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Submitted to AUK as part of requirement for graduation

“Kosovo’s Comparative Advantages: the Agriculture Sector”

A Honors Society Project

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Kosovo's Comparative Advantages: the Agriculture Sector

A Honors Society Project

Presented to

The Academic Faculty

By

Arzana Myderrizi

In Partial Fulfillment

of the Requirements for Membership in the

Honors Society of the American University in Kosovo

Abstract

Trade deficit presents an ongoing concern for the economy of Kosovo. The large reliance on imports and a limited level of exports have resulted in a continuous trade deficit, which requires structural policy measures for improvement. Moreover, since the trade deficit is financed largely by remittances and second generation migrants who are expected to decrease their transfers to Kosovo, there is an immediate need to design a strategy that will lead to a reduction in the trade deficit. Therefore, this report aims to identify the main comparative advantages within the agriculture sector, as a potential sector that can generate growth in exports and substitution of imports. The report provides a critical review of the current stock of knowledge and seeks to identify the main barriers of utilizing the comparative advantages within this sector.

For this purpose, new qualitative and quantitative data were gathered through face-to-face interviews and case studies. The most important part of the primary research conducted for this report are the interviews with four experts in the field, and two interviews conducted with representatives from two successful local companies. Additionally, a small-scale survey with 20 local companies was conducted, in order to analyze the positions and some of the main barriers that these companies face in exporting their products. The results are expected to provide a good benchmark for designing effective public policies, and provide guidance for interested investors within this sector.

The research findings show that Kosovo has a comparative advantage within its agriculture sector. The agriculture sector can serve as a source of development in Kosovo, especially if the fruits and vegetables sector is developed. In order for this to be achieved, certain recommendations are provided including, more research for the agriculture sector, larger amount of government budget allocated for this sector, improvement of contract law and enforcement, improvement of standards and packaging, and creation of advisory services and trainings.

Acknowledgements

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Table of Contents

Abstract	1
Acknowledgements	2
List of Tables and Figures	4
1. Statement of Problem	5
2. Background to the Research Problem	6
2.1 The theory of comparative advantage.....	6
2.2 General Information on Kosovo’s Trade Balance	7
2.3 Identifying comparative advantages in Kosovo	10
2.4 Does Kosovo have a comparative advantage in its agriculture sector?.....	12
3. Research Conducted	13
3.1 Interviews	14
3.2 Small-scale Survey	15
4. Analysis of Results	16
4.1 Kosovo’s barriers in exporting its products	16
4.2 Kosovo in CEFTA	19
4.3 Agriculture as a solution.....	21
4.4 Can agriculture be a source of development in Kosovo?	23
4.5 Two success stories(APC and Ask Foods)	26
4.6 Government’s support for the agriculture sector.....	28
5. Conclusion	32
6. Recommendations	33
7. References	35
8. Appendices	38

List of Tables and Figures

Tables

Table 1. Kosovo's trade balance (in million euros) 2008-2011

Table 2. Kosovar Agro-Food Trade, 2005-2008

Table 3. Selected indicators for agriculture: Kosovo and the region

Table 4. Cereals yield per ha, Kosovo

Table 5: Agricultural Labor Costs for Selected Countries

Table 6. Comparative Advantage Estimates for Selected Kosovar Crops

Table 7. Yield Means (t/ha) for selected products

Table 8. Interest rates on agro loans, 2011

Figures

Figure 1. Main categories of Kosovo's imports

Figure 2. Main categories of Kosovo's exports

Figure 3. Structure of exports by trading partners (in percent)

Figure 4. Products Categories

Figure 5. Product Competitiveness

Figure 6. Exporting Countries

Figure 7. Main obstacles for exporting

Figure 8. Structure of loans by economic activity; CBK

Figure 9. Interest rates for agricultural loans in EU

1. Statement of Problem

The aim of this report is to examine the comparative advantages that Kosovo has in the agriculture sector. The comparison is drawn between Kosovo and other states in the region. The main motivation for this report stems from the fact that Kosovo suffers from a persistent trade deficit, with a slow export growth rate and low diversification of exports. Delivery of services is mainly concentrated on non-tradables and takes only an insignificant part of total exports. At the same time, growth of imports is rapid with a lion share going to consumption goods, including consumed agricultural products. The resulting persistent trade deficit is financed mainly through international transfers, such as remittances, and to a lesser degree foreign aid.

While the trade deficit reflects the underlying economic structure, which points out to a vast dependence on imports in the future, both data in Kosovo and international experiences show that remittances and foreign aid cannot be counted on as stable sources for future financing. As a result, Kosovo's trade deficit is unsustainable and the need for a change in the underlying allocation mechanism of labor and capital within the economy is inevitable.

Thus, this study seeks to identify Kosovo's comparative advantages with particular focus on the agriculture sector, which can serve as a vital area for both the development of public policies supporting export, growth, and import substitution, as well as for building business investment strategies for investors who aim to grasp the best available business opportunities at a time when change can be rationally anticipated.

2. Background to the Research Problem

2.1 *The theory of comparative advantage*

One of the first theoretical approaches to international trade, the theory of absolute advantage, was developed by Adam Smith in his book the *Wealth of Nations*. This theory suggests that if a foreign country can provide us with certain commodities cheaper to what it costs us to produce them domestically, and if we can supply the other country with goods that we can produce at a lower cost, it is beneficial for both countries to trade the relatively cheaper goods. So, by trading their relatively cheaper commodities both countries would gain from trade.¹ However, David Ricardo was the first scholar to suggest that even though a country might not have an absolute advantage in any goods it can still specialize in producing and exporting the least disadvantageous goods and still gain from trade.

The theory developed by Ricardo, known as the comparative advantage theory, emphasizes that specialization within economies will create gains from trade. No matter the size of the economy, there will always be gains from trade, as long as countries open themselves to free trade regimes. If one country is relatively better at producing a good, it should specialize in producing that particular good, and export it in order to pay for the good that it imports, for which the other country is relatively better at producing. So, all the countries will produce and export the goods for which they have cost advantages and import the cost-disadvantageous goods. In the Ricardian model “a country need only produce a single commodity with trade, one in which its labor comparative advantage is greatest.”²

¹ Gonzales, Luis; *The Theory of Comparative Advantage*; 2004

² Jones, Ronald; *General Equilibrium Theory and Competitive Trade Models*;

2.2 General Information on Kosovo's Trade Balance

Since 1999, the negative trade balance has been a major economic concern for Kosovo. Its imports largely outweigh its exports, which leads to a huge trade deficit, thus decreasing Kosovo's competitiveness in regional and international markets. Table 1 shows Kosovo's trade balance (in million euros) for the years 2008, 2009, 2010, and 2011. While in 2011, Kosovo's imports were worth of €2.48 billion, its exports were worth of only €312.5 million, leading to a trade deficit of €2.17 billion. Compared to the share of trade deficit to GDP in 2010, which was 43.9% of GDP, in 2011 the share increased considerably, becoming 50.9% of GDP. As Kosovo's imports increased by 15.3% annually, its exports had an annual increase of only 6.3%.³

Description	2008	2009	2010	2011
Exports	198.5	165.3	294.0	312.5
Imports 1	,928.2	1,935.5	2,144.9	2,479.3
Trade balance	-1,729.7	-1,770.2	-1,850.9	-2,166.8
Ratio exports/imports (%)	10.3	8.5	13.7	12.6
Trade openness (% of GDP)	55.2	53.7	57.9	65.6

Table 1. Kosovo's trade balance (in million euros) 2008-2011; *Source: CBK (2012)*

