

Kosovo edition “Private Sector Development”

Foreword

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Private Sector Development

This is the third edition of the quarterly e-newsletter “This is the third edition of the quarterly e-newsletter “Development and Transition”, a Kosovo edition of a regional publication which the United Nations Development Programme has been publishing in close collaboration with the London School of Economics (LSE) since 2006. The first edition presented articles on poverty and development, and the second focused on the opinions of scholars and practitioners on conflict and development. The theme of this issue is private sector development.

Development & Transition aims to facilitate for UNDP’s partners and the public at-large policy-oriented discussions and debates about how the nature, evolution and challenges of development and transition intersect with UNDP’s activities concerning (and views on) the most important challenges facing Kosovo. Areas of particular emphasis include human development, poverty alleviation, the Millennium Development Goals, and Poverty Reduction Strategies. Not all the views expressed in the newsletter are necessarily those of UNDP; rather, the aim of the newsletter is to encourage open debate about those issues UNDP considers important.

This edition includes articles analysing various aspects of private sector development, starting with barriers to development, the role of remittances in private sector growth, analysis of lessons learned, and possible routes forward. It also analyzes the role of the private sector in revitalizing Kosovo’s economy and overall economic and human development.

This theme is particularly resonant, as Kosovo’s economy has proven unable to convert high per capita aid and private transfers into sustainable economic growth and development. One recurrent theme is the weakness of the private sector response. Even today, aid and remittances per capita are somewhere in the area of 390 Euros annually. This continues to be among the highest rates in the

world, but while the huge surge in aid and private transfers has generated modest growth, private sector investment in productive sectors has not taken-off.

Kosovo possesses a solid foundation for private sector development. It has the legal and regulatory framework based on international best practices that are considered conducive for private sector growth. The stable euro serves as Kosovo’s currency. Competition in the markets for goods and services have been introduced. The administrative cost of setting-up a new business and labour regulations do not pose obstacles to business creation, operation and expansion. The tax burden is relatively low especially in relation to taxes introduced on labour which are at an acceptable level for the private sector. Moreover, Kosovo enjoys free trade with the EU and has the competitive advantage of being close to Western Europe with relatively low transport costs to access its markets.

The above notwithstanding, private sector growth in Kosovo still relies on a few, low productivity activities which in turn are heavily dependent on declining donor assistance. Bias towards retailing and trade renders the private sector unable to sustain high economic activity and generate the necessary growth for significant job creation. The overwhelming majority (98%) of businesses are micro-enterprises employing one to ten employees, typically engaged in low-barriers-to-entry, low-value-added activities such as wholesale or retail trade or service activities such as hotels and restaurants (more than 56% of all firms). Only 10 percent of enterprises are engaged in manufacturing and 7 percent in construction. As a result of this weak and uncompetitive private sector, the merchandise trade deficit in Kosovo remained some 50% of GDP in 2006 with total value of imports accounting to EUR 1.26 billion and total value of exports amounting to only EUR 100 million.

This data suggests that a critical issue in Kosovo is the urgent need to develop a solid private sector that will sustain high economic activity and generate the necessary growth to facilitate significant job creation. This matters not just because of the high level of unemployment, but also because of critical role of private sector in taking over functions financed by declining aid and remittances.

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Note: The viewpoints expressed herein do not necessarily reflect those of the United Nations Development Programme.

Private Sector Development in a Transition Economy: Kosovo

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The Challenge

Since 1999, Kosovo has been going through a transition from the socialist system of the former Yugoslavia to a free market economy. Under the Yugoslav system, the bulk of the economy was accounted for by Socially-Owned Enterprises (SOEs). During the 1990s and the conflict in 1999, many of the SOEs fell into disuse and disrepair, and many also suffered significant physical damage. Thus it has fallen to the private sector to take up the slack of economic development.

There are 55,000¹ registered businesses in Kosovo; the vast majority are micro to small in size and almost all of them are engaged in internal trade and services. Manufacturing is rare in itself and manufacturing for export almost non-existent. Consequently, Kosovo's economy has almost no international outreach and what capital it receives from overseas comes almost exclusively in the form of remittances and declining donor support. Neither of these appears to contribute very much toward productive investment.

