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Ministria e Tregtisë dhe Industrisë-Ministarstvo Trgovine i Industrije-Ministry of Trade and Industry

Trade Brief

The Trade Dimension of the SAA with the EU and the Kosovo Economy

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INTRODUCTION

Further integration into the world economy would inevitably result from the decrease of trade barriers and bring new opportunities for Kosovo. It should lead to better trade linkages in general and support economic growth. Kosovo has already taken its first steps in economic integration through membership in the Central European Free Trade Agreement (CEFTA), established in 2006. In addition, Kosovo currently benefits from Autonomous Trade Measures of the EU; this corresponds to preferential treatment which permits duty free access to the EU market. However, the latter trade arrangement will be soon replaced with the Stabilization and Association Agreement (SAA), an agreement which will gradually move both parties towards a bilateral free trade area with the removal of import duties on the Kosovar side. The Stabilization and Association Agreement (SAA) represents the first contractual relationship between Kosovo and the EU and it is seen as an important milestone in Kosovo's European integration process

Therefore, for Kosovo, a deal with the world's largest trading bloc is most attractive. Kosovar businesses will be given access to 500 million consumers in 28 EU Member States. Businesses will benefit from the SAA with the reduction of trade barriers and the creation of a more stable and transparent trading and investment environment; for companies it will also be easier and cheaper to export their products to trading partner markets. Moreover, the benefits of the SAA go far beyond trade, as the EU concludes SAAs in exchange for commitments to political, economic, trade, reform in a country. In this light, Kosovo will make major advances in areas such as intellectual property, public procurement, competition policy, and trade and sustainable development.

However, challenges still remain! And some of these challenges are identified in the final part of this brief. In addition, the brief outlines the negotiating process and the concessions granted to Kosovo products.

THE NEGOTIATING PROCESS

The Kosovo's negotiating position has been based on consultations with various stakeholders, including local producers and the business community. The agreement is largely a result of analysis, requests and information which the Negotiating Group has constantly received from the business community and their representatives through direct communication and in-depth discussions at the National Council for Economic Development and Trade Policy Sub-groups at Ministry of Trade and Industry (MTI). The Kosovo Chamber of Commerce, AMCHAM and Kosovo Business Alliance were continuously informed and consulted about the negotiation process, and their recommendations regarding the list of products to be protected or exempted from customs duties have been taken into consideration in the final agreement. Based on the decision by the Government of Kosovo, the role of the chief negotiator has been delegated to the Ministry of European Integration (MEI), but MTI was leading the process of negotiating the trade part of the agreement. In addition, other Kosovo institutions were involved in the process, including the Office of the Prime Minister, Ministry of Finance, Ministry of Agriculture, Ministry of Foreign Affairs and Ministry of Justice.

As pointed out, the negotiation process relied on detailed analysis of the potential impacts the agreement would have on the Kosovo economy and specifically on the external sector, output, employment and government revenues.[1] Regarding the impact on specific sectors, MTI build its position based on a specific methodology. It identified sensitive products by taking into account two main reference indicators: the trade balance ("does Kosovo import or export more of the relevant goods?") and the tendency of the trade balance ("is the deficit/surplus growing or decreasing?"). In particular, cases where there is a trade deficit but the deficit has been declining in the past years were of crucial importance for the Kosovar economy, and as such sensitive to the negotiation deal. It was considered that sectors exercising these tendencies may show that some import substitution is taking place and/or exports are growing. This could be interpreted as a tendency that the Kosovar industries have already started a catching up process with global or at least regional competitors. Also, there were sectors with persisting trade deficit, thus they were seen as sensitive to the time frame of liberalization.

The Negotiation Process lasted for 9 months, even though preparation started a year earlier (see Box 1 for important dates of the process).

BOX 1: IMPORTANT DATES RELATED TO SAA NEGOTIATIONS

In chronological order, below you may find the events that led to conclusion of the SAA:

December 2012 - the European Council (EC) confirmed the progress and the possibility of the opening of SAA negotiations between Kosovo and the EU;

April 2013 – the EC has confirmed that Kosovo has fulfilled the short-term criteria regarding the rule of law, public administration, minority rights and trade;

June 2013 – taking into consideration the fulfilment of short-term criteria, the EC appreciated the achievements and confirmed the launching of negotiations for a SAA;

October 28, 2013 – the first meeting between the Government of Kosovo and the EC to negotiate the SAA was held. The second meeting took place on November 27, 2013;

May 2, 2014 - the third and last meeting of negotiations on SAA took place;

July 25, 2014 - the SAA negotiations between Kosovo and the EU were concluded;

The next step is the adoption of the SAA by the Council of the EU and the signing of the agreement between the parties.