Divided by sector, Kosovo's imports mostly include: mineral products, food beverages and tobacco, machinery and transport equipment, base metals, chemicals, plastic and rubber, vegetables, live animals, and stone and ceramic. Figure 1 shows a comparison of Kosovo's most important categories of imports in 2010 and 2011. More than 20% of Kosovo's imports in 2011 were comprised of mineral products, which represent the largest share of Kosovo's imports (€538.1 million). The imports of food, beverages, and tobacco, in 2011 faced an annual rise of 16.2%, a percentage that did not change much from 2010. The sector of base metals faced an increase of total imports from 8.9% in 2010 to 9.2% in 2011.⁴

³ Central Bank of the Republic of Kosovo, *Annual Report*, 2011

⁴ Central Bank of the Republic of Kosovo, *Annual Report*, 2011

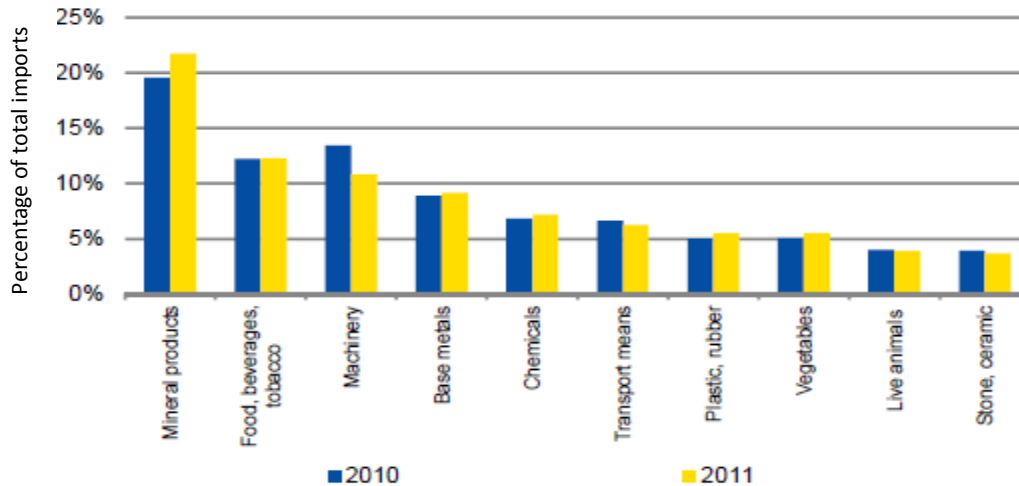


Figure 1. Main categories of Kosovo’s imports; *Source: CBK (2012)*

Exports in Kosovo mostly consist of base metals, mineral products, machinery equipment, food, beverages, and tobacco, plastic and rubber, and textile. Figure 2 shows that Kosovo’s exports are dominated by base metals, which both in 2010 and 2011 accounted for around 60 % of total exports. The sector of machinery, which mostly includes the exports of electricity, had a yearly growth of 40.6%. Its total value in 2011 was €15.1 million or 4.8% of total exports.⁵ So, while Kosovo’s exports are dominated by raw materials and unfinished goods, its imports are mostly consumer goods.

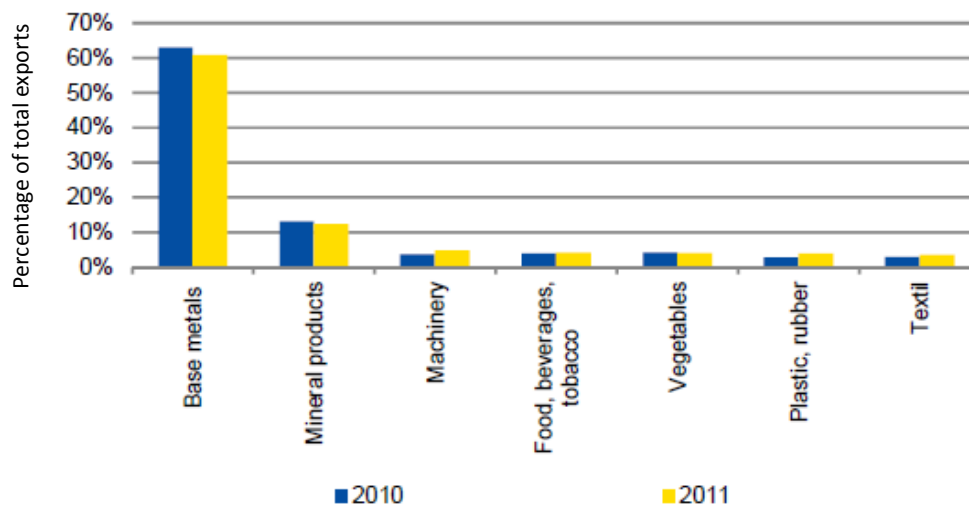


Figure 2. Main categories of Kosovo’s exports; *Source: CBK (2012)*

⁵ Central Bank of the Republic of Kosovo, *Annual Report*, 2011

Kosovo trades mostly with the EU countries and member countries of CEFTA. The Central European Free Trade Agreement (CEFTA), which Kosovo joined in 2007, was created with the goal of removing trade barriers between member states, forming conditions for trade diversification and growth, motivating economic collaboration, contributing for EU integration, and creating multilateral trade system.⁶ However, Kosovo's membership in CEFTA and its effect on Kosovo's trade balance have been highly debatable. Especially after 2008, after Kosovo signed its independence, Bosnia and Serbia detained exporting Kosovo products, which hurt its trade balance. Still, if we look at trading partners in 2011, we can notice that not much has changed from previous years. As seen in Figure 3, 73.8% of total trade exchanges were made with the EU and members of CEFTA, while 26.8% of Kosovo's total exports go to Italy, to which Kosovo exports nickel ore. Kosovo also exports to Germany, Holland, Austria, France, etc. but within CEFTA it mainly exports to Albania and Macedonia. The structure of imports by trading partners is very similar to that of exports as Kosovo also imports from the EU and CEFTA members. The largest share of imported goods, within CEFTA members, comes from Macedonia (14.7 %) and Serbia (10.9%).⁷

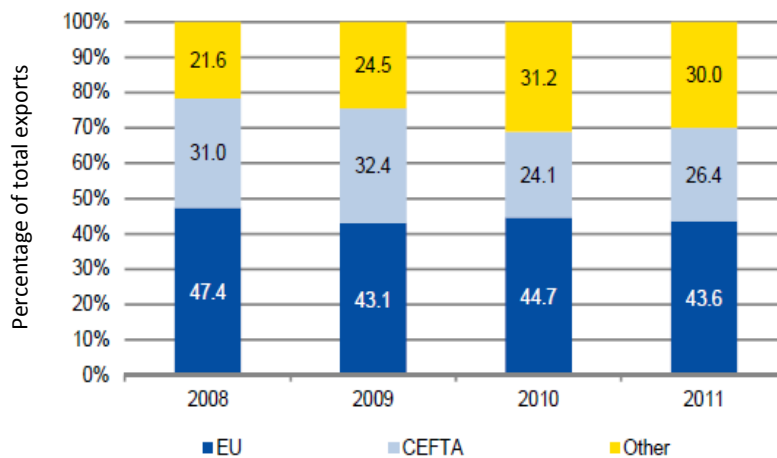


Figure 3. Structure of exports by trading partners (in percent); *Source: CBK (2012)*

⁶ Kosovo in CEFTA: In or Out?; *GAP, 2011*

⁷ Central Bank of the Republic of Kosovo, *Annual Report, 2011*

2.3 Identifying comparative advantages in Kosovo

Agriculture is a significant economic activity in Kosovo. “Kosovo has a surface area of 1.1 million hectares of land, out of which 53% is arable with the remaining 41% composed of forests and mountains.”⁸ 13% of Kosovo’s total GDP is generated from the agricultural sector, which also accounts for 16% of total exports.⁹ Despite having a huge potential in this sector, Kosovo still imports most of its agricultural products.

