Even though this problem is being addressed and solved with many countries, trucks with Kosovo licence plates cannot enter Serbia. The lack of travel documents, transporting vehicle documents, car documents are a big problem and a big barrier in the communication with the foreign partners. A large number of Kosovars possess UNMIK travel documents that expire in two years with very complicated procedures for extension.

Moreover, when transiting through Macedonia, companies from Kosovo have reported that they had to bribe Macedonian officials. Although there might have been limited cases of bribery, the existence of this phenomenon in the first place constitutes a barrier to expanding trade (i.e. increasing exports) and also increases the costs of imported goods.

The lack of information for the foreign markets, the lack of knowledge for the European market, the lack of knowledge of EU laws, is another barrier to expanding foreign trade.

5.3. Poor state of public infrastructure

Power sector is still not stable which is disincentive to investment by local producers and from attracting foreign investors. Power shortages are a fundamental constraint to all enterprises, imposing higher operating costs, production losses, and reducing competitiveness (World Bank, 2004). A World Bank survey with SMEs in Kosovo showed that firms reported 90 days of power outages with an average duration of six hours per day. The need for alternative sources of power increases costs for firms. Based on that survey, three-quarters of all enterprises have had to purchase generators. The cost of purchase and operation of a generator represents an additional two percent of operating costs. The total cost to firms of inadequate power supply translates into about 8-9 percent of annual sales, which either reduces profit, or is passed on to consumers through higher product prices, or both.

The Riinvest Report on Privatization states that electricity shortages, inadequate water supply, poor transport network etc, were seen as a major source of raising the costs of doing business, in particular for manufacturing firms. In this respect, the WIIW report argues that the development of physical infrastructure of Kosovo could benefit from a number of European initiatives such as the Stability Pact, Corridor 8.

5.4. Limited access to finance

In Kosovo a stable banking system has been developed, but with the small potential for lending, with high interest rates, shorter repayment period and other lending requirements. Lending conditions and interest rates of commercial banks are considered to be not favourable for private business development. Because of the unresolved political status and underdeveloped capital market, commercial banks offer loans with high interest rate in order to cover business risk. The availability, cost, and duration (only up to three years) of loans from financial institutions is considered to be a serious problem to business development in a situation where businesses face lack of finance for investment projects and also for their working capital. It is essential, if business is to expand that it makes more extensive use of bank credit.

In spite of these facts, deposits and lending have increased during the last three years. Deposits increased and reached the level of over 600 million Euro. Loans consist of more than 50 per cent of deposits with around 78 percent of loans dedicated to businesses (the rest consists of loans to households). Most of lending (as of October 2004) is to trade sector (around 45 per cent of total lending), services, tourism, and hotels/restaurants (10 per cent), industry (4 per cent), agriculture (3 per cent), real estate (2 per cent), other sectors (28 per cent).

Loans are still expensive and short term, and these conditions do not encourage investment activities that would spur economic development. In terms of sectoral allocation of loan portfolio, one can see that industry and agriculture as two sectors with potential for export are underrepresented in terms of loans allocated to businesses in these two sectors. It seems that the amount and terms of the credit offered does not encourage investment in these sectors.

Loans by commercial banks are not loans for start-up businesses. The only current sources for financing start-ups are micro finance institutions.

On the other side, there is a need to educate potential borrowers on bank requirements for extending loans (balance sheets, business plans) and to encourage the banking community to make available longer term finance (5-10 years) at lower interest rates. In addition, an improved legal and institutional environment (mortgage and bankruptcy laws and better court system) would facilitate lending.

5.5. Incomplete legal framework and lack of law enforcement

Basic economic legislation has been put in place, including the privatization legislation. However, the legislative framework in Kosovo is far from being complete. In fact, it is one of the most complex legislations in Europe if not wider. Three legislative components

comprise this complex legislation: (i) the pre-1989 non-discriminatory laws of former Yugoslavia, the so-called 'applicable law', (ii) UNMIK Regulations, and (iii) Laws adopted by the Assembly of Kosovo. It is clear that such a complicated legislative framework has impact on business activity and in enforcement aspects of legislation. It reflects the current political status of Kosovo with UNMIK administration devolving more competences and responsibilities to Kosovar government, and in the process of standards review and initiation of the process for the settlement of the final political status of Kosovo.

One of the major business constraints for business community in this aspect is the lack of full functioning of immovable property rights registry. This will be a challenge for the Cadastral Agency of Kosovo to accelerate the transfer of existing textual and geographical data into property right registry and implement measures to reconcile the gap.

A problem *per se* is the functioning of judicial system in Kosovo as pertains to enforcement of property, contract and creditor rights (particularly within the local municipal court system). This competence is still with UNMIK and measures should be undertaken to strengthen enforcement of legislation. In this respect, there is an immense need for training of judges on commercial law, and particularly in Law on Obligations (the Contract Law). The organization of courts and their procedures need evaluation so that contract disputes receive timely resolution.

Another important aspect that contributes to overall business climate in Kosovo is the structure of the law enforcement institutions - courts. Currently, this structure is largely unchanged from the previous system, whereas the legal framework within which these courts operate is new (the three components mentioned earlier).

Examples of the legislation that is not based on interdisciplinary approach, and which attempts to regulate only one aspect of a certain government entity by bringing damage to another government entity have been present, and have led to wider misunderstandings among the stakeholders and society (such as the Collective Bargaining agreement concluded between the former Government, Trade Union, and Chamber of Commerce, which did not take into consideration budgetary constraints for its implementation).