Normally, one would look to the SME sector as the engine of growth - in particular for job creation - but at present there is little evidence of this occurring in Kosovo. And given the relative absence of large-scale enterprise, especially foreign-owned businesses, this means that the prospects for employment growth are poor and that there remains no short-term remedial measure or any focus on those factors which are pivotal for long-term employment creation. In order to rectify this situation, Kosovo needs to rapidly boost its very low productivity levels in all industries.

Indeed given the size and very inefficient structure of the agricultural sector (which accounts for perhaps as much as one-third of gross domestic product), the absence of any serious manufacturing sector and the predominance of micro and small trading enterprises, very low productivity is inevitable. Moreover, it is likely that product and process innovation, and research and development, is extremely

limited in Kosovo. This plus the absence of capital investment and widespread training have all militated against productivity gains to a point where, outside a few pockets in the service sectors such as banking, they barely exist. Addressing this deficiency is crucial for long term competitiveness and the creation of sustainable employment.

The privatisation process is now gathering momentum and that is to be welcomed, but a striking characteristic of it, thus far, has been the lack of overseas investment. Figures from the Kosovo Trust Agency (KTA), charged with the privatisation of the (in many cases moribund) SOEs, suggest that over 90% of privatised assets have gone to Kosovans. While there is absolutely nothing wrong with this in itself, overseas investors bring much more to the country than just investment capital, including among others, innovation, technology and skills development, all of which are crucial to productivity and competitiveness.

The absence of an integrated skills and training infrastructure in Kosovo is another characteristic of the present economy. This creates both short and longer term challenges. To begin with it means that companies hoping to expand have to undertake even relatively modest amounts of training on their own. This is time consuming, expensive and a drag on growth. In the longer term, if left unaddressed, this will further undermine already very low levels of productivity and discourage foreign investment.

This is all the more serious because increasingly across the world highly skilled and available staff have become a major differentiator in the battle for investment capital in both services, for example in call centre activities, and in manufacturing, as in electronics assembly. This does not necessarily involve high-level skills, but basic entry-level ones, notably so-called 'soft-skills' such as the ability to communicate with colleagues, working to set programmes and keeping regular hours. This likewise is a major challenge for private sector growth in Kosovo.

The most immediate challenge is the chronically high unemployment rate which is variously estimated at between 40% and 55% of the working-age population, however, the existence of a large "grey" economy means that the real rate of unemployment is probably at the lower end of this range.

This burden of unemployment is felt most keenly by the young as they strive to build a career and establish a predictable income stream. Moreover, the sheer waste of resources that unemployment on this scale creates is stag-

gering, to say nothing of the socio-psychological burden this places on individuals, families and civil society.

Barriers to development

There are a number of important conditions that need to be fulfilled for private sector development to proceed. Since, due to limitations in space, this article cannot go into detail about these issues, brief discussions on each are given below in order to highlight their importance in establishing a firm foundation on which a thriving private sector can be built. Indeed it is fair to say that much development of the private sector will be contingent upon these issues being addressed.

Legal framework. In order for the private sector to flourish, it is vital that there is an adequate legal framework for business. This requires not only the existence of commercial law but also a court system which ensures that disputes are resolved in an effective and timely fashion. Critical issues within the legal framework include the protection of intellectual and industrial property rights, clarity over land ownership and a minimal bureaucratic burden for small businesses. In addition, a planning regime which facilitates investment in priority growth sectors without compromising the environment and the rights of citizens would do much to accelerate growth and potentially offer 'competitive advantage' to Kosovo. Although significant progress has been made in this area, especially as regards land ownership, commercial law remains incomplete, and the capacity of the courts insufficient. This remains a significant challenge for Kosovo.

Electricity supply inconsistencies. The current state of the electricity supply system must be improved if the private sector is to become a driver of economic growth in Kosovo. A regime of five hours' supply out of every six may be at least partly acceptable to domestic consumers and small trading companies but is a major barrier to the development of productive industries which will generate real wealth for the people of Kosovo. Irregular electricity supply also acts as a huge disincentive to potential foreign investors. It is vital, therefore, that sufficient generating and distribution capacity be available to satisfy the demands of industry, both now and in the future. Improvement of both technical efficiency and revenue collection will be required in the short term, before the proposed new generation becomes available in some ten years' time.