According to the World Bank, “the natural resource endowments of Kosovo, its young labor force, and its proximity and free access to the EU market suggest that Kosovo has the potential to boost its agricultural production and exports.” Agriculture has always been a significant sector of economy in Kosovo, but it faced a fall-down during the 90s. In the socialist period, considerable investments were made in the agricultural sector in Kosovo and its productivity rose significantly. Large quantities of agricultural goods were produced in Kosovo and exported to ex-Yugoslavian countries, especially wine, fruit, and vegetables. Also, about half of the total agricultural revenues were generated from the livestock production. However, during 90s investments fell, productivity decreased, and the number of population that was working in the agricultural sector doubled. Export markets for agricultural products were lost, and there were radical cuts in of previously subsidized inputs such as fertilizer and irrigation. Both the loss of markets and the cuts in subsidies lead to a drastic decline in the trade of agricultural products.¹⁰

Agro-food imports are huge and from 2005 to 2008 they increased by 68%, from €280 million in 2005 to €470 million in 2008. The value of exports rose drastically, too, but exports were greatly outweighed by imports, leading to an agro-food trade deficit of €453 million in 2008. Table 2 shows the imports, exports, and the persisting trade deficit in the agro-food sector during 2005-2008. One factor that leads to this deficit in Kosovo, as the World Bank’s report states, is considered to be the lack of competitiveness in the agricultural sector, but in addition to that, the liberalized trade regime is also seen as another factor that led to an increase in agro-food imports

⁸ Lushi, Xhevat; *Development of Agriculture Cooperatives in Kosovo*, 2007

⁹ Brajshori, Muhamet; *Analysts urge greater emphasis on Kosovo’s agriculture sector*; SETimes, 2012

¹⁰ WorldBank; *KOSOVO: Unlocking Growth Potential: Strategies, Policies, Actions*; A Country Economic Memorandum, 2010

in Kosovo. Moreover, the agriculture products that Kosovo trades are mostly traded with its neighboring countries, especially Serbia, Albania, Macedonia, and Greece.¹¹

	2005	2006	2007	2008
Imports	285.5	319.4	384.1	473.7
Exports	7.9	11.6	18.1	20.7
Net exports (exports minus imports)	-277.6	-307.8	-366.0	-453.0

Table 2. Kosovar Agro-Food Trade, 2005-2008; *Source: World Bank, 2012*

The labor costs of Kosovo’s agricultural sector are quite competitive; however, labor productivity is low. Labor costs in Kosovo are around 15% of those in EU countries, if compared using as a benchmark the labor costs of services and industry. Labor productivity is also quite low compared to these countries and this highlights the need for labor-intensive agricultural production or the need to shift excess labor to other sectors.” The World Bank report, states that “[F]ocusing on its comparative advantages in agriculture will not only increase Kosovo’s output in the sector, it could also boost Kosovo’s exports and, more importantly, substitute for imports.”¹² Also, Dr. Robert E. Lee et al. state that some of the main strengths of Kosovo’s agricultural sector, or more specifically the food and vegetables (F&V) sector are: “[G]ood irrigated land is available to small farmers; [S]mall farmers in Kosovo are familiar with F&V production; Kosovo agriculture can supply many of the F&V Kosovo consumer demand; and Kosovo can produce export quantities of some products.”¹³

According to the World Bank report, Kosovo tends to have its main comparative advantages in producing high-value fruits and vegetables. This conclusion was reached by analyzing the Domestic Resource Cost Ratio (DRC), which is a “a standard indicator of potential international competitiveness that measures the relative efficiency of domestic production by comparing the opportunity costs of using domestic primary factors—land, labor, and capital—to

¹¹ WorldBank; KOSOVO: Unlocking Growth Potential: Strategies, Policies, Actions; A Country Economic Memorandum, 2010

¹² WorldBank; KOSOVO: Unlocking Growth Potential: Strategies, Policies, Actions; A Country Economic Memorandum, 2010

¹³ Lee, Robert E. et al. Audit of the Kosovo Fruit and Vegetable Sector, USAID, 2009

the value added generated.” In this report, DRC’s were used to estimate the farmers’ competitiveness for apples, onions, tomatoes, potatoes, cabbage, pepper, plums, pears and table grapes. The main reason why these commodities were chosen for this analysis was their relevance in gross agricultural output and potential for export. The table with DRC’s for each of these commodities will be provided and discussed in the Analysis of Results part of the report.

However, Masters and Winter-Nelson, provide a critical analysis about DRC’s in estimating the developing countries’ comparative advantages. The DRC, according to them, is “the shadow value of nontradable factor inputs used in an activity per unit of tradable value added.”¹⁴ Masters and Winter-Nelson, argue that relying mainly on the DRC, in order to develop a set of economic activities, may lead to decisions that do not necessarily create the biggest possible contribution to economic growth. Since the DRC isolates the costs of domestic factors (land, labor), it understates the social gains, which make an even larger use of these factors instead of tradable inputs. Conversely, the social cost/benefit ratio (SCB) provides a more accurate measure of this social profitability. So, the DRC ratios are biased against activities that use limited tradable inputs, and the SCB provides better estimates of comparative advantages.¹⁵

2.4 Does Kosovo have a comparative advantage in its agriculture sector?

Scholars and practitioners seem to have different opinions as to whether Kosovo enjoys a comparative advantage in its agriculture sector or not. For example, according to Beilock, in order for a country to prosper, agriculture can play an important role, but not the primary one. Kosovo is poorly endowed to prosper as an agriculture-led economy. Furthermore, even if this was not a barrier, the tariff/quota and other supporting policies for farmers that other nations already have, would make it impossible for Kosovo to develop as an agriculture-led economy. Beilock states that there is no country with agriculture as a primary sector that Kosovo can use as an economic model. He presents a list of countries where agriculture accounts for at least 20% of

¹⁴ Masters, William and Winter-Nelson Alex: Measuring the Comparative Advantages of Agricultural Activities: Domestic Resource Cost and Social-Cost Benefit Ratio, 1995

¹⁵ Masters, William and Winter-Nelson Alex: Measuring the Comparative Advantages of Agricultural Activities: Domestic Resource Cost and Social-Cost Benefit Ratio, 1995

GDP, and concludes that low prosperity is closely related with a high portion of agriculture in the country's GDP. So, his main argument is that there is no prosperous country where agriculture is one of the two most important economy sectors.¹⁶

On the other hand, Booz, Allen, and Hamilton, list four important advantages that Kosovo can use in order to improve its agricultural goods' competitiveness. To begin with, the geographical position of Kosovo puts it quite close to other EU regional markets. Also, Kosovo has great potential to increase its productivity since "it currently lags behind European benchmark countries in cropping intensity (0.9), yield per hectare (20), and export value per harvested hectare (€25)." Kosovo also receives donations for its agricultural sector enhancement (around €15–18 million per year), particularly given for programs for 20 or more crops in all areas of the country. In addition to these, Kosovo has an advantage of a growing season, which supports harvesting around 30 days before that in northern Europe. Regardless of these advantages, Kosovo has significant barriers and challenges, six of which are identified by Booz et al.: "1) the untapped potential of small farmers, 2) lack of demand driven focus, 3) infrastructure capacity issues, 4) transportation disadvantages, 5) inadequate agriculture regulations, and 6) trade access issues."¹⁷

3. Research Conducted

Against this background, Kosovo's comparative advantages in the agriculture sector were explored by collecting both qualitative primary data and secondary data. The quantitative analysis was conducted in the form of a small-scale survey.

