Ministry of Trade and Industry
Trade Department

Trade Policy Analysis: Factors inhibiting export growth on goods

August 2020, Prishtinë

Prepared by:

Zef Dedaj	Head of Trade Policy Division
Merita Fetahu	Trade Analyst
Bulinë Gashi	Senior Officer for Tarde Analysis
Anita Sutaj	Seniro Officer for Trade

Focus points:
- Introduction
- The direction of trade
- Factors inhibiting export growth
- Factors contributing to import dependency
- Concluding remarks

Introduction

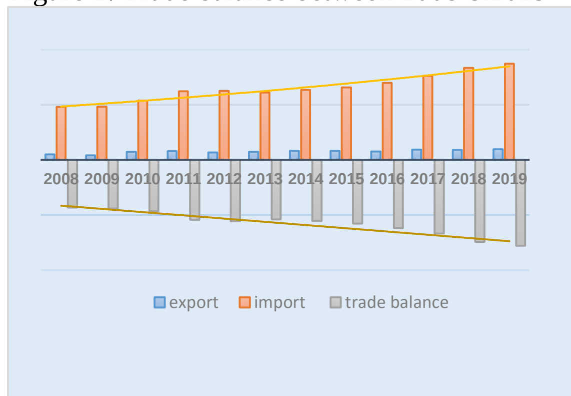
This brief on trade in goods aims to elicit interest by audiences in terms of analysis and proposals regarding trade issues in Kosovo. The brief covers the year 2019, analysing trade in goods taking a more in-depth look at the changes in export and import flows, allowing to have a clear understanding of Kosovo's performance in trade in goods, and examines in particular, the factors inhibiting export growth.

The direction of trade

According to (Ask, 2020), trade in goods in 2019 indicates a trade deficit of 3,113.34 billion euros, which shows that it is higher by 4.5%, compared to 2018. Total export flowed in 2019 were 383.5 million euros, an increase of 4.5% compared to 2018 and a rise of 93.1% compared to 2008, noting a high growth rate of exports, while total imports were 3,496.9 billion euros in 2019. Exports covered imports by only 11%, on average, between 76% and 80% of total Kosovo's exports of agricultural and industrial products have been directed to the markets of the region, respectively to CEFTA member countries. However, the share of agricultural products exported to countries in recent years has fallen to 40-45%, suggesting that agricultural products have begun to orient themselves in EU markets. This is reflected in a gradual increase in exports of agricultural products after 2016 when the SAA agreement entered into force; thus exports of agricultural products doubled in value from 11.9 million in 2016 to 22.4 million in 2019.

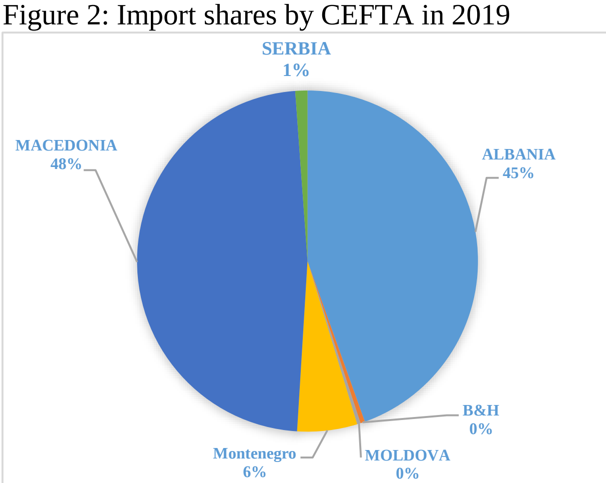
The two main trade blocs that dominate the import structure in Kosovo are the EU and CEFTA, where together they constituted over 63 percent of total imports of goods in 2019. Within the EU, Germany was the largest import partner, followed by Italy and Greece, while from the regional countries Albania and Macedonia, are a significant source of imports with 92 per cent of the total CEFTA imports. In the last four years, the level of import flows from CEFTA countries has decreased slightly due to the imposition of 100 percent tariff towards Serbia and B&H in 2018. Serbia, previously as the dominant exporting country in Kosovo, experienced a 98.5% drop in imports the following year. A substantial share of Kosovo's market, lost by B&H and Serbia, was taken over by imports from outside regional trading partners, including Turkey and China. This is reflected in an increase in import flows in 2019; however, Kosovo has to some extent increased its integration with other countries such as Turkey, China, Switzerland, and Israel, from which Kosovo has increased the value of imported goods by 170 million euros or 25% thus, goods imported from these countries cover 24% of Kosovo's total imports. Following figures show Kosovo's trade balance over the years, along with the import shares by CEFTA and EU countries.