5.6. Corruption and unfair competition

Corruption appears to be one of the major constrains for businesses in Kosovo as expressed in Riinvest and the World Bank surveys. The incidence of official corruption, however, is difficult to be measured. In a World Bank study on Obstacles to Growth, one third of respondents identified corruption as a major or very severe obstacle to doing business in Kosovo. On the other hand, the USAID report on Corruption in Kosovo based on a survey with 505 respondents concluded that although the corruptive behaviour on the part of the

government officials is present, in general, this problem is not perceived as endemic and as widespread as some might think. Anti-corruption programs and strategies are needed in particular sectors and in both central and municipal levels. As far as the institutions involved in corruption are concerned, perception of the Riinvest survey with 38 foreign and joint stock companies is that among the most corrupted institutions in Kosovo are customs administration, health institutions, local administration, central administration, and courts in the rank of priority. Surprisingly, tax administration was not mentioned at all, which is a positive and encouraging finding. A more detailed analysis of the intensity of this constraint and its evolution during the last 3-4 years is provided in chapter 6 of this report.

A logical consequence of rent seeking and corruptive behaviour on the part of officials is tax evasion, which in turn leads to market distortion and unfair competition. Most of Kosovar businesses complain about this phenomenon. Unfair competition ranks the first among the constraints to business according to Riinvest SME surveys in 2002 and 2003. Unfair competition is also present as an obstacle as far as the regional trading partners are concerned. The absence of reciprocal treatment of Kosovar exports within the region is a significant constraint to their access to potential markets giving the regional competitors unfair advantages. These problems have been detailed out in chapter 5.1.

Cutting the roots of corruption now when this phenomenon is only in its inception phase, rather than later when it becomes endemic, is a challenge for policy and legislation makers. The fact that a large portion of firms in Kosovo operate in informal sector, represent a significant competitive barrier for firms operating legally. Firms that hide taxes create unfair competitive advantages over legal firms and thus distort the market.

5.7. Inappropriate labor force skills

Labor force in Kosovo is still considered to be uncompetitive in terms of skills as it is considered not to have the appropriate skills for the market economy. An SME report by Riinvest Institute shows that almost half of 300 SME interviewed in 2002 are only partially able to fulfill their needs with qualified staff. The reason for this, according to them, is that the education system is not able to prepare new graduates with appropriate practical skills. In the Riinvest SME survey, most firms answered that they consider the skills of new graduates to be below average based on needs. They suggest that additional training for new graduates is necessary in order for them to increase labor productivity and efficiency.

While the progress towards the market economy in the early phases of transition depended on the willingness and commitment of governments to implement reforms, the long run adjustment of transition economies depends greatly on the ability of human capital to absorb and apply the knowledge that is necessary to compete internationally. Human capital that is able to adjust to technological changes and to the principles of market economy is a prerequisite to bring economic prosperity for the nation as a whole.

Moreover, human capital is also vital to wider process of societal change that underpins economic reforms. As such, education is an important factor of economic growth.

Given the trend toward the knowledge-based economy, the human capital embodied in the Kosovar population is the nation's most important economic asset. Improving educational standards stimulates economic development directly through its effect upon the productivity of workers. In addition, a more educated workforce is more flexible and adaptable, and thus better able to respond to the changing needs of the Kosovar economy. A further particular advantage to the Kosovar economy is that the successful promotion of key competencies will stimulate self-employment. Better education increases chances for Kosovars to compete in foreign labour markets and attract foreign investors in the domestic market.

Majority of the new jobs created in Kosovo during the last four years have been created in the SME sector, for which the entrepreneurship skills are essential. Consequently, an education system that equips the new graduates with these skills ensures faster employment and therefore economic growth.

5.8. Constraints to agricultural development

With more than sixty percent of the population living in rural areas, agricultural development in Kosovo is crucial to providing income for households residing in rural areas as well as supplying domestic market with food products. Agriculture accounts for more than 20% of GDP. Because of the importance of agriculture in providing jobs and income in Kosovo, in this section we discuss some constraints related to agricultural development in particular.

A report by MAFRD / ASPAUK (2004) shows that Kosovo is severely disadvantaged in agriculture compared to its neighbours as most of them provide direct subsidies to farmers, impose tariffs from 15-30 percent and quotas to protect their local producers. On the other side, Kosovo does not offer any protection. Only recently the tariff rate is abolished for agricultural inputs.

Following are among the main constraints to agricultural development in Kosovo:

- Lack of integration into regional trade,
- Inappropriate fiscal policy for agricultural development,
- Low productivity in farming sector (small and uncompetitive farms, land fragmentation etc.),
- Undeveloped marketing chain for agricultural products,
- Uncompetitive agro-processing sector,
- Lack of services e.g. advisory services, rural finance and mechanization contractors,

- Neglected physical rural infrastructure (roads, telecommunications, electricity, warehouses),
- Agriculture is unattractive for the young, as well as poor training and education facilities related to agriculture.

Bank and lending institution perceptions are that agriculture is a risky sector for lending money. Current interest rates are high when compared to the potential returns from agricultural activities. Statistical information from BPK shows that from the total lending portfolio of all banks, loans to agriculture constitute only 3 per cent of total loans. Those engaged in agricultural activities rarely keep accurate financial records, do not register their businesses etc., which makes banks reluctant to lend to them. Many small farms operate at subsistence levels, and after the family's consumption needs are met, they generate very little surplus for market. Such farmers have no or at best very little chance of obtaining commercial credit, even from micro credit lenders.