To begin with, the qualitative secondary research includes mostly reports from the World Bank, the Central Bank, USAID, and GAP Institute for Advanced Studies. The 2011 annual report of the Central Bank of the Republic of Kosovo was used to provide information about the trade balance in Kosovo, and the structure of exports and imports. In order to discuss more specifically about the exports and imports of agricultural products, a 2010 report from the World Bank was

¹⁶ Beilock, Richard; Rethinking agriculture and rural development in Kosovo; 2005

¹⁷ Boos, Allen, & Hamilton, Kosovo Agricultural Opportunities Strategy, USAID, 2010

used in the research. In addition to providing general data on the exports and imports of agricultural products, the Domestic Resource Cost Ratio (DRC) of particular commodities is used. According to the World Bank, the DRC enables us to evaluate agricultural products' competitiveness, whereby a lower than 1 DRC means that the product is competitive enough.

Furthermore, the USAID report was a source of discussion about the main strengths of Kosovo's agricultural sector. Also, to look at the main effects of CEFTA on Kosovo's trade balance, a report from the GAP Institute for Advanced Studies is incorporated in this research.

3.1 Interviews

As part of the qualitative primary research, this report includes five interviews with experts in the field and two with local exporting companies. The interview with experts included five questions, which were mainly questions about the main obstacles that Kosovo faces in exporting its domestic products, the potential that Kosovo has in developing as an agriculture-led economy, the competitiveness of Kosovar agricultural products, and about CEFTA's effect on Kosovo's trade balance. Three of the interviewees requested the questions to be sent to them by email due to lack of time to meet, while the two other interviews were made by face-to-face conversations. Interviews were conducted with the following experts:

-Ekrem Gjokaj, Head of Department for Economic Analysis and Agricultural Statistics, Ministry of Agriculture, Forestry, and Rural Development;

-Ardian Kryeziu, Deputy Chief of Party & Trade Component Lead, USAID Business Enabling Program;

-Petrit Gashi, PhD, Professor of International Trade, University of Prishtina-Faculty of Economics; and

-Artane Rizvanolli, PhD, Senior Researcher, Riinvest.

-Sytrime Dervisholli, Head of Trade Agreements Division, Ministry of Trade and Industry

Moreover, representatives from two Kosovar companies were interviewed: Artin Nimoni, from Ask Foods and Shkelzen Shabani, from Agroprodukt Commerce (APC), both local companies that have proven to be quite successful in exporting their products into the regional and EU markets. The interviews with companies focused mostly on the products that these companies export, if they see their products as competitive in the region, if they are satisfied with the support that they get from the government, and about the effect that Kosovo's entrance into CEFTA had on their company. Both the questionnaire with the experts and the one with the companies can be found in appendix I and II, respectively.

Based on the interviews and additional information from other sources, two case studies, one for Ask Foods and the other for APC, are included in this report. The main goal of these case studies is to present the success stories of two Kosovar companies who have managed to become quite successful and provide competitive and highly demanded products for Kosovo, the region, and EU.

3.2 Small-scale Survey

Finally, in order to enrich the analysis on the subject matter, I have conducted a small-scale survey with 20 local companies. The main goal of this survey is not to be highly representative of all other Kosovar companies, but rather serve as a sample of showing what barriers some of these companies face in exporting their products, if they believe that their products are competitive enough, and whether they are satisfied with the support that they get from the Government of Kosovo. This survey was a call-based survey and it includes seven questions. Almost 50 companies were contacted, but only 20 of them were willing and had the time to respond. From the 20 companies included in the survey, 5 are producing fruits and vegetables, 4 companies are producing dairy products, and 11 companies other products such as, fresh drinks, wine, honey, etc (Figure 5). A sample of the questionnaire is attached in appendix III. Also, the table with the names and locations of each company that was interviewed can be found in appendix IV.

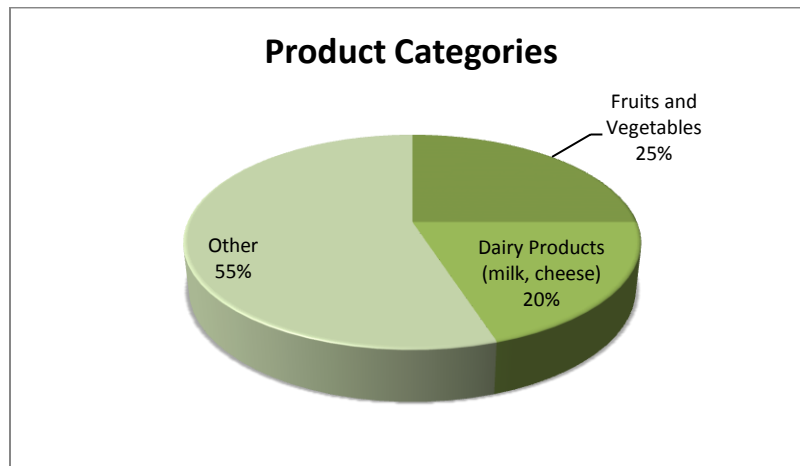


Figure 4. Products Categories

4. Analysis of Results

To identify the potentials of Kosovo for agricultural production and exports, I have organized the analysis of results in four sections: firstly, a general picture of Kosovo’s main obstacles in exporting its products is provided; second, CEFTA’s effect on Kosovo’s trade balance and its importance for expansion of Kosovo’s exports is discussed; third, an analysis of Kosovo’s agriculture sector is made with a specific focus on advantages/disadvantages of this sector; and the fourth section discusses the support provided by the government for the agriculture sector.

4.1 Kosovo’s barriers in exporting its products

The main barriers that Kosovo faces in exporting its products identified by both the experts and the interviewed companies are listed in the box below.

Kosovo 's Obstacles in Exporting its Products

Experts' Opinions

- lack of an appropriate, clear and predictable regime for export and import
- huge competition in the regional and EU markets
- insufficient production for export
- access to finances
- not meeting the necessary EU standards
- the imposition of tariffs by transit countries

Companies' Opinions

- huge competition in the foreign markets
- high cost of production
- high transportation costs
- insufficient support from the government

Some of the barriers that Kosovo faces in exporting its domestic products that were identified by the experts include: strong competition in the regional and European markets, insufficient production for export, failure to comply with EU standards, the imposition of tariffs or other protectionist measures by other countries, and the lack of an appropriate, clear and predictable regime for export and import. Another important barrier identified by one of the experts is the lack of knowledge of marketing and branding, and low-quality (or lack of) packaging, which makes high-quality Kosovar products less attractive. Kosovar producers usually only produce and sell in short periods during the season because of technical limitations: e.g. not having a greenhouse to produce in colder weather; or a cool storage facility which would enable maintaining stocks to be sold after summer.

On the other hand, the main barriers that were identified by the companies include: huge competition in the foreign markets, high cost of production, and high transportation costs. 65% of the companies interviewed said that their products are competitive, while 45% said that they are not (Figure 5). This result is probably not very consistent with most of the findings, which

show that Kosovar agricultural products are not competitive yet. However, considering the survey includes more exporting rather than non-exporting companies, it is more reasonable to conclude that most of the exporting companies, believe that their products are competitive. 12 of 20 companies interviewed export their products, out of which 2 companies export their products to the Balkans, the EU, and other countries; 5 companies to the Balkans and the EU, and 5 other companies only to the Balkans (Figure 6). Almost all companies listed high cost of production, high transportation costs, and competition in the foreign markets, as their main barriers. Also, a small number of companies listed some other obstacles, including, lack of marketing strategies, protectionist measures from other countries, etc. (Figure 8).