Figure 1: Trade balance between 2008 &2019



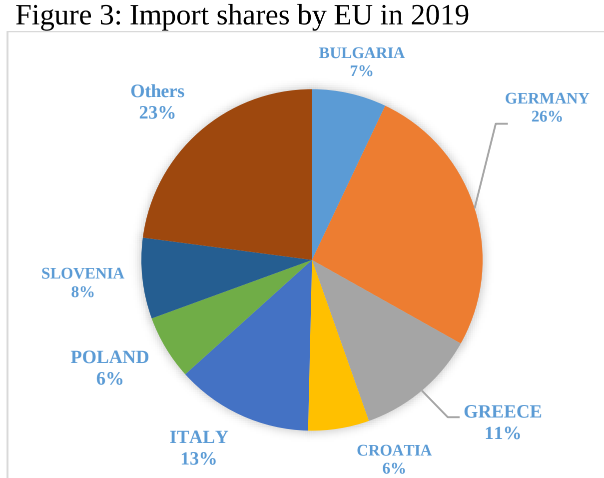
Source: authors' calculation based on KSA

Figure 2: Import shares by CEFTA in 2019



Source: author's calculation based on KAS

Figure 3: Import shares by EU in 2019

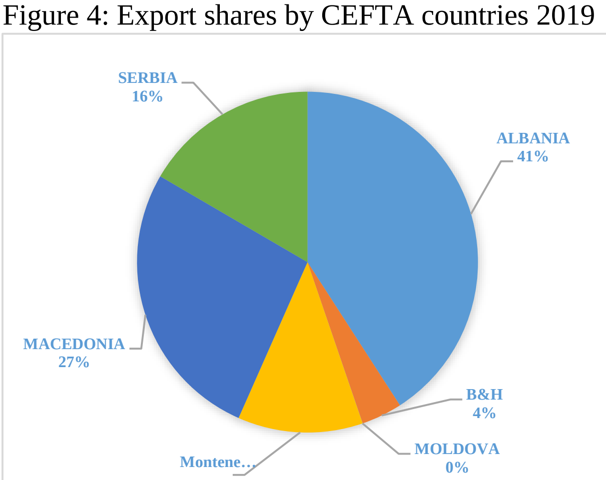


Source: author's calculation based on KAS

Imports continue to be dominated by the minerals sector (petroleum fuels and its products), the food industry sector, machinery and equipment, but as a product, imports of oil and oils have dominated in general imports, followed by cars, steel bars, electricity, cigarettes, and medicines. However, unfortunately, Kosovo continues to import large quantities of agricultural products; consequently, the demand for domestic consumption for processed and unprocessed agricultural products is met mainly by imports. The statistical data show that for the category of agricultural commodities we have a high trade deficit, e.g., during 2019 exports of agricultural products are estimated at 65.5 million euros, while imports amounted to 759.8 million euros while the deficit trade for agricultural products is -694.3 million euros.

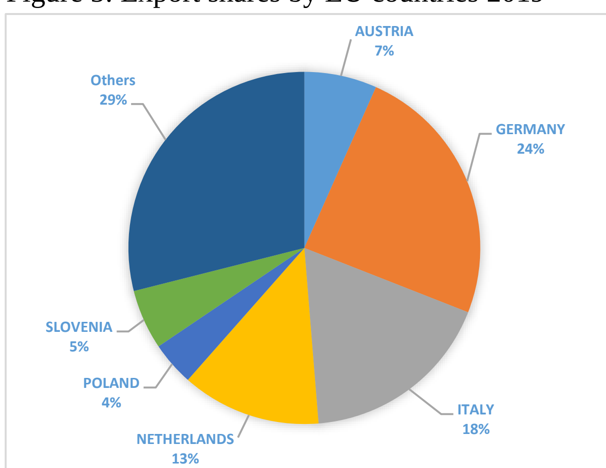
On the contrary, the current export situation in Kosovo and the high trade deficit reflect a low level of competitiveness in the domestic and foreign markets and the lack of variety of products. Kosovo on an annual basis has an average GDP growth of about 4%. Exported goods account for less than 6% of GDP and are concentrated in sectors with low value-added components, in particular metals and minerals. The reason that the performance of commodity exports deteriorates from time to time is due to lower external demand and falling prices of metals and minerals as a significant component of Kosovo's exports. The high trade deficit reflects an underdeveloped and narrow domestic production base. Domestic companies competing in international markets are exposed to the most top competition from products from foreign products. Entering new markets, finding demand for a new product remains a challenge for the local manufacturing sector; besides trade agreements in place, Kosovo continues facing a large negative trade balance. Considering the proximity of the CEFTA countries, Kosovo should seek the demands and needs of the regional markets to whom facilitation of the trade is possible due to the CEFTA agreements. Even though Kosovo has a free trade agreement into force with Turkey, only 2% of total export is concentrated in this market. In 2019 Kosovo exported around 164 million euro to CEFTA; nevertheless, Albania, Macedonia and Serbia constitute 84% of the total export of Kosovo. While, in terms of export with EU members in 2019, Kosovo exported around 127 million euro, with the most significant market being Germany and Italy. Following figures show export shares by CEFTA and EU countries.