Political uncertainty. The lack of certainty over the political future of Kosovo creates some degree of risk to potential investors. The associated risk premium can be seen in the behaviour of financial institutions and investors and, if not

resolved, may adversely affect the availability of finance to local businesses and deter foreign investors.

Access to finance. If the private sector is to grow effectively and in a sustainable manner, it requires access to affordable and flexible finance that can be accessed relatively quickly according to the requirements of the individual enterprises. This funding is normally structured and delivered via a range of financial instruments, including non-refundable grants, a variety of debt schemes, external equity injections, and reinvested earnings.

At the present time, the range, scale and scope of the financial sources and products available to commercial and agribusinesses is relatively limited and, according to many enterprise owners, business representatives/advisors and academics, is not appropriate for normal operational activities, let alone growth and risk-oriented ventures. Recent foreign investments in the banking sector look likely to increase competition and hence improve conditions for private sector businesses but interest rates and repayment terms still cause difficulties for many small businesses.

Taxation and customs. At present the great bulk of Kosovo's taxes are collected at the border. If productive industries are to be developed then a shift to internally raised taxes, both corporate and personal, is vital to encourage the importation of capital goods and raw materials for productive purposes. Unless rectified, this issue is likely to discourage both domestic and foreign investors in manufacturing.

It is clear that any premature removal of duties could have a highly adverse impact on the Government's revenue position, but Kosovo's long-term competitiveness will depend on its ability to grow and attract manufacturing industry. Some existing policies militate against this by taxing categories of intermediate goods and raw materials. This has been recognised and the number and range of goods subject to border taxes is being steadily reduced.

Standards. There is currently no consistent use or application of standards in Kosovo while measurement standards have not been maintained, there is no standardisation and only limited metrology infrastructure. The establishment of a consistent set of internationally recognised standards will help to drive the improvement of the quality and competitiveness of products and materials within the domestic market and facilitate both export trade and import substitution. The current absence of any standards is a major barrier to export trade development. Similarly, the widespread adoption of internationally accepted accounting principles is a necessary condition for the great-

er availability of debt and equity finance for businesses. Work is already underway to develop the necessary standards infrastructure to support economic development.

The Way Forward

The size of the economic challenge facing Kosovo is clearly considerable, but it is not insurmountable. Recent world history demonstrates that many countries faced with straitened economic circumstances have managed to engineer major turnarounds in relatively short time periods and have achieved sustainable economic growth.

Asia affords many examples of success in this regard: Korea, Malaysia, Singapore and Taiwan and more recently India and China have all witnessed the emergence of flourishing economies which are showing every sign of being sustainable, albeit through economic cycles. Elsewhere, European countries like Ireland and more recently the Baltic States offer similar cause for optimism.

The World Bank concluded that of the eight East Asian economies examined (the so called "Tigers"), certain characteristics were present in all of them. These included:

- a 'market oriented' bias;
- an emphasis on human capital development (aimed at the elementary and schools system);
- a stable banking system (sometimes with subsidies to corporate interest rates);
- high savings rates; and
- a focus on stimulating dynamic export industries, sometimes accompanied by strong support to individual sectors and firms most likely to succeed in export markets.

It is important to be realistic about the ability of the government to take a lead role in private sector development in Kosovo. UNMIK and the PISG have chosen to pursue a market-oriented approach with minimal state involvement and a greater role for the private sector including widespread use of 'private sector partnerships' and other forms of close collaboration between the government, business and civil society.

There are several reasons for this including a simple and pragmatic one: such an approach requires fewer state-based resources by tapping into reservoirs of capital, expertise and experience in the private sector and thereby allowing the latter to grow with minimum centralised direction commensurate with democratic principles and protecting the well-being of citizens.

The Ministry of Trade and Industry (MTI) has gone so far as to set this partnership approach on a semi-formal basis. In

its recent "Partnerships for Economic Growth" publication, MTI formally set out its commitment to the creation of a favourable business environment, thus allowing the private sector to operate with a considerable degree of freedom. There is some way still to go before this goal is achieved but the commitment has been made and now the main requirement is to turn this commitment into concrete actions.