[1] The impact analysis and the methodology relied on the "Study on Impact Assessment (SIA)", completed at the beginning of 2013.

AGREED CONCESSIONS

The Agreement with the European Union (EU) is rather asymmetric, in favour of Kosovo; thus, all Kosovo products are immediately exempted from custom duty, except baby beef, sugar, and wine, which are subject to quantitative restrictions. On the other hand, Kosovo will phase out custom duties according to specific transitional periods until the domestic economy catches up with new competitors coming from the EU market. Kosovo has entered into an agreement with 99.7% of Kosovo products, thus 0.3% of products are not part of SAA EU Kosovo Agreement.

Specifically, due to high degree of sensitivity, greater concessions were required on agricultural products. As a result, 11 tariff lines were excluded from the SAA negotiations, while 1,745 tariff lines were negotiated. There are 1,204 products (68.56%) that will be liberalized immediately from the entry into force of the Agreement; in this group there are 160 agricultural products that are exempted from custom duties.[2] The remaining 541 Agricultural products will be liberalized within 5, 7, and 10 years after the entering into force of the Agreement.

For fish and fish products, Kosovo has agreed to liberalize immediately 490 products (99.59%). Only 2 products will be liberalized within 5 and 7 years, respectively.
Processed Agricultural Products (PAPs) originating in the EU are considered sensitive products by Kosovo; as a result, 135 products (42.72%) out of 316 PAPs are immediately liberalized. Excluded from SAA are 3 tariffs lines, while 178 tariff lines will be liberalized within 5, 7 and 10 years after the Agreement is in force.

With regards to industrial products, Kosovo has agreed on the following concessions: 4,763 (69.84%) out of 6819 products are immediately liberalized, while 1,740 products are exempted from custom duties. Remaining 2,056 Industrial products will be liberalized within 5 and 7 years after entering into force of the Agreement.

THE IMPACT ON THE ECONOMY

The opening of trade plays an important role in the economy in many aspects. It has been evidenced that international trade is one of the most important ingredients of economic growth and development, resulting in higher incomes and welfare levels for societies.

It is known that the process of EU accession has important positive effects. Despite the fiscal impact of this agreement in Kosovo, a loss of government revenues estimated at approximately 25 million Euros, it opens up the EU market for Kosovo businesses; it

[2] Law no. 04/L-163 Law on Goods Exempt from Custom Tax and Goods with Zero Rate of the Custom Tax. This law stipulates the goods which are exempt from customs tax and which may be released for free circulation with zero customs tax rate because of the nature of goods and because of their special use.

provides access to technology, knowledge, know how etc.; it expands trade and investment opportunities; it brings positive spill over effects on domestic producers as it creates new competition, the need to innovate and catch up with the newest technology. Furthermore, the expansion of the market increases the credibility of the country in terms of rules and regulations, and institutional framework. The impact of trade openness on attracting FDIs is of high importance to developing and transitional economies like Kosovo. It is worth mentioning that from the Kosovo perspective, trade liberalization provides the possibility of linking domestic producers to the global value chains. These effects are likely to promote growth, rise in employment and poverty reduction. Job creation means more incomes and, as a result, better living standards – or improved welfare in general.

However, other experiences tell us that the benefits from the trade liberalisation are conditional on supply-side factors. This is also the case with Kosovo. Even though the production base in Kosovo is narrow, with the commitment of domestic producers and the new opportunities that this trade opening is expected to bring, this production base will eventually expand. However, if the institutional performance is not further improved so as to create even more favourable conditions for businesses and new investments, trade liberalization might not generate fully the desired outcomes, affecting both the benefits to consumers and the producers. In order to show strong growth results, this needs to be accompanied by appropriate policies such as better education and higher skill levels, better infrastructure, financial and macroeconomic stabilization, etc.
In addition to the things mentioned above, another very important thing that Kosovo can benefit from the EU in general, and from the SAA in particular, is financial and technical assistance. This type of support is expected to play an important role in stimulating the implementation of reforms related to education, training, banking and finance, SMEs promotion and macroeconomic stabilization. Moreover, a share of EU financial assistance is provided in the form of grants to be distributed to industrial and agricultural sector in order to boost the economy of Kosovo.

All in all, it seems reasonable to conclude that the SAA will benefit the Kosovo economy and businesses by providing additional opportunities to overcome the actual supply side constrains that are considered to be a major problem in the economy of Kosovo. More importantly, the advantages of the Free Trade Agreement within the framework of the SAA can be used as a route to increase the level of productivity, another important factor that determine the international competitiveness of businesses in Kosovo.