Figure 4: Export shares by CEFTA countries 2019



Source: author's calculation based on KAS

Figure 5: Export shares by EU countries 2019



Source: author's calculation based on KAS

Lastly, other important partners were India and Switzerland with 9% and 7% accordingly share in total Export in 2019. The agriculture sector is an essential contributor to overall Kosovo exports. In comparing 2015 to 2019, agricultural commodities have moved from 41.68 million to 65.51, a 57 percent increase. The increase in the agricultural products exported can be attributed to the SAA agreement entered into force in 2016. Incapacity to cover the domestic demand has initiated a gradual increase in agricultural imports which has contributed to a high trade deficit.

While, compared to imports, the analysis of the structure of Kosovo's export goods shows that despite the fall in prices in the international market for nickel, it leads in the topmost exported goods. The value of nickel exports has increased from 36 million euros in 2018 to 51.3 million euros in 2019, which comprises of 13.4% in total exports of Kosovo, an increase of 42.5% compared to 2018; however, the range of goods produced by Kosovar companies is still limited, it is not distributed, and it is entirely homogeneous. The structure of exports in general for many years now has been almost the same, but in recent years there is a significant change in terms of products covered within the plastics sector. Kosovo has exported plastic products, about 50.8 million euros, which is 13.3% of total export growth. Likewise, as sectors with export potential is considered to be the food industry sector which is continuously growing. But if we analyze the general structure of goods, exports of base metals and mineral products the main items for Kosovo exports, they have covered 45% of exports at the general level in 2019.

Factors inhibiting export growth in Kosovo

This section identifies the main factors that, for many years, are hindering the growth of the export sector in Kosovo. The analyses of such factors fall under the dimension of product diversity, scale production and quality. The discrepancies between imports and exports of Kosovo have resulted in a significant negative trade balance for several years now; thus, below are identified several factors which have continuously inhibiting export growth in Kosovo.

Weak manufacturing sector. Due to the weak manufacturing sector, firms in Kosovo are not yet able to compete internationally with a broad range of products. For instance, post-war private sector collapse, privatisation process which has not been able to revive the sector, lack of foreign direct investment (FDI) the weak performance of Kosovo institutions and companies, lack of legal framework enforcement, are just some the causes which have affected the unfavourable situation of the export sector for many years. Likewise, Kosovo's economy is slightly less diverse than other economies in the region at similar levels of income. Although, many firms in Kosovo face difficulties to get access to the international market with their products unless they can provide more attractive products, with better quality and cheaper as well.

Limited progress on quality and innovation. In this respect, limited progress was made in the field of innovation. The determining factor in the market entry is the capacity to upgrade and produce according to specific requirements relating to quality; thus, Kosovar companies must improve their quality products which would enable them to compete with the international market and launch new qualitative products. In this relation, the effects of the institutional quality may seem to be indirectly linked to the development of the export sector, e.g. lack of industrial policy measures to boost exports to increase the quality and quantity of domestic production remains a challenge. Such measures could include innovative ideas. The poor performance of the export sector for some firms are related to specific problems affecting the firm's competitive position in the international market such as the absence of a strategy to do business internationally, innovative approach both in production and work process a limited number of links with foreign partners, limited possibilities to enter business networks (Trade Policy, 2009). Moreover, lack of innovation skills is counted to be as a problem related to the macroeconomic level. For Kosovar firms to be able to adapt innovation, they should have access to a pool of labourers with the new skills and capabilities that will enable firms to enhance the productivity and increase the use of technologies. In Kosovo, firms still face difficulties at accessing new technology and investing in innovation, mainly due to the limited capacity of human resources in absorbing new knowledge, and due to cost and access to finance. This is very much related to the fact that Kosovo is still in the stage of building up the innovation structure, though, the strategy and adequate programmes initiated at the national level that could support firm innovation are still weak (EC, 2019). Likewise, many firms face difficulties in hiring new employees, mainly because of insufficient experience or skills. A shortage of qualified specialists in marketing, sales, and design make it harder to compete in export markets. Furthermore, high cost and low quality of infrastructure, regulatory environment, as well as physical power supply, physical and IT connectivity undermine firms' competitiveness, particularly in export markets. Difficulties in developing new products, and in certifying the quality of existing products, constrain firms' ability to compete in export markets, having in mind the new product development is essential, especially in export markets. Also, the lack of knowledge of export markets or export promotion strategies by firms in Kosovo is missing. Export promotion is usually done through fairs, and the costs are challenging for companies (Cojocaru, 2017).