¹ Ministry of Trade and Industry

Barriers to SME Development in Kosovo

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The Private Sector plays an increasingly important role in every national economy contributing as it does to employment, tax revenue, economic growth and cultivation of the market system. Today in Kosovo, the Private Sector is comprised of micro, small, medium, and large enterprises. Small and Medium Enterprises (SMEs) constitute around 98% of all enterprises in Kosovo and have the potential to play a major role in economic growth. There is also general agreement regarding the important role SME's play in employment.

During the past few years the number of SME's in Kosovo has increased significantly, moving from 28.000 in 2003 to around 70.000 in 2007¹. This growth was primarily due to the high level of entrepreneurial spirit among citizens of Kosovo and not, as may generally be thought, to favorable business conditions. However, these enterprises continue to face barriers posed by the business environment including, complex and inefficient regulations; difficulties in accessing financial services, skills, knowledge, and technologies; or obstacles to selling goods and services in national, regional, or international markets. These factors which act as a brake on business activities, ultimately serve to damage the image of the Kosovo business environment. While some of these obstacles are inherited from the past, others are due to the continuous uncertainties that have prevailed in Kosovo since 1999.

Surveys conducted by Riinvest since 2000 have observed, on an annual basis, the obstacles that are considered by SME's as the main barriers to their business activities. Data shows that since 2002 'Unfair Competition' (taxation, the informal economy and public services) is considered to be the main barrier, the intensity of which has remained

constant throughout the years. While in 2000 the 'Lack of Legislation' was considered as the main barrier, in 2006 this is ranked below main barriers. It is interesting to observe (Table 1.1) the fact that entrepreneurs in Kosovo consider the main barriers to be those related to the external environment, while those related to the internal environment i.e. human/entrepreneurial capacities, are considered as secondary or tertiary.

Table 1.1: Most Common Barriers Experienced by Kosovan SMEs

| Barriers | Intensity ² |
|---------------------------------|------------------------|
| Unfair Competition | 78 |
| Corruption | 76 |
| Informal Economy | 73 |
| Public Services | 70 |
| High Taxes | 69 |
| Roads and Telecommunication | 64 |
| Fiscal Evasion | 62 |
| Strong Competition | 60 |
| Administrative Burden | 58 |
| Lack of Legislation | 58 |
| Delay in payments | 54 |
| Access to Finance | 44 |
| Lack of Demand | 44 |
| Lack of Information on Business | 39 |
| Insufficient Capacities | 28 |
| Raw materials and equipments | 27 |
| Knowledge of employees | 13 |
| Management abilities | 8 |

Source: Riinvest 2006

Differences in the perception of barriers remain more or less the same among the various sectors (i.e., trade, services and production). The disparities that exist relate to the intensity of these barriers rather than their ranking and a slightly higher intensity is observed in Production and Trade as compared to the Service Sector.

Apart from examining general barriers for SME's, Riinvest surveys also closely observe specific obstacles that Kosovan entrepreneurs are faced with during export-import activities. Survey results show that 'Inadequate Infrastructure' remains the central barrier for exports, followed by 'Political Risk' and 'Custom Procedures' for

exports. The second group of barriers includes 'Export Quotes', 'Health Regulations', 'Transportation' and 'Lack of Information'. While previous studies have shown that 'Lack of Documentation', in particular the certificate for the origin of goods, were the highest barriers for exporting enterprises, more recent results show a significant drop in the intensity of such obstacles, leading them to be ranked at the very bottom of the list.

In relation to Import barriers, Kosovan entrepreneurs complain mostly about Customs rates and the procedures related to imports. The ranking of barriers has not experienced a significant change over the years, with 'Inadequate Legislation', 'Inadequate Infrastructure', 'Transportation' and 'Methods of Payments', representing top barriers for Import activities.