Import of agricultural and processed food products makes it difficult for local producers to be competitive. All producers and processors have complained that they are disadvantaged by the customs duties and taxation currently imposed and also by the inflow of illegal goods entering Kosovo (MAFRD / ASPAUK (2004)). There is a lack of certification schemes and enforceable inspections of processing facilities, which would help to give the consumer confidence that locally produced agricultural products are safe. The farming sector lacks an adequate advisory service.

6. Intensity indicators of the constraints and their evolution over the last four years

In this section a dynamic analysis of constraints to business creation and growth in Kosovo is provided using different data sources. This helps to get a sense of how most of the constraints identified and discussed in Section 5 have evolved over the last four years.

The Riinvest Institute for Development Research from Prishtina used surveys of private SMEs to identify the main barriers to doing business. A sample survey of 300 SMEs in 2000 was extended to 600 and was maintained in the forthcoming years (2001, 2002, and 2003) with the same set of barriers and methodology of assessment (Table 3). Riinvest intensively used these data in other reports, most of which we will be referring to later in this section. Therefore, it is important to compare the intensity indicator and observe the trend of these barriers. Out of a total list of 14 barriers, we have identified 9 of them which are more worth looking at. Table 3 also presents some of these barriers covered by another survey, i.e. the survey of 110 export oriented companies in 2003. The last column of the table refers to assessment of the World Bank of some of these barriers, using a different methodology (*see also Figure 1*).

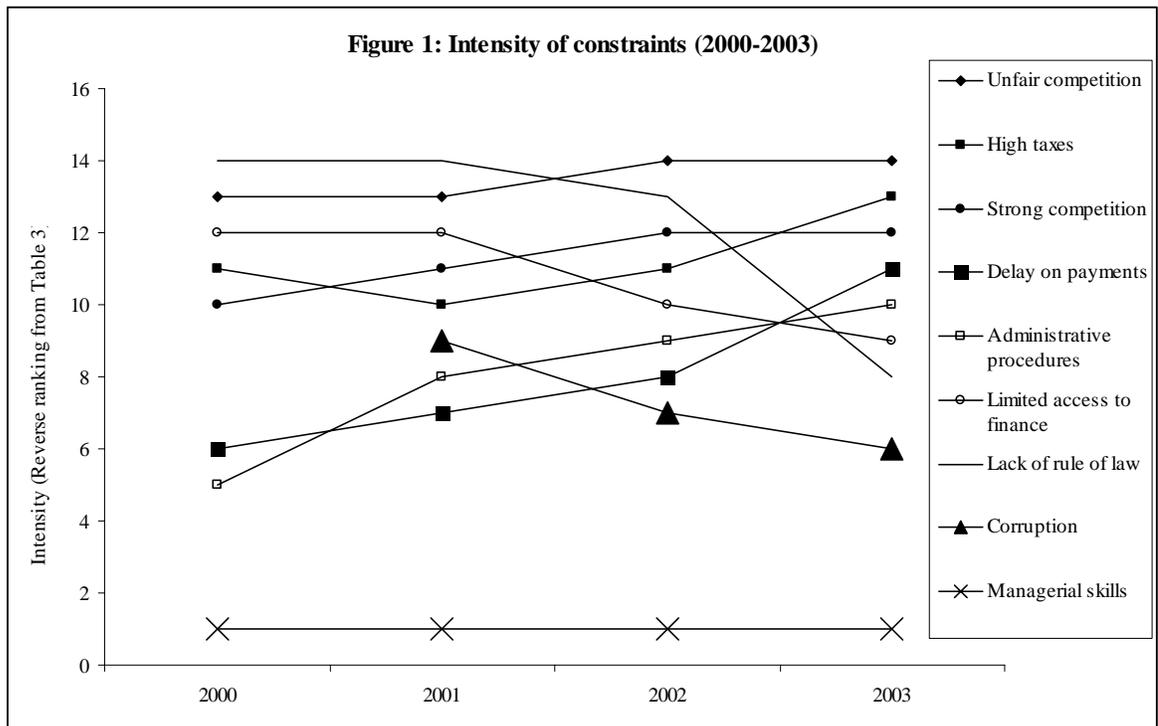
Table 3: Intensity indicator and ranking of barriers to doing business in Kosovo (2000-2004)^{a)}

| Barriers | Survey of 300 SMEs | Survey of 600 SMEs | | | | Survey of 110 export oriented companies | World Bank Survey of 329 SMEs |
|---------------------------|--------------------|--------------------|-------------|--------------------------|--------------------|---|-------------------------------|
| | 2000 (rank) | 2001 (rank) | 2002 (rank) | 2003 (rank) | 2003 (rank) | 2004 (rank) | |
| Unfair competition | 75 (2) | 74.7 (2) | 74.9 (1) | 72.4 (1) | n/a | 44% (2) | |
| High taxes | 51 (4) | 57.4 (5) | 58.6 (4) | 68.3 (2) | 66.3 ^{b)} | 30% (9) | |
| Strong competition | 49 (5) | 57.7 (4) | 63.1 (3) | 64.9 (3) | n/a | n/a | |
| Delay on payments | 34 (9) | 38.9 (8) | 44.5 (7) | 56.0 (4) | 57.0 ^{c)} | n/a | |
| Administrative procedures | 27 (10) | 39.5 (7) | 44.8 (6) | 55.1 (5) | n/a | 24% (13) | |
| Limited access to finance | 61 (3) | 61.0 (3) | 54.1 (5) | 52.3 (6) | 71.6 (1) | 32% (7) | |
| Lack of rule of law | 85 (1) | 75.9 (1) | 67.4 (2) | 51.8 (7) | n/a | 26% (10) | |
| Corruption | n/a | 40.6 (6) | 42.5 (8) | 49.2 (9) ^{d)e)} | n/a | 35% (4) | |
| Managerial skills | 12 (14) | 12.5 (14) | 10.3 (14) | 12.4 (14) ^{d)} | 15.8 (14) | 8% (14) | |