Visa restrictions. In this context, it should be noted that Kosovo has the youngest population in Europe, and the lack of freedom of movement due to visa restrictions has been perceived as a significant barrier. Youth, in particular companies, lack of visa make them face difficulties to participate in the international trade fairs and many other workshops where many opportunities and networks have been lost (Zogaj et al., 2016).

Non-tariff barriers. Another unjustified reason for the lowest level of exports in the region is a clear sign of the difficulties that Kosovar companies face in international trade. These difficulties relate to non-trade barriers. In this respect, CEFTA countries have imposed on regular basis barriers to trade against both agricultural and non-agricultural products exported by Kosovo. Besides, the transit issue through the territory of some of the CEFTA countries became a problematic issue for Kosovar imports or exports since CEFTA entered into force. The barriers that are used are of different natures: non-tariff barriers, technical barriers to trade and sanitary and phytosanitary standards/measures (Dedaj et al., 2015). Moreover, according to the World Bank study, Kosovar exporters take almost two days (42 hours) for border compliance and another 1.5 days (38 hours) for documentary compliance compared to the average of 7 hours and 3.8 hours in the other Western Balkans countries. Furthermore, Kosovar firms will have to pay 222 euros for exports compared to an average of 60 euros from the remaining CEFTA countries. Additional constraints in the field of trade are the emerge from the inability to travel with personal documents issued by Kosovo authorities and with Kosovo's registered transport vehicles, and there is no recognition of certificates and other documents issued by Kosovo authorities by Serbia, Bosnia and Hercegovina and Moldova. Difficulties in the export of agricultural products are also presented as a result of Kosovo’s non-membership in the European Plant Protection Organization (EPPO) and the World Organization for Animal Health (WOAH). This hinders businesses to export the products in EU countries, even though such products are negotiated in the SAA, and should enjoy zero customs duty for exports. Also, export markets in EU do not have confidence in Kosovo products as many of them lack adequate certification and do not meet required standards or non-recognition and lack of accreditation of Kosovo products; all these creating high costs for testing the products and lack of human capacities have significantly affected exporters. However, this is an issue that needs to be pushed forward by Kosovo institution and be more committed to improving the quality infrastructure to facilitate firms to increase the broad range of products export and be able to compete internationally. Other issues that hinder international trade are customs procedures for the export and import of goods which refer to all stages related to the cross-border movement of goods in export and import trade. Significant difficulties have been caused by heavy documentation requirements, heavy bureaucracy and slow clearance.

Institutional obstacles. It should be noted that Kosovo exporters face internal challenges in preparing to export their goods, e.g. the lack of staff in the Food and Veterinary Agency in Kosovo and bureaucratic procedures applied by some Government institutions make production and export more difficult and costly. In this respect, the business environment in Kosovo needs further improvement and still does not provide the best conditions for business development (Huruglica et al., 2019). In terms of internal obstacles, companies also complain regarding the lack of regular supply of electricity which logically creates more costs for the manufacturing sector. Therefore, to this day, the supply-side constraints are the major impediment for Kosovo enterprises to expand internationally. Without manufacturing, or indeed without a production sector, Kosovo is unable to benefit from free trade initiatives in the region or broader (Nixha, 2019). Likewise, the poor-performing institutions and high level of corruption remain challenging (Trade Policy, 2009), as both have contributed substantially to a high-risk environment unconducive to business activities in Kosovo.