In general, the ranking of barriers faced by SMEs in Kosovo has not changed drastically over the years. Indeed, even today these issues are a challenge for the Kosovo government and society as whole. Removing/reducing these barriers is an essential step towards the development of the Private Sector in general, which represents the main objective for all policymakers and practitioners intent on enhancing the business climate in Kosovo.

¹ Ministry of Trade and Industry, PISG

² The calculation of the indicators: The respondents have classified barriers according to their degree 1-5. The individual values are multiplied with the number of responses received and then divided by the overall number of respondents. 100% represents the highest degree of barrier while 0% the lowest degree of barrier.

Role of Private Sector Development in the Revitalization of Kosovo Economy

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Kosovo is one of the countries where the transition to market economy is closely related to private sector development, in particular, to the development of Small and Medium Enterprises (SMEs), which play a key role in economic reforms implemented in Kosovo.

Development of SMEs in Kosovo has marked a considerable progress. However, the environment was not always friendly and favourable for this sector. Seven years after the end of conflict, we may say that the SMEs sector has shown tendencies of stabilization and normal development. The entrepreneurs' expectations for easy and fast profits slowly

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are being replaced by more meaningful positions and more realistic expectations, which are mainly supported by the market development dominated by the offer and demand.

Since the beginning of 1990s until now, the SMEs in Kosovo have boosted. Despite the fact that these enterprises were incepted and developed in an unfavourable time, a large number of these SMEs managed to survive.

The strategic importance in the development of SMEs can be summarized in the following points:

1. In 1991, Kosovo had a small number of private enterprises; while in 2005 some 48 thousand businesses were registered, out of which 97% were small and medium enterprises. The registration procedures are amongst the easiest, cheapest and fastest in the Balkans region. This boost is a significant indicator of Kosovo populations' entrepreneurial spirit.
2. Almost 98,52 % of enterprises have less than 10 employees. Therefore, we may conclude that the enterprise structure in Kosovo is mainly dominated by micro enterprises.
3. Currently, the SME sector is the greatest absorber of labour force, since they present 65% of the aggregate employment.
4. The contribution of SME sector in GDP is dominant, whereby 80% of GDP is realized through SMEs.

Despite the importance of SMEs, unfortunately the capacities of these enterprises are not satisfactory, as a result of the following:

- Low capital base;
- Very difficult loan terms;
- Unfair competition;
- De-stimulating fiscal and customs policy;
- Lack of working premises and accompanying infrastructure;
- Lack of legislation and implementing mechanisms;
- Lack of electric energy;
- Lack of spatial plan and implementation mechanisms;
- Low level of professional qualifications, as well as low advisory, training and education capacities of business services providers and of the SME supporting network.

In supporting the economic development (private and SME sector), the role of PISGs both in human resources as well as in material and financial resources was significant.

The PISG have continuously supported the economic development through various activities and projects.

Amongst the activities in which the PISG, and more specifically Ministry of Trade and Industry (MTI) is involved are the following:

- The European Charter on Small Enterprises, working premises, privatization, Private Sector Development Strategy, Voucher Scheme of Counselling and Training, SME research and structured interviews, International Conference on Small Enterprises, SME Consultative Council, SME Observatory in Kosovo, Loan Guarantee Scheme, the Best Enterprise for 2005, The Women in Business Fair, Financial Fair 2007, Free Trade Agreements, establishment of a legal infrastructure, continuous PISG commitment to include Kosovo in regional initiatives and projects and opportunities to create free trade zone in the territory of Kosovo, assistance for local producers in marketing their products abroad, drafting and implementation of foreign and internal trade policies, implementation of consumer protection measures, competition in local market, promotion of local and international trade, establishment of links between trade enterprises aimed at the development of national and international trade, regulatory counselling on international trade by cooperating with other authorities, establishment of links with international financial institutions, trade and export stimulation measures, promotion of Kosovo exports and entrepreneurship in boosting the exports, creation of opportunities for local producers in moving to international markets, concrete assistance in the privatization of public enterprises, presentation of trade exchange of Kosovo with other countries, development of construction industry, drafting of tourism development vision and strategy.