- a) the intensity indicator was calculated based on respondents' ranking of the factor on a 1-5 grade scale, implying the following: 1= very big problem, 2= big problem, 3=problems, 4= small problem, and, 5=did not cause any problem. Individual values were multiplied by the number of respondents and divided by the possible maximum value of the indicator. This yielded a percentage value of maximum 100 (all the respondents attributing maximum importance to the factor), and minimum 0 (all respondents attributing minimum importance to the factor).
- b) refers to customs tariffs with other countries.
- c) delays at border crossings.
- d) authors' calculations based on Riinvest's data base.
- e) In the same year, a survey of 60 foreign and/or joint foreign and domestic owned companies corruption was identified as the barrier number one against foreign direct investment in Kosovo.

Figures in parentheses indicate rank.

Sources: Riinvest's Reports 1) *SME Development in Kosovo, various years*, 2) *Foreign Direct Investment in Kosovo: Policy Environment and Promotional Strategy*, 2002, 3) *Trade Policy and Export Promotion in Kosovo*, 2003, *Kosovo's Business Environment: Constraints to Growth*, World Bank, 2004.



The barriers identified by Riinvest did not experience any significant changes in ranking over a three year period with the exception of lack of rule of law in 2003 (explained by the progress made by UNMIK in passing a considerable number of regulations, see Figure 1). While progress with availability of regulations was clearly made, and businesses did not complain much about that in 2003, it is not known why unfair competition (which is related to the lack of rule of law) has become the most severe barrier.

It is also important to note that in addition to similar ranking of barriers, the reports under consideration provide very similar recommendations in 2001 and 2002 (there were no recommendations for annual report of 2003).

Before addressing some remarks to the barriers identified by Riinvest through SME survey in Table 3, let us discuss some details of the same barriers identified in other reports, such as that of 'limited access to finance'. It was found that around 63% of SMEs considered this as a barrier causing serious problems. SMEs in the sector of trade perceived it more acutely followed by manufacturing ones, with high interest rates and short terms loans as the main cause. Furthermore, the report identified the causes of limited access to finance by SMEs in the emerging market for finance at that time, and addressed a number of recommendations as how to improve this access in order to boost investment by SMEs. The recommendations were addressed to specific stakeholders that had impact in the

development of SMEs such as, policy-makers UNMIK and the Kosovar government, regulatory framework, banking community, business community, and the donors.

In a follow-up Report on SME financing and development in 2003, the barrier of limited access to finance was perceived more as a serious problem among manufacturing businesses (72%) rather than businesses dealing with trade (68%) or services (59%). The analysis by firm size showed that smaller SMEs considered lack of finance more as a serious and/or moderate problem. Also in 2003, when Riinvest conducted a survey of 110 export oriented companies to identify the barriers hindering their activity, it found the intensity indicator of limited access to finance or lack of credit as the highest one (out of a total of 14 listed barriers). The ability and experience of managers like in SME surveys was found to have the lowest intensity indicator.

The issue of taxes was also examined in greater details in a separate report of Riinvest. The key findings in this respect were that majority (62%) of private businesses considered customs duties as too high, with 37% that felt that they were “acceptable”. Based on what was identified with regard to taxes, it was recommended to lower business taxes and introduce a broader taxation base, that would match more closely the tax burden with abilities of various businesses to meet their tax obligations, or apply differentiated taxes.

Another problem discussed in the report, was fiscal evasion and informal (sometimes referred to as ‘grey’) economy, the two constrains causing lower level of revenues from tax collections, and generating unfair and strong competition among businesses, namely those who paid taxes were at disadvantaged position from those that did not do so. Strong competition was mainly addressed to import, but also to unfair competition.

The findings of a more recent survey of 329 SMEs in Kosovo by the World Bank found that the most severe obstacle to their development was related to electricity shortages. And this shows how the perceptions of businesses about barriers to doing business are directly influenced by the emergence of problems such as electricity shortages. Infrastructure related problems were an obstacle even before, but the businesses tend to emphasize more the priority of those problems they face during the day, and less those that affect their business in longer term.

However, the figures for 2004 in Table 3 once again confirm that in the post-war period in Kosovo, ‘unfair competition’ was continually emphasized by businesses as the biggest obstacle to their business. Among other barriers in the survey of the World Bank, corruption appears to be mentioned frequently, whereas ‘limited access to finance’ and ‘high taxes’ have significantly dropped in ranking as of 2004, even though the latter has been increased in ranking in 2003. Banking competition and improvements in taxation system may be the main explanation of this fall in ranking.

What is interesting in all findings of the surveys considered so far in this section, is that all of them reveal external barriers or the ones related to environment as the main constraints, and leave at the bottom managerial and employee skills. Table 3 showed that this issue is not considered as a barrier with an impact whatsoever, and that is why it has not changed in ranking through the period under consideration, i.e. it was considered as the least affecting barrier to doing business.

7. Policy recommendations

The discussion about the recommendations presented in this section follows the same approach as the list of constraints discussed in Section 5. These are measures that are proposed in the reviewed studies, reports and publications. It is worth mentioning that different recommendations were proposed for the same problem/constraint only in some limited cases. Differences between the proposed measures/recommendations consist mainly of their scope and deepness.