Factors contributing to import dependency

It is generally acknowledged that an economy’s vulnerability is widely determined by the level of exposure to the global economy. Economies that are highly import dependent, particularly on the strategic imports, tend to be more vulnerable to the availability and costs of such imports. For economies like Kosovo that are highly dependent on imports, given that imports constitute a significant share of their GDP, over 50 percent of the total Kosovo import share of GDP in 2019. There is no denying that Kosovo’s import dependence has posed a binding constraint to growth in Kosovo. As of 2008, the share of imports in GDP for Kosovo have substantially increased covering on average 50 percent in GDP. The vulnerability on manufactering sector and Kosovo’s reliance on import-dependent growth has been documented, particularly in the aftermath of the economic crisis of 2008. The growing reliance on imports can be attributed to the lack of effective policies to minimize the risks associated with an increased import dependence, thereby exacerbating a country's vulnerability to economic shocks. In other words, policymaker has not strengthened the domestic demand as a way of reducing import dependence and building a more resilient domestic production over the long term. Often, policies undertaken were insufficient given the fact that Kosovo's economic structure is comprised of generally small and medium-sized enterprises (SMEs) and thus the domestic demand is insufficient to offset the import dominance created over the years. The lack of an industrial policy is one of the obstacles in the field of production that would stimulate domestic production, as well as the weak manufacerting sector along with the lack of quality has disabled firms becoming competitive in the international market.

Finally, due to weak quality infrastructure firms can not export many agricultural and non agriculture products, therefore, Kosovo still relies heavily on imports. In this relation, taking into consideration the fact that SMEs are fragile, an essential measure to boost domestic demand is to adopt policies that could strengthen them, these incentives to the private sector should come in the form of effective policies such as taxation and subsidies. Effective strategies can orientate the private sector more toward meeting domestic demand, the essential needs of the poor and eventually to export growth. Likewise, Kosovo's limited exporting propensity due to a narrow range of products gives rise to the risks associated with the lack of diversification. Lack of export diversification doesn't just have adverse macro-economic effects on employment, prices, employment and growth, but it also creates dependency upon limited geographical destinations for trade (Anon., 2011). Kosovo's lack of diverse products has initiated a significant dependence on imported goods from CEFTA and EU countries, particularly on consumer goods such as beverages, meat and poultry products. Regional cooperation is a necessary step to be undertaken to stimulate trade facilitation process. Regional markets are essential to exploit economies of scale and increase trade competitiveness. Since Kosovo's export market is only limited to several products which are reflected in a low export capacity, regional cooperation has established a high degree of import dependency to meet the domestic demand. Additionally, the removal of trade barriers has the potential to increase product diversity. Recent research shows that a 10 percent decrease in market entry costs results in a 3-4 percent increase in export diversity and a 5 percent increase in market diversity (Anon., 2011). Recently, Kosovo imposed a 100 percent tariff towards Serbian and B&H goods. Even though the tariff can be attributed to the political tensions between the neighbouring countries, one cannot ignore the economic implications to the domestic economy given the high import flows originating from the tariff affected countries. Effective policies to reduce import dependency for Kosovo depend on a comprehensive analysis of the country's position in the regional supply chain, and the prospects of the regional and global demand. It is critical that developing economies like Kosovo that are highly vulnerable to economic shocks and have the weak exporting capacity be given access to the regional and global markets. Although Kosovo's economic size can be a significant constraint on its ability to impede further import dependency, regional cooperation will help Kosovo integrate its economy through industrial collaboration and production, export diversification and joint industrial trade and policies. While there is a common understanding of the benefits that trade facilitation provides, to have a practical implementation of trade facilitation, should not be associated with obstacles.

Concluding remarks

Kosovo's weak domestic production base has continuesly resulted in a poor performance in the external sector and is not contributing to economic growth and development. The structure of the external sector shows high levels of concentration of exports in unprocessed minerals and base metals and other related products. This makes the Kosovo economy vulnerable to price and demand shocks in international markets, hence, diversification of economic activity is paramount, especially into higher value-added manufacturing sectors. For domestic producers, market access is no longer a significant issue as over 80 percent of outward trade is liberalized. Agricultural products have a high trade deficit, meaning that Kosovo needs a broader strategy to develop competitiveness in the economy, which will enable efforts to increase quality, promote exports and create conditions to encourage the development of a diversified, highly productive and value-added economic base. Nevertheless, still, the liberal trade policies have largely fallen short of delivering the expected results that are, a creation of a strong manufacturing base and a well-performing private sector. On the contrary, the liberalization of international trade has further aggravated Kosovo's import dependency, widening the trade deficit. NTBs and other border related procedures remain an issue for exporters. Therefore, trade facilitation reforms should be encouraged. For producers, including exporters, the most pressing problems at the moment are on the supply side, which relates to producing internationally competitive goods. Accordingely, this calls for a more active role of government through targeted industrial policy mechanisms and measures to improve the business environment. *Furthermore,* it is necessary to stimulate universities to develop undergraduate and postgraduate programs in food engineering and to encourage students to choose the food sector as a career.

Finally, investment in quality infrastructure is also needed to establish the quality of accredited laboratories to enable businesses to meet the strict standard requirements of the sector and meet the needs of the broader market.