PISG – MTI through its Private Sector Development Department is the sole mechanism within the Government of Kosovo that institutionally supports:

- Establishment of a friendly environment and of an efficient SME support system in Kosovo;
- Harmonization of local policies (legislation and regulations) with the those of EU;
- Long lasting growth and sustainable development of SMEs in relation to GDP and new jobs;
- Establishment of a dialog and cooperation between all governmental sectors and institutions, which directly or indirectly deal with SMEs;
- Reviewing laws and regulations related to SMEs;

- Advisory body for SMEs;
- Research of relevant issues for SMEs;
- SME strategy and action plan;
- Data bases of SME support programs;
- Observation points for SMEs (annual reports, Observatory);
- Drafting of new SME support schemes;
- Information campaign on SME related issues;
- Improvement of physical environment in support of SMEs;
- Development of training capacities for business advisors;
- Provision of SME support services, etc.

OUR PARTNERS

Local partners: Network of SME supporters in Kosovo, different sectors within the Government of Kosovo, especially Department of Labour in the Ministry of Labour and Social Welfare (MLSW) and the Department for the Education of Adults within the Ministry of Education, Science and Technology (MEST), Regional Enterprise Agencies (REA), Chamber of Commerce of Kosovo (CHCK), Independent Trade Unions of Kosovo (ITUK), Euro-Info Kosovo Centre (EICC), Kosovo Business Women Network, Group of Young Economists (GYE), RIINVEST and other associations.

Donors in partnership: AER, UNDP, GTZ, SOROS, SWIS-Cooperation, ATA, USAID-CKBS, AGEF, KFW, EBRD, DFID, OSBE.

Foreign partners: Albanian Agency of SMEs, Regional Agency of Tetova, Development Agency of Brčko District (DABD), SBDC-Slovenian small Business Development Centre, Directorate for the Development of Small and Medium Enterprises in Montenegro, NEPA of Macedonia, etc.

Private Sector Development Strategy: Cooperation in the drafting of private sector development strategy was one of the activities of PISG. Strategy aims to be compatible with the development plan of Kosovo:

- Proposals for the development of SMEs that should be compatible with the European Charter on SMEs;
- Identification of necessary steps for the implementation of measurable and standardized infrastructure, which is tested and qualitative in compliance with EU norms and suggests actions for their funding by the EAR.

Sustainable funding: PISG considers that one of the problems of SMEs is sustainable funding, by identifying that the danger of paying back the loans is the main

problem why banks are not providing favourable loans. Therefore, the project "Loan Guarantee Scheme" has been designed, through which banks will be encouraged for provision of loans with favourable terms.

Development of the Private Sector in Kosovo – The need for a strategy

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Kosovo's on-going journey towards progress and development and eventual integration into the European Union is a complex and demanding task after recovering from the devastation brought about by the conflict in 1999.

The huge influx of development assistance from various international humanitarian organizations has started to wane, leaving the challenge for Kosovo to stabilize and strengthen its economy and enhance capacities of its population and workforce, whilst also working to attain economic growth and equitable distribution.

However, just like any country in transition, Kosovo's economic growth must be anchored on a number of issues such as the development of its private sector (including privatization of publicly owned companies), creation of continuous inward and foreign investments, strong fiscal policy and structural reforms in governance.

The current political instability (resulting from the undetermined future status) is greatly affecting Kosovo's economy. The sustained high unemployment rate at 40% (according to Labour Statistics¹) and poverty incidence at 42.8% (based on World Bank estimates²) reflects that Kosovo, characterized by an average annual growth rate of 2%, needs a stronger and more dynamic private sector. This is crucial to long-term, rapid economic growth, which is a necessary condition for sustained poverty reduction, increased employment and the improved welfare of Kosovo's citizens.

But, Kosovo's businesses today are facing tremendous challenges.

Ambiguity of applicable laws and an inefficient and allegedly corrupt judiciary³ are causing immense problems. The EU pillar in Kosovo has done a superb job in creating

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a modern framework but implementation and enforcement in the field is significantly hindered due to lack of capacity among Kosovan institutions and an extremely slow judicial system. The state legislature is still treading a long way to creating enabling conditions for the sound development of businesses.