Figure 5. Product Competitiveness

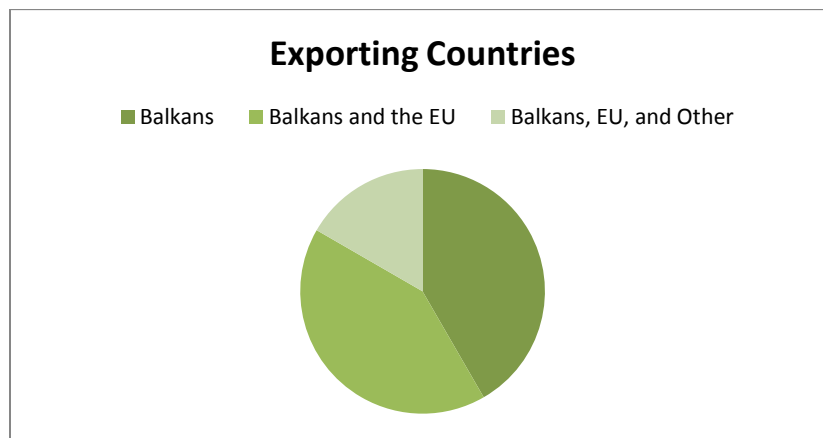


Figure 6. Exporting Countries

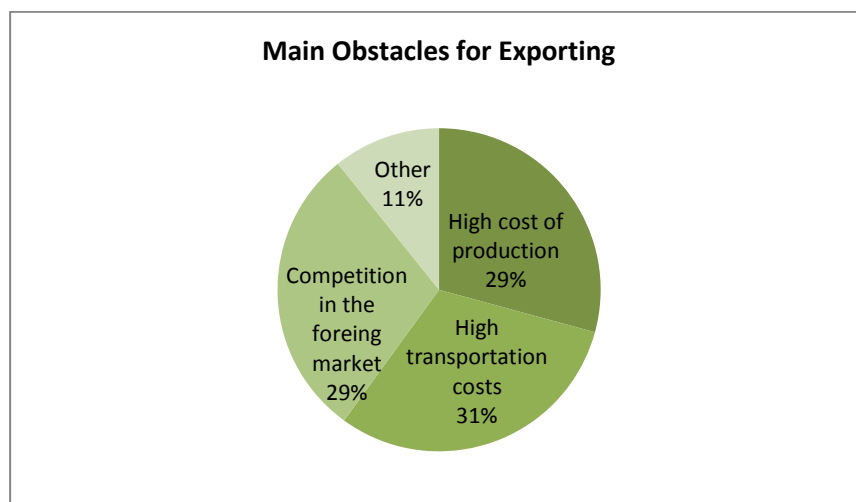


Figure 7. Main obstacles for exporting

4.2 Kosovo in CEFTA

Both the findings from the secondary research and the primary research show that CEFTA’s effect on Kosovo’s trade balance is to be questioned. Since Kosovo’s entrance into CEFTA, there have not been any significant changes in the trade balance, but even if there were it would be difficult to attribute these to CEFTA without any rigorous analysis (Rizvanolli). According to Mr. Kryeziu, Kosovo did not have many benefits, if any from CEFTA agreement, due to the well-known political issues with some member countries, such as Serbia and Bosnia as well as lack of a proper organization of export community to lobby to the Government properly. Additionally, the effect on exports is likely to have been limited to some extent by technical or administrative obstacles introduced by trade partners (e.g. Serbia and BiH), but that definitely is not our most important problem (Rizvanolli). Notwithstanding these problems, Kosovo does enjoy custom-free access for manufactured and agricultural CEFTA members and to the EU for manufactured and almost all agricultural products through EU’s autonomous trade measures (ATM), but these are barely utilized, which should not surprising considering that most Kosovar products have difficulties competing even in the domestic market (Rizvanolli). Mr. Gashi, is as well skeptic about Kosovo’ entrance into CEFTA, and claims that Kosovo was never “actually” a member of CEFTA, meaning that it did not enjoy the benefits, but rather held the burden of CEFTA.

In the same vein, the representatives of Ask Foods and APC, more or less agree that CEFTA did not have a positive effect on their company's exports. Kosovo's economy is the least developed in the region and needs to be protected from a flux of free flowing goods from neighboring states. Kosovo and its companies are less developed and therefore do not stand to gain much from the agreement. In fact it just makes it much easier for Kosovo based importers/distributors to import products from the other CEFTA members and sell them in the Kosovo markets. Producers in Kosovo are less well off because of their size in relation to the neighboring producers, therefore they have less economies of scale and there are cases where imported products are actually cheaper than those produced domestically (Nimoni). Additionally, when asked about CEFTA's effect on their companies' exports, most of the exporting companies included in the survey said that CEFTA had a negative effect on their exports. More specifically, 9 out of 12 companies who export their products out of Kosovo stated that CEFTA had negatively affected their exports. A summary of some of the main opinions about CEFTA's effect on Kosovo's trade balance is presented in the box below.

CEFTA's Effect on Kosovo's Trade Balance

Experts' Opinions

- Kosovo was never really a member of CEFTA
- no significant changes in the trade balance
- not much benefits due to the well-known political issues
- the effects on imports (and competition in the domestic market) are likely to have been limited
- the effect on exports is likely to have been limited to some extent by technical or administrative obstacles introduced by trade partners (e.g. Serbia and BiH)

4.3 Agriculture as a Solution

The main question that this study seeks to answer is whether agriculture can actually serve as a source of development in Kosovo. Both primary and secondary findings suggest so; however, a lot of progress needs to be made in order to reach to a point where the agriculture sector will be developed enough so that agriculture products can be used for exporting or for subsidizing imports.

Using some of the most important indicators for agriculture, Table 3 was compiled, which draws a comparison of different agricultural indicators for Kosovo and some other countries in region. As seen from the table, 16.5% of the population in Kosovo is employed in the agriculture sector, while in Macedonia or Serbia the percentage of people employed in the agriculture sector is 20% and 24%, respectively. Highly important in this table is the percentage of irrigated land in each country, which puts Kosovo in quite a competitive position. 13% of the total agricultural land in Kosovo is irrigated land, while in Macedonia and Serbia the percentage of irrigated land is 7.34 and 0.7, respectively. Table 3 includes the agriculture value added as a percentage of GDP for each country, as well. The value added, which is the “net output of a sector after adding up all outputs and subtracting intermediate inputs,”¹⁸ for Kosovo’s agriculture sector is 12% of GDP. In Albania the agriculture sector value added is 19% of the GDP, while in Macedonia it is 5%, and Serbia 11%. Also, a component which is highly important when analyzing a country’s comparative advantages in the agriculture sector is the yield (in kg) per hectare of particular commodities. Here, the yield per hectare of cereal is included, which again proves that Kosovo is similar, or even in a better position, compared to the other countries. The yield of cereal per hectare in Kosovo was calculated from table 4, which shows the yield per hectare for different types of cereals. Based on the yield per hectare for each cereal, a weighted average was used to calculate the average yield of cereal per ha in Kosovo. Based on these calculations (Table 4), Kosovo’s cereal yield per hectare is 3.85tonnes or 3,850 kg/ha, which is comparable with all the listed countries in table 3.