Trade regime:

- The government should reduce (or eliminate) the duty on all capital equipment and raw materials.
- The UNMIK customs administration should adopt a more proactive approach and scrutinize more closely Macedonian certificates of origin of goods.
- The UNMIK should approach the Serbian and Montenegrin authorities with a view to having tariffs abolished.
- An Export promotion agency should be created to promote Kosovo products in foreign market and provide information on export market.
- There is also a need to increase the efficiency the export processing zones.
- It is essential that Kosovo is able to take part in the Balkan free trade negotiations for the purpose of creating symmetrical reports with the countries of the South Eastern Europe.
- Opening the foreign representative offices in most important centers of the EU and other countries would help Kosovar businesses promote their products and facilitate business relations with foreign partners.

Poor state of public infrastructure:

- Attract private sector participation in export-oriented power generation and lignite mining.
- Kosovo to be become part of the regional network of power supply.
- Improve rail transportation in order to reduce transportation costs of goods.
- Improve telecommunications network and allow for competitive companies to enter the market
- Involvement of Kosovo in the regional and EU initiatives geared towards improving public infrastructure

Limited access to finance:

- Joint efforts and activities of the Government, UNMIK, and international financial organizations (GOs and NGOs) to influence the increase of credit supply and the improvement of credit terms and conditions.
- Establishing the Kosovo Bankers Association⁵ and use this vehicle to adopt best practices and standards in product development and service provision, and introduce an information campaign about the different pledge options available.
- Business community to get organized in business associations to address their concerns and interests.
- The banks to improve their terms and conditions for loans through various mechanisms.
- There is a need to educate potential borrowers on the requirements for loans (such as business plans etc.).
- The government to improved legal/ institutional environment (mortgage and bankruptcy laws and better court system).

Incomplete legal framework and lack of enforcement

- A more complete and stable legal/regulatory framework impacting business and commercial activity should be in place and operational,
- Tax authorities should to be aware when designing tax a system, i.e. recognize the ability of enterprises to retain profits for investment and other productive uses, and aware that differences do exist among enterprise by size and sector.
- UNMIK and the Government of Kosovo should accelerate the process of completing commercial legislation in order to ensure a competitive environment for businesses and free of state control.
- A number of secondary legislation need to be adopted and then the focus should shift to the implementation phase of the legislation.
- Commercial dispute resolution should be apolitical and based on principles of effectiveness, fairness, and transparency.
- The organization of courts and their procedures need evaluation so that contract disputes receive timely resolution.
- Increased trust in courts will have dramatic positive impact on attracting foreign investment and market stability.
- One important aspect, however, should be taken into consideration: adopting of new legislation should not be a process whereby the quantity would win over the quality of legislation. Draft laws should be carefully examined and all externalities should be taken into consideration, and especially the should include the cost factor.

⁵ This association has been established and is operating.

Corruption and unfair competition

- Policies and procedures should be transparent in order to avoid rent seeking behavior on the part of officials.
- The Government should undertake several actions to minimize the possibilities for corruption, among others through strengthening enforcement of the rule of law at the municipal level, as this level of government is most frequently exposed to corruptive behavior.
- Adoption of the Competition Law in October 2004 is an encouraging step forward in this respect, but efforts should be made to ensure its effective implementation.
- Establishment of a single office for business registration, known as 'one-stop-shops' to shorten the time for business registration and to minimize irregularities and potentials for rent seeking should be an urgent measure to be implemented.

Inappropriate labor force skills:

- The education system needs to strengthen links with the labor market and encourage the growth of self-employment.
- There should be a regular appraisal of whether the key generic competencies required in the labor market are being effectively developed in pupils and students.
- Schools need to develop regular contacts with local employers and seek to develop opportunities for work placements.
- The Government (respective Ministries) to engage, help and facilitate in training activities by the private sector.

Agricultural development:

- Measures proposed to agricultural development should be in place for medium term until the farming sector takes uphill. Most of the measures proposed depend on the terms of trade with neighboring countries and their reduction in protection, and other opportunities in the Kosovo economy.
- Imposing tariffs and quotas:
 - on imports for key competing products,
 - on imports of fruits, vegetables and eggs on seasonal basis, and
 - compensate for high fuel costs in mechanization.
- Stimulating agro processing industry.

Other recommendations

- Development of an SME Strategy for Kosovo that would include: (i) an assessment of needed financial support for the sector, and the identification of international and other sources that could be attractive financing involving better terms and conditions, and (ii) a coordinated approach to technical assistance that identifies gaps between SME skill needs and technical assistance currently being provided.
- It is essential that the business community and the government improve communication between each other substantially.