In addition, Kosovo's physical infrastructure is extremely poor. Power shortages and an unstable water supply are hurting the already deprived businesses and are causing serious long-term harm to business development. Unreliable energy supply is probably one of the major non-political obstacles impeding Kosovo's economic development. On the other hand, the transportation infrastructure (roads, rail and air) need serious investment and improvement to overcome Kosovo's isolated geographic position and link it to international corridors.

Moreover, Kosovo's land and property market is perplexing. Uncertainties regarding land or property ownership are challenging businesses and business growth. Kosovo still doesn't have its own laws that regulate private ownership issues, for example, under international law (and due to its undetermined political status) Kosovo is still obliged to use some Serbian laws that date prior to 1989.

The Tax rates are amongst the highest in the region compared to countries with similar macro-economic indicators. Profit Tax for instance is 20 %, (Macedonia has a flat tax of 10% for corporate and personal income), double taxation has not been avoided and there are no tangible benefits or incentives for new investors, be it local or foreign.

Furthermore, credit and loan interest rates (between 11 to 18 % annually), are extremely high and don't support business development. The income reported by the Banks operating for the last seven years in Kosovo was around 300 million euro from loans only which reflects the fact that the Banks have been making huge profits while maintaining high prices. On the other hand, access to mainstream finance for innovative ideas and business start-ups is impossible.

Furthermore, the conflict caused a considerable brain drain, and significantly diminished the effectiveness of Kosovo's educational system. Today, Kosovo seriously lacks skilled labour and a favourable labour climate. Businesses in Kosovo need a sophisticated workforce with managerial and technical skills but not enough is being done to institutionally address these issues. Kosovo's pri-

vate enterprises generally do not employ advanced management practices, marketing and promotion strategies, or information systems. Most entrepreneurs and managers develop their business objectives and concepts without first designing a business plan or strategy. Feasibility studies are rare.

In addition, lack of favourable foreign trade agreements with neighbouring and EU countries is hurting Kosovo businesses and draining its economy. Kosovo has signed the Central European Free Trade Agreement (CEFTA) accord and has approached it with great political optimism and long term development hopes. But in reality, Kosovo is challenged by its underdevelopment meaning it is not an equal player with other CEFTA countries.

Incomplete institutional and market reforms, unpredictable governance, extremely low exports and foreign investments, inadequate public services and lack of promotional policies supporting competitiveness of local producers coupled with non-acceptance of UNMIK travel documents by some countries and rigid visa requirements, make things only more frustrating.

Therefore, Kosovo's 'post-status' Government needs to urgently articulate a strategy to define how it can effectively promote private sector-led growth. Because growth will create jobs and jobs are a rare commodity for working age Kosovans today. A strategy that will spur entrepreneurial development and stimulate investments should be designed to support the private sector and its crucial role in Kosovo's economy.

When considering these issues, some fundamental question come to mind, namely: What are the true reasons that some countries prosper and thrive while others fail and remain poor? After its political status is resolved, what can Kosovo do to prosper? Is it a matter of knowledge? Maybe education? Perhaps natural resources? Or is it that the Government is the key?

The Private Sector Development strategy in Kosovo should focus on reducing barriers to competition and build mechanisms that support and encourage local producers. It should also foster flexible labour and property markets and introduce equitable tax systems. Legal and judicial systems that protect property rights, enforce contracts, and provide for dispute resolution will all be good starting points to attract foreign investments and create enabling conditions for the economy to get off the ground.

Kosovo has great potential for development and progress. It has a central location in the region and lies amidst a potential market in South-East Europe of 100⁴ million people. It has abundant natural resources and a young motivated labour force with a strong entrepreneurial spirit. It has a powerful diaspora that has been keeping Kosovo alive through remittances for decades. All these resources need to be used in a smart and creative manner and at an accelerated pace. Catching up and competing with regional and global players will not be easy for Kosovo's businesses, but it is a challenge that needs to be addressed.