¹⁸ World Bank, 2013

Country	Employment in agriculture (% of total employment)	Irrigated Land (% of total agricultural land)	Agricultural land (% of land area)	Agriculture, value added (% of GDP)	Cereal yield (kg per hectare)
Kosovo	16.5	13	53	13	3,850
Albania	44	16.8	58.1	19	4,762
Macedonia	20	7.34	40.2	11	3,329
Serbia	24	0.7	57.8	9	4,959
Croatia	15	1.1	23.2	5	5,486
Greece	13	16.9	63.6		4,908
Turkey	24	13.4	50.6	10	2,727

Table 3. Selected indicators for agriculture: Kosovo and the region¹⁹

Cereal	Production (t)	Production of each cereal as a percentage of total production	Yield of Cereal (t/ha)	Weighted Average
Wheat	293,064	0.67	4.1	2.75
Rye	1,410	0.003	2.5	0.01
Barley	6,393	0.015	3	0.04
Malting Barley	848	0.002	3.1	0.01
Oats	8,865	0.02	2.5	0.05
Maize	68,424	0.156	3.3	0.52
Maize(mixed)	58,495	0.134	3.6	0.48
Total: 437,499			Total: 3.85 t	

Table 4. Cereals yield per ha, Kosovo; *Source: Agricultural Household Survey, 2008*

¹⁹ World Bank, 2008-2010; Trading Economics, 2007; Kosovo Agency of Statistics, 2010. Kosovo Agricultural Household Survey, 2008

Kosovo's labor costs are highly competitive, and this is another factor put Kosovo in a competitive position. Table 5 lists the gross labor costs in Kosovo, the Balkans, and some EU countries. As seen from the table, Kosovo's gross labor costs are much lower when compared to the EU countries, and lower or similar to the Balkans countries.²⁰

Country	Gross Labor Costs (€/month)
Kosovo	232
Albania	161
Bosnia & Herzegovina	420
Macedonia	343
Bulgaria	161
Croatia	841
Hungary	638
Poland	586
Greece	1,984
Portugal	1,557
Spain	2,135
Italy	2,904

Table 5. Agricultural Labor Costs for Selected Countries; *Source: World Bank, 2010*

4.4 Can agriculture be a source of development in Kosovo?

According to Mr. Gjokaj, Kosovo does have potential in its agriculture sector, considering its arable land, good climate, and human and natural resources. Moreover, all the interviewees do believe that agriculture can be a source of development in Kosovo. Agriculture can be a source of development, especially if the food and beverage industry is further developed which would create demand for agricultural products, and create more 'added value' in the country-stated Ms. Rizvanolli. Most agricultural products are not currently competitive, but there are a few success stories which suggest that some of our products can be (Rizvanolli). Two of these success stories will be discussed in the next section of this report.

²⁰ WorldBank; KOSOVO: Unlocking Growth Potential: Strategies, Policies, Actions; A Country Economic Memorandum, 2010

Can agriculture be a source of development in Kosovo?

Experts' Opinion

- Agriculture can serve as a vital tool of promoting economic growth in Kosovo, considering its climate, the agricultural land, and natural and human resources
- Yes, especially if the food and beverage industry is further developed
- Considering its land and low labor costs, agriculture can be a source of development in Kosovo

Furthermore, all these data are highly important for a general analysis of the agriculture sector in Kosovo; however, not specific enough to prove where Kosovo's comparative advantages actually lie. As briefly explained in the literature review section, a ratio, which is widely used by developing countries to estimate the comparative advantages of certain commodities is the Domestic Resource Cost ratio. In absence of sufficient data for calculating the DRC of some particular goods in this report, a study done by the World Bank, which uses DRC's to discuss about the comparative advantages of Kosovo's agriculture sector will be discussed.

In this study, onion, potato, tomato, cabbage, apples, pepper, plum, grape, and pear, were considered and the DRC's for these goods were calculated. Table 6 shows that Kosovo has a comparative advantage in producing all the listed products, with a particular focus on onions, potatoes, and tomatoes. These positive DRCs are probably because of the low-cost of labor and land. The World Bank study therefore suggests that if Kosovo concentrates on its agricultural sector's comparative advantages, it could increase its exports and substitute for imports, which is even more important.²¹ Table 7 lists the yield means (t/ha) for the same products, and when compared to table 4, it can be concluded that Kosovo is more competitive in producing fruits and vegetables, rather than in the production of cereals, such as wheat or rye.

²¹ WorldBank; KOSOVO: Unlocking Growth Potential: Strategies, Policies, Actions; A Country Economic Memorandum, 2010

Product	Domestic Resource Cost
Onion	0.08819
Potato	0.08177
Tomato	0.09381
Cabbage	0.30889
Apples	0.14015
Pepper	0.14064
Plum	0.11397
Grape	0.32377
Pear	0.15511

Table 6. Comparative Advantage Estimates for Selected Kosovar Crops, *Source: World Bank, 2012*
**A DRC with a value of less than one means that a country has a comparative advantage in the production of that particular product*

Product	Yield Mean (t/ha)
Onion	14.1
Potato	21.4
Tomato	23.9
Cabbage	22.8
Apples	9.8
Pepper	21.7
Plum	9.6
Grape	9
Pear	9.2

Table 7. Yield Means (t/ha) for selected products; *Source: Agricultural Household Survey 2008*

4.5 Two success stories- APC and Ask Foods



Case Study 1. Agroproduct Commerce (APC)

APC was established in 1991 as a family-owned business. APC is the leading agricultural company in Kosovo for cultivating, collecting, stocking, processing and selling wild mushrooms, cultivated berries, and vegetables.

Currently, the company's revenue is generated by the frozen vegetable's line, which consists of 13 products, all dedicated to the domestic market of Kosovo and raspberries, which are mostly exported.

APC's main exporting markets have been international markets such as Italy, Netherlands, Austria, Germany etc., mostly selling mushrooms and berries; however, since 2008 APC has established raspberry plantations which is dedicated to mainly exports of semi-finished products.

APC in ten years

With the current trends of economic development and with regards to Kosovo's natural resources such as land (agricultural land), APC aims to develop and expand its farming capacities which parallel increase the production and exporting capacity. APC aims to maintain its market place, its identity as a successful agricultural business, and working to become one of the leading regional agricultural businesses (Shabani).



Case Study 2. Ask Foods

Located in the village of Livoq, in the Gjilan district in Eastern Kosovo, Ask Foods was established in 2008 by 3 brothers. They developed a factory in 2010 and the company currently employs 108 people. This number reaches over 400 during the peak season. The company started with a vision of producing premium quality processed products from only the best fruits and vegetables. They use modern food processing technology in line with traditional food recipes to get the best quality products. They produce a range of all natural products with no additives, preservatives, artificial colors, aromas or flavors. Their mostly sold product is homemade ajvar.

Ask Foods is one of the few companies in Kosovo that exports its products to Macedonia, Croatia, Serbia, Albania, Germany, Sweden and the USA.

ASK Foods is certified with ISO 9001:2008 and HACCP food safety.

Ask Foods in ten years:

The company is currently investing heavily in developing one of the most modern apple orchards in the whole of Europe. They are also investing in a modern fruit and vegetable collection/storage and packing center. They are developing and increasing the capacity of their processing factory and in less than 10 years' time, production will be 95% export oriented with large sales to the US, UK and African countries as well as regional countries with higher incomes. We are also developing a new Organic factory for jams and juices (Nimoni).



4.6 Government's Support for the Agriculture Sector

When analyzing the agriculture sector in Kosovo, it is highly important to look at the support that this sector gets from the government or any other organization. Recognizing that high cost of production and competition are the main identified barriers that local agricultural producers face, government subsidies, easier access to agro-loans, or any other forms of support that would lower the cost of production, are vital for the development of this sector.