Annexes

Annex 1: Recommendations: time, costs and the involved parties

| Recommendations | Time | Costs | Parties involved |
|--|---------------------|--------------------------|--|
| <p>1. Trade regime:</p> <ul style="list-style-type: none"> • Reduce (or eliminate) the duty on all capital equipment and raw materials. • Negotiate with S&M to have tariffs abolished • An Export promotion agency should be created • Increase the efficiency the export processing zones • Kosovo to take part in the Balkan free trade negotiations • Open the foreign representative offices | Short to medium run | Significant but bearable | Government, Business, Customs service, Associations, |
| <p>2. Poor state of public infrastructure:</p> <ul style="list-style-type: none"> • Ensure that the resolution of this problem is a top priority on the government agenda • Kosovo to be become part of the regional network of power supply • Improve rail transportation in order to reduce transportation costs of goods | Medium to Long run | Very high | Government, International donors |
| <p>3. Lack of finance:</p> <ul style="list-style-type: none"> • Increase of credit supply and the improvement of credit terms and conditions • Business associations to address their concerns and interests • Educate potential borrowers on the requirements for loans • Improved legal environment (mortgage and bankruptcy laws and better court system) | Short to medium run | Not significant | Government, Banks, Courts, Business Associations |
| <p>4. Incomplete legal framework and lack of enforcement</p> <ul style="list-style-type: none"> • Complete commercial legislation • Contract disputes receive timely resolution • Draft laws should be carefully examined for externalities | Short run | Not significant | Government, Courts, |

| Recommendations | Time | Costs | Parties involved |
|---|-------------------------|-------------|---|
| 5. Corruption and unfair competition | | | |
| <ul style="list-style-type: none"> • Policies and procedures should be transparent • Establishment of ‘one-stop-shops’ to shorten the time for business registration and to minimize irregularities | Short run | Low costs | Government, Courts, |
| 6. Inappropriate labour force skills: | | | |
| <ul style="list-style-type: none"> • The education system needs to strengthen links with the labour market • Promoting key competencies • Schools need to develop regular contacts with local employers • The Government (respective Ministries) to engage, help and facilitate in training activities by the private sector. | Medium to Long run | Significant | Government, Business Associations, |
| 7. Agricultural development: | | | |
| <ul style="list-style-type: none"> • Imposing tariffs and quotas: <ul style="list-style-type: none"> ○ on imports for key competing products, ○ seasonally on imports of fruit, vegetables and eggs, and ○ compensate for high fuel costs in mechanisation. • Stimulating agro processing industry | Short to Medium run | Significant | Government, Farmers, Banks, Business Associations |
| 8. Other recommendations | | | |
| <ul style="list-style-type: none"> • Development of an SME Strategy for Kosovo that would include: (i) an assessment of needed financial support for the sector, and the identification of international and other sources that could be attracted to fund, and (ii) a coordinated approach to technical assistance that identifies gaps between SME skill needs and technical assistance currently being provided. • Business community and the government improve communication | Short run (immediately) | Low costs | Government, Business Associations |

Annex 2: Available studies on the constraints to business creation and growth

| Institution / Title of the publication | Year |
|---|---------------|
| MTI | |
| Kosovo's Trading Environment | 2002 |
| Business in the Balkans | 2002 |
| Trade Policy for Kosovo | 2004 |
| Survey of 300 Enterprises in Kosova | March 2003 |
| Construction Sector Assessment | January 2003 |
| Trade Policy, Institutions and Market Access Issues | February 2003 |
| The SME Sector in the CARDS Courtiers - A Panorama at Country and Regional Level | May 2004 |
| USAID | |
| Evaluation of the USAID/SME and Agriculture/Agribusiness Programs, Final Report Volume I | 2004 |
| Corruption Assessment-Kosovo | 2003 |
| Kosovo Media Assessment | 2004 |
| Challenges of Transition | Sht.01 |
| Early Warning Reports | 2003-2004 |
| Commercial legal and institutional reform assessment: Diagnostic Assessment Report for Kosovo | 2004 |
| DFID | |
| Kosovo's International Trade: Trade Policy, Institutions and Market Access Issues | 2003 |
| UNMIK | |
| Towards a Kosovo Development Plan | 2004 |
| Kosovo Outlook 2004 | 2004 |
| Next Steps for Kosovo's Medium-Term Economic Development | 2003 |
| EURECNA | |
| Survey of 300 Enterprises | 2003 |
| ICG | |
| Kosovo: A Strategy for Economic Development | 2001 |
| Kosovo: Toward Final Status | 2005 |
| IMF | |
| IMF Report on Kosovo | 2002 |

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|--|----------------|
| IMF Staff Visit to Kosovo March 10-19, 2004, Aide Memoire | 2004 |
| Kosovo: Institutions and Policies for Reconstruction and Growth | 2003 |
| KBS USAID | |
| Investing in the Future - A Trade and Investment Guide to Kosovo | 2004 |
| Kosovo Export/Import Roadmap | 2002 |
| MAFRD | |
| Measures to improve fiscal and trade policies In Kosovo agriculture | 2004 |
| Norwegian Agricultural Economics Research Institute | |
| Taxation of Agriculture in selected countries | 2002 |
| OECD | |
| Recent Trends Policies and Challenges in SEE countries | Nov 2000 |
| EU | |
| Building the Medium Term Strategy for Kosovo | 2002 |
| Riinvest | |
| Understanding Social Ownership | 2003 |
| Labour Market and Unemployment in Kosova | January 2003 |
| Selected Aspects of the Social Situation and Development of the Pension System in Kosova | December 2001 |
| Foreign Direct Investment in Kosova Policy Environment and Promotional Strategy | September 2002 |
| Local Economic Development in Kosova | April 2002 |
| Kosovo Budget System – Policies and Sustainability | January 2003 |
| Socially owned Enterprises and their Privatization | June 2002 |
| Education and Economic Development in Kosova | February 2004 |
| SME Financing and Development | September 2001 |
| A Follow-up on Development in SME finance | March 2003 |
| Key Issue in Building in Taxation policy in Kosova | February 2001 |
| Trade Policy and Export Promotion in Kosova | November 2003 |
| The Balkan Network | |
| Obstacles to Growth | Sht.01 |
| UNDP | |
| Human Development Report-Kosovo | 2004 |
| Human Development Report-Kosovo | 2002 |
| The Kosovo Mosaic | 2003 |

| | |
|---|----------------|
| World Bank | |
| Economic and Social Reforms for Peace and Reconciliation | 2001 |
| Kosovo Business Environment: Constraints to Growth | 2004 |
| Kosovo Economic Memorandum | 2004 |
| Doing Business in 2005 | 2005 |
| WIIW - The Vienna Institute for International Economic Studies | |
| Costs of Protection in the Southeast European Countries: Policy Conclusions | 2004 |
| GSIM Measurement of the Costs of Protection in Southeast Europe | 2004 |
| The Welfare Cost of Tariff Protection In the Balkan Countries | 2004 |
| Trade flows in southeast Europe | 2004 |
| Illegal trade in south east Europe | 2004 |
| Southeast Europe: regional cooperation with multiple equilibria | 2004 |
| European Balkan Observer, vol.2, no.4 | 2004 |
| European Balkan Observer, vol.2, no.3 | 2004 |
| European Balkan Observer, vol.2, no.2 | 2004 |
| European Balkan Observer, vol.2, no.1 | 2004 |
| Institutional Constraints on Southeast European Development | 2002 |
| Kosovo: A protectorate's economy | 2003 |
| MAFRED | |
| Measures to improve fiscal and trade policies in Kosova agricultures | February 2004 |
| A strategy for sustainable agriculture and rural development in Kosova | May 2003 |
| The Market for Fruit & Vegetables in Kosova and Balkan Regional Market Study | August 2002 |
| Review of Agriculture credit in Kosova | October 2003 |
| Kosova SME and Agriculture/Agribusiness Programs | May 2004 |
| SOK | |
| Kosova Agriculture Survey - "Statistics on agriculture on Kosova" | September 2003 |
| Kosovo Labour Force Survey | August 2002 |
| ESI | |
| Towards a Kosova Development plan. The stat of Kosovo economy and possible ways forward | August 2004 |
| Ministry of Economy and Finance | |
| Monthly macroeconomic monitor | January 2004 |

| | |
|---|----------|
| Kosovo Economy in 2002 | 2003 |
| Medium term macroeconomic background to the Budget for 2005 | 2004 |
| Kosovo: a strategy for economic development | 2001 |
| Kosovo Official GDP | |
| BPK | |
| Annual report 2003 | 2004 |
| Annual report 2002 | 2003 |
| Annual report 2001 | 2002 |
| Monthly statistic bulleting, 04/39 | Nov 2004 |

KOSOVO

CLUSTER AND BUSINESS SUPPORT PROJECT

Constraint Study

Appendix “B”

List of Studies
of
Business Constraints
and
Business Environment

List of publications for the constraint study

| Institution / Title of the publication | Year | Obstacles | Methodology | On page | Recommendations | Comments |
|---|---------------|-----------|--------------------------------|---------|-----------------|----------|
| MTI | | | | | | |
| Kosova's Trading Environment | 2002 | some | survey | allover | yes | |
| Business in the Balkans | 2002 | yes | case study | allover | None | |
| Trade Policy for Kosovo | 2004 | yes | secondary data | allover | some | |
| Survey of 300 Enterprises in Kosova | March 2003 | Yes | survey | | Yes | |
| Construction Sector Assessment | January 2003 | yes | Secondary sources & evaluation | allover | yes | |
| Trade Policy, Institutions and Market Access Issues | February 2003 | yes | Secondary sources & evaluation | allover | yes | |
| The SME Sector in the CARDS Courtiers - A Panorama at Country and Regional Level | May 2004 | limited | Secondary sources | allover | yes | |
| USAID | | | | | | |
| Evaluation of the USAID/SME and Agriculture/Agribusiness Programs, Final Report Volume I | 2004 | limited | evaluation | - | limited | |
| Corruption Assessment-Kosovo | 2003 | | | | | |
| Kosovo Media Assessment | 2004 | | | | | |
| Challenges of Transition | Sht.01 | some | secondary data | 11.Sht | some | |
| Early Warning Reports | 2003-2004 | yes | survey | | various | |
| Commercial legal and institutional reform assessment: Diagnostic Assessment Report for Kosovo | 2004 | | | | | |
| DFID | | | | | | |
| Kosovo's International Trade: Trade Policy, Institutions and Market Access Issues | 2003 | yes | secondary data | allover | yes | |
| UNMIK | | | | | | |
| Towards a Kosovo Development Plan | 2004 | some | secondary data | 12 | some | |

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|---|----------|---------|----------------|---------|------|--|
| Kosovo Outlook 2004 | 2004 | some | secondary data | 16 | some | |
| Next Steps for Kosovo's Medium-Term Economic Development | 2003 | limited | observation | all | some | |
| EURECNA | | | | | | |
| Survey of 300 Enterprises | 2003 | yes | survey | allover | yes | |
| ICG | | | | | | |
| Kosovo: A Strategy for Economic Development | 2001 | | | | | |
| Kosovo: Toward Final Status | 2005 | | | | | |
| IMF | | | | | | |
| IMF Report on Kosovo | 2002 | yes | secondary data | | yes | |
| IMF Staff Visit to Kosovo March 10-19, 2004, Aide Memoire | 2004 | some | secondary data | allover | yes | |
| Kosovo: Institutions and Policies for Reconstruction and Growth | 2003 | limited | secondary data | allover | some | |
| KBS USAID | | | | | | |
| Investing in the Future - A Trade and Investment Guide to Kosovo | 2004 | yes | secondary data | allover | None | |
| Kosovo Export/Import Roadmap | 2002 | some | case study | 21- | some | |
| MAFRD | | | | | | |
| Measures to improve fiscal and trade policies In Kosovo agriculture | 2004 | | | | | |
| Norwegian Agricultural Economics Research Institute | | | | | | |
| Taxation of Agriculture in selected countries | 2002 | | | | | |
| OECD | | | | | | |
| Recent Trends Policies and Challenges in SEE countries | Nov 2000 | | | | | |
| EU | | | | | | |
| Building the Medium Term Strategy for Kosovo | 2002 | some | secondary data | 14-18 | some | |
| Riinvest | | | | | | |