Some of the main agricultural policies or legal frameworks developed until now by the Republic of Kosovo, which are considered to have significantly improved the agriculture sector in Kosovo, are:

-**The Agriculture and Rural Development Plan for 2007-2013**, which aimed to reorganize Kosovo's agriculture sector in line with that of the European Union, and improve the living standards of Kosovo's rural population.²²

-**The Law on Food**, approved in 2009, with the goal to "establish legal bases for regulation of the requirements in the field of food public health protection and determination of quality and food safety"²³

- **Law on Foreign Investment**, adopted in 2005, the main of which is "to promote and encourage foreign investment in Kosovo by providing foreign investors with a set of fundamental and enforceable legal rights and guarantees that will ensure foreign investors that they and their investments will be protected and treated with fairness and respect in strict accordance with the rule of law and widely accepted international standards and practice."²⁴

In the government's program 2011-2014, the support for the agriculture sector is listed as highly important for the economic development of Kosovo. Some of the key objectives of the government include: increasing the budget for the agriculture sector up to 3% of the state budget, developing more efficient cross-sectoral coordination, increasing advisory services, improving

²² Agricultural and Rural Development Programme (ARDP) 2007-2013, Ministry of Agriculture, Forestry and Rural Development

²³ Law No. 03/L-016 on Food, Assembly of Republic of Kosovo, 2009

²⁴ Law No. 02/L-33, Article 1., Assembly of Kosovo, 2005

the access to agricultural loans, supporting and promoting the export of agricultural products, and improving and developing infrastructure capacities.²⁵

In 2012, the government in cooperation with USAID signed an agreement with six largest Kosovo banks for creating a fund of agricultural loans, which would lower the high-risk perceptions of this sector. The fund was backed up by the USAID, which made a fund of € 20 million of loans available to local farmers. In addition to this, USAID provides support for the agriculture sector in Kosovo through the New Opportunities for Agriculture project. This project aims to provide technical support to farmer and food processor in order for them to become more competitive and decrease the volume of imported agricultural products that can be produced in Kosovo.²⁶ Out of the total 2013 budget of €1.58 billion of the Government of Kosovo, €44.6 million will be dedicated to the Ministry of Agriculture, Forestry and Rural Development, which means that 2.8 % of the budget is allocated for the agriculture sector.²⁷

Nevertheless, agriculture is one of the sectors, which has the lowest share to total loans in Kosovo, with only 3.6% in 2011 (Figure 8).²⁸ In addition to the small amount of loans that are provided for the agriculture sector, the interest rates are very high, which is probably a factor that slows-down the economic activity in this sector. Currently the interest rate for attaining an agricultural loan at the ProCredit Bank in Kosovo is 24%, while at Raiffeisen Bank it is 23% (Table 8).²⁹ The high interest rates make it almost impossible for farmers, especially small farmers, to attain agricultural loans. Quite differently, in the EU, the average interest rate for agricultural loans over the twenty-year period of 1989-2008 was 5.6%, the lowest (4%) being in 2005 and 2006 and the highest (7.9%) in 1991(Figure 9).³⁰

²⁵ The Program of the Government of the Republic of Kosovo, 2011-2014

²⁶ Brajshori, Muhamet; *Kosovo agriculture development gets support*; SETimes, 2012

²⁷ Karadaku, Linda; *Kosovo plans significant infrastructure spending in 2013*, SETimes, 2012

²⁸ Financial Stability Report. (2011). Central Bank of the Republic of Kosovo.

²⁹ Bankometer, GAP Institute, 2011

³⁰ Pietola, Kyosti et al. *The Penetration of Financial Instability in Agricultural Credit and Leveraging*; Sept.2011

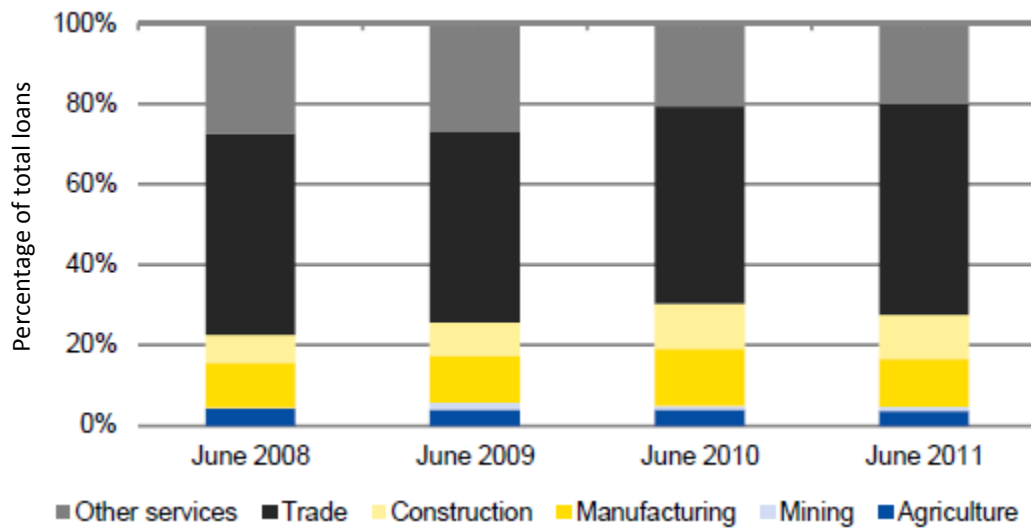


Figure 8. Structure of loans by economic activity; CBK

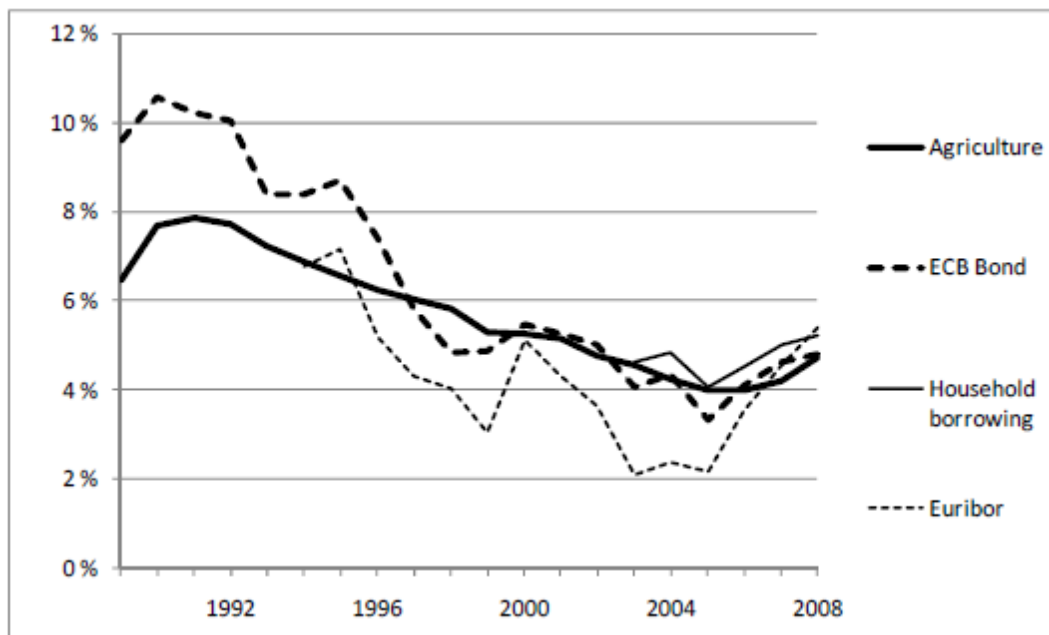


Figure 9. Interest rates for agricultural loans in the EU

Amount	Bank			
	PCB	RBKO	BPB	BE
€ 1,000	24.00%	23.00%	15.00%	21.00%
€ 5,000	20.60%	18-23%	15.00%	18.00%
€ 10,000	15.60%	13.00%	15.00%	15.00%
€ 50,000	13.20%	12.50%	15.00%	14.00%
€ 100,000	13.20%	12.50%	15.00%	12-14%

Table 8. Interest rates on agricultural loans, 2011; *Source: GAP Institute for Advanced Studies*

Both local companies (Ask Foods and APC), which were interviewed for this study, when asked whether they are satisfied with the government's support for their company none of the companies responded positively. APC representative believes that the government should aid domestic production because clearly the neighboring countries have established policies that support and promote their domestic production, not only for their local markets but as well as international markets. Government of Kosovo has a limited budget if not to say a poor budget, thus there are still alternative sources of aid for the domestic producers, such as offering trainings in managing their companies, business techniques, technical trainings, and as well trying to merge domestic producers in Kosovo with potential buyers in the region or the EU (Shabani). On the other hand, Mr. Nimoni from Ask Foods stated that lowering the cost of production can realistically only happen with newer technologies because the cost of labor is going up and will continue to do so. The government can focus on subsidizing local farmers and give more incentives to start producing raw materials so that processors such as Ask Foods can get all of their raw materials from Kosovo. The government can also subsidize exported products so that they are more competitive in other markets as this strategy is used by most of the regional countries (Nimoni).

5. Conclusion

The persistent negative trade balance is probably the most significant economic problem in Kosovo. As such, this report identifies comparative advantages within the agriculture sector, as a potential sector that can generate growth in exports and substitution of imports.

Agriculture is a highly important economic sector in Kosovo. 13% of the total GDP is generated by the agriculture sector and agricultural products account for 16% of the total exports in Kosovo. Regardless of its economic significance, the agriculture sector in Kosovo faces many barriers and is not supported enough so that it serves as a source of development, which would facilitate in reducing Kosovo's negative trade balance.

The main barriers for Kosovo's companies in exporting its products identified in the findings of this research include: strong competition in the regional and European markets, insufficient production for export, failure to comply with EU standards, the imposition of tariffs or other protectionist measures by other countries, and the lack of an appropriate, clear and predictable regime for export and import. These are just generic obstacles which every other sector faces in Kosovo, on top of a long list of agriculture-specific problems, such as lack of knowledge of marketing and branding, low-quality packaging, and many other technical limitations. Another very important agriculture-specific problem is the high interest rates on agricultural loans in Kosovo (12-24%), which slow-down this sector's economic activity.

Despite the many barriers and limitations, the research findings show that Kosovo has a comparative advantage in producing certain agricultural products, considering the low land and low labor costs, its climate, geographical position, and production per hectare. Kosovo is especially competitive in producing fruits and vegetables, particularly onions, potatoes, tomatoes, cabbages, apples, peppers, plums, grapes, and pears. As such, this study concludes that the agriculture sector in Kosovo can serve as a vital tool of generating economic growth, increasing exports, and subsidizing for imports, especially if the fruits and vegetables sector is developed. The main challenge for Kosovo now is to take the necessary steps for dealing with the before-mentioned obstacles, and developing policies which would improve the current state of the agriculture sector.

6. Recommendations

In order for the agriculture sector in Kosovo to develop further and generate growth of exports or substitution of imports, certain steps need to be taken, some of which are recommended below.

- **Gather more official disaggregated data at a higher frequency for the agricultural sector in order to design better targeted support policies**

Considering the vital importance of the agriculture sector in Kosovo's economy, insufficient analysis has been conducted to analyze it. More studies are necessary for identifying the potentials of Kosovo in developing its agriculture sector and for exploring and recognizing niche markets for the new potential products, for example wild fruits and mushrooms. As such, in order to develop effective supporting policies for the agriculture sector, it is very important that more studies are undertaken to analyze this sector. This needs to be supported mainly by the government, but also by non-governmental organizations who seek to facilitate in developing the agriculture sector in Kosovo.

- **The government should allocate more of its budget in the agriculture sector**

In order to attract investment and facilitate the local producers to compete in the regional markets the government should allocate more of its budget to the agriculture sector. This includes providing subsidies and grants for local farmers who do not have the capacity to compete in the market. Subsidies would lower their costs of production, thereby increasing their products' competitiveness.

- **Improve contract law and enforcement**

Improving the contract law and enforcement would contribute to lower interest rates for agricultural loans, and improvement of rural credit accessibility. This is very important considering that currently the interest rates on agro-loans in Kosovo are the highest in the region, which puts Kosovar agro-producers at a disadvantage and slows-down the economic activity in this sector.

- **Improve standards and packaging**

In order for the products to be competitive, improving the standards and packaging is a necessary step to be taken. Regional and EU markets seek for high-quality products, thus it is not possible to enter these markets without improving the standards and packaging of the products.

- **Develop advisory services and trainings**

Advisory services and trainings need to be developed in order to facilitate agricultural companies in developing their marketing strategies and meeting various EU companies' standards. It is also important that farmers are trained on using modern and effective land-processing methods, with the aim of preserving soil productivity.

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8. Appendices

8.1 Appendix I

Interview with Experts

1. What do you think are the main obstacles that Kosovo faces with regard to exporting its domestic products?

2. How do you think that Kosovo's entrance into CEFTA agreement has affected its trade balance?

3. Do you think that agriculture can be a source of development in Kosovo?

4. In your opinion, does Kosovo have a potential in its agriculture sector? Do you believe that Kosovo's agriculture products are competitive in the region?
 - 4a. If Yes, what makes these goods competitive?
 - 4b. if No, what do you suggest that Kosovo can do to make its agriculture products competitive in the region?

5. Besides agriculture, what other sectors do you see as pivotal for growth and employment and hence reduction of trade deficit?

Date of the interview:

Signature of the interviewer:

Signature of the interviewee:

8.2 Appendix II

Interview with Companies

1. Could you provide a short paragraph of your company's profile?
2. What are the mostly sold products of your company?
3. Do you sell your products outside of Kosovo? If yes, where? If no, are you planning to do so anytime soon?
4. Do you think that your products are competitive in the region? If no, what are the main obstacles? If yes, what are your company's advantages?
5. Do you think that the government should do more to help local producers lower their cost of production? If yes, would you suggest any specific action?
6. How has Kosovo's entrance into CEFTA agreement affected your company? Can you explain this impact or its leak thereof?
7. Where do you see your company in a 10-year period?

Date of the interview:

Signature of the interviewer:

Signature of the interviewee:

8.3 Appendix III

Small-Scale Survey with Local Businesses

1. What category do the products that your company produce belong:
 - a) Fruits and vegetables
 - b) Dairy products (milk, cheese, etc.)
 - c) Other (Please specify)_____

1. Do you think that your products are competitive in the region?
 - a) Yes
 - b) No
 - c) Somewhat

2. Do you export your products?
 - a) Yes
 - b) No

3. If you export your products, where do you export them?
 - a) In the Balkans region
 - b) In European Union countries
 - c) Other

4. How has Kosovo's entrance into CEFTA agreement affected your company?
 - a) CEFTA had no effect on our company
 - b) CEFTA helped our company to increase exports
 - c) CEFTA had a negative effect on our company's exports

5. Do you think that you have enough support from the Kosovo Government?
 - a) Yes
 - b) No
 - c) There is some support, but not enough

6. What are the main obstacles that you face in exporting your products?

- a) High cost of production
- b) High transportation costs
- c) Competition in the foreign market
- d) Other (Please specify)_____

8.4 Appendix IV

Company Name	Location
APC	Podujeve
Babanaj	LlukaE Eperme
Bylmeti	Fushe Kosove
Liri	Prizren
Opoja	Dragash
Sharri	Dragash
Stone Castle	Rahovec
Willis	Ferizaj
Fabrika e Vajit të Lulediellit	Prishtine
Ask foods	Gjilan
Bonita/Libella	Prishtina
Bibita	Peje
Gruda	Peje
Abi	Prizren
EuroFood	Prizren
AgroFerma	Gjakove
KoniSoni	Gjilan
Venaria "Eco"	Rahovec
Top Joy	Istog
AgroElita	Kline