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|--|----------------|---------|-----------------------|---------|-------------------------|--|
| Understanding Social Ownership | 2003 | No | research | | None | |
| Labour Market and Unemployment in Kosova | January 2003 | | | | | |
| Selected Aspects of the Social Situation and Development of the Pension System in Kosova | December 2001 | | | | | |
| Foreign Direct Investment in Kosova Policy Environment and Promotional Strategy | September 2002 | | | | | |
| Local Economic Development in Kosova | April 2002 | | | | | |
| Kosovo Budget System – Policies and Sustainability | January 2003 | | | | | |
| Socially owned Enterprises and their Privatization | June 2002 | | | | | |
| Education and Economic Development in Kosova | February 2004 | | | | | |
| SME Financing and Development | September 2001 | | | | | |
| A Follow-up on Development in SME finance | March 2003 | | | | | |
| Key Issue in Building in Taxation policy in Kosova | February 2001 | | | | | |
| Trade Policy and Export Promotion in Kosova | November 2003 | | | | | |
| The Balkan Network | | | | | | |
| Obstacles to Growth | Sht.01 | yes | case study | 40-51 | some | |
| UNDP | | | | | | |
| Human Development Report-Kosovo | 2004 | limited | | | | |
| Human Development Report-Kosovo | 2002 | limited | | | | |
| The Kosovo Mosaic | 2003 | Yes | public opinion survey | allover | yes | |
| World Bank | | | | | | |
| Economic and Social Reforms for Peace and Reconciliation | 2001 | yes | secondary data | allover | yes | |
| Kosovo Business Environment: Constraints to Growth | 2004 | yes | survey of 329 firms | i-v | broad and comprehensive | |
| Kosovo Economic Memorandum | 2004 | yes | secondary data | 23-43 | considerabl | |

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|--|----------------|---------|------------|---------|-----|--|
| | | | | | e | |
| Doing Business in 2005 | 2005 | | | | | |
| WIIW - The Vienna Institute for International Economic Studies | | | | | | |
| Costs of Protection in the Southeast European Countries: Policy Conclusions | 2004 | | | | | |
| GSIM Measurement of the Costs of Protection in Southeast Europe | 2004 | | | | | |
| The Welfare Cost of Tariff Protection In the Balkan Countries | 2004 | | | | | |
| Trade flows in southeast Europe | 2004 | | | | | |
| Illegal trade in south east Europe | 2004 | | | | | |
| Southeast Europe: regional cooperation with multiple equilibria | 2004 | | | | | |
| European Balkan Observer, vol.2, no.4 | 2004 | | | | | |
| European Balkan Observer, vol.2, no.3 | 2004 | | | | | |
| European Balkan Observer, vol.2, no.2 | 2004 | | | | | |
| European Balkan Observer, vol.2, no.1 | 2004 | | | | | |
| Institutional Constraints on Southeast European Development | 2002 | | | | | |
| Kosovo: A protectorate's economy | 2003 | | | | | |
| MAFRED | | | | | | |
| Measures to improve fiscal and trade policies in Kosova agricultures | February 2004 | Yes | Evaluation | allover | Yes | |
| A strategy for sustainable agriculture and rural development in Kosova | May 2003 | Yes | Evaluation | allover | | |
| The Market for Fruit & Vegetables in Kosova and Balkan Regional Market Study | August 2002 | | Survey | | Yes | |
| Review of Agriculture credit in Kosova | October 2003 | Yes | | allover | Yes | |
| Kosova SME and Agriculture/Agribusiness Programs | May 2004 | limited | evaluation | | | |
| SOK | | | | | | |
| Kosova Agriculture Survey - "Statistics on agriculture on Kosova" | September 2003 | | Survey | | | |

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|--|----------------|-----|------------------------------|--|-----|--|
| Kosovo Labour Force Survey | August 2002 | | Survey | | Yes | |
| ESI | | | | | | |
| Towards a Kosova Development plan. The stat of Kosovo economy and possible ways forward | August 2004 | Yes | Evaluation Secondary sources | | | |
| Ministry of Economy and Finance | | | | | | |
| Monthly macroeconomic monitor Kosovo | January 2004 | | | | | |
| Kosovo Economy in 2002 | 2003 | | | | | |
| Medium term macroeconomic background to the Budget for 2005 | 2004 | | | | | |
| Kosovo: a strategy for economic development | 2001 | | | | | |
| Kosovo Official GDP | | | | | | |
| BPK | | | | | | |
| Annual report 2003 | 2004 | | | | | |
| Annual report 2002 | 2003 | | | | | |
| Annual report 2001 | 2002 | | | | | |
| Monthly statistic bulleting, 04/39 | Nov 2004 | | | | | |
| | | | | | | |
| Labour Market and Unemployment in Kosova | January 2003 | | | | | |
| Selected Aspects of the Social Situation and Development of the Pension System in Kosova | December 2001 | | | | | |
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