¹ Statistikat e tregut te punes – Enti statistikor i Kosoves 2005. - http://www.ks-gov.net/ESK/esk/pdf/shqip/sociale/stat_treg_punes_05.pdf

² World Bank Report: Poverty in Kosovo is widespread, but inroads can be made.- <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/KOSOVOEXTN/0,,contentMDK:20665819~menuPK:297788~pagePK:141137~piPK:141127~theSitePK:297770,00.html>

³ Transparency International Report: 25/05/2007: Corruption Undermines Judicial Systems Worldwide http://www.balkantimes.com/cocoon/setimes/xhtml/en_GB/features/setimes/features/2007/05/25/feature-01

⁴ Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Greece, Former Yugoslav Republic of Macedonia, Romania, Serbia and Montenegro, and Turkey.

Development of Agriculture Cooperatives in Kosovo

Xhevat Lushi,
Agriculture Expert

Introduction

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. There are a total of 30 municipalities in Kosovo and 1500 villages. Agriculture is the key economic activity, and the biggest employer in rural areas. Most farms in Kosovo are small family farms with approximately 80% ranging in size from 0.5 – 2.0 hectares. Farms are mainly used to support the needs of households.

The infrastructure in rural areas is quite poor, and access to good machinery or technology is very limited. As a consequence, farms generate very few, if any, material goods to meet the requirements of households. Since farmers do not have access to loans or other business services there is a general lack of initiative to overcome this situation. As a result, poverty is highest amongst this group of Kosovo's population.

In recognition of this and the need for structures to assist farmers through supplying farming inputs for production as well as providing assistance in marketing and access to finances, UNDP implemented the project 'Support

to Agricultural Organizations' (SAO) from November 2004 to July 2007. The objective of the SAO project was to mobilize farmers into agricultural organizations/cooperatives that would in turn contribute to economic growth, reduction of unemployment and alleviation of poverty in the agricultural sector of Kosovo.

Development of Agricultural Cooperatives in Kosovo

Background

Agricultural Cooperatives in Kosovo date back to 1945, immediately after the end of Second World War. These Cooperatives were regulated by the **Law on Collective Fund of Farmers**, according to which the lands remained in the private property of farmers. Later on, the Law on Cooperatives of 1953 placed privately owned arable land under the management of Agro-Combines (industrial complex consisting of related production of processing units).

The period 1977 – 1990 saw a high intensity of Cooperative development in Kosovo. During these years 142 new Cooperatives were established, which resulted in an increase in crop yields, improvement of cattle races, improvement of milk and meat production and the betterment of agricultural equipment.

Prior to 1990 Kosovo had 152 Agricultural Cooperatives, most of which were providing services, inputs and collection of surplus agricultural products.

The League of Kosovo Cooperatives (LKC) as an independent professional organization was established in 1977 by the 14 Agricultural Cooperatives that were formed pursuant to the Law on Farmers Association. The LKC was established in order to develop the Cooperatives, and specifically agricultural production in the private sector.

Challenges of Agricultural Development in Kosovo

Kosovo has been transformed into an importer of agricultural products; in 2003 the share of imported products was 25% (around € 250 million) of the total amount of Kosovo imports. The export of agricultural products is very small (around € 7 million) or 18% of total exports. These exports include mushrooms, potatoes, animal skin and fruit juices.

Agriculture Equipment and Machinery

Agricultural equipment and machinery is a very important asset that gives farmers opportunities for long-term investments with high productivity potential. It is important that these assets can also be used as col-

lateral for loans. According to the UNDP-Kosovo Human Development Report survey from 2004, around 60% of rural families do not have agriculture machinery or equipment, thus hampering the increase of production and of yields in rural areas.

Limited Access to Financial Resources

So far the provision of loans is short-term in nature, very rarely for investment purposes and generally characterized by a low level of risk, and high interest rates. The investment loans for agriculture are hardly functioning in rural areas. According to the World Bank's Economic Memorandum of Kosovo¹, loans in the agricultural sector are at a minimum level, namely 2% from the total amount of loans provided by banks².

Limited Access to Markets

Currently, urban markets in Kosovo sell mostly imported products; due, in part at least, to the fact that local farmers are scattered, and cannot provide sufficient supplies of agricultural products for large markets. Therefore, the improvement of access to markets and enhancement of opportunities for better access of local products to markets is essential to boost economic development.

Lack of Initiative by Farmers for Joining to Agricultural Cooperatives

Agro-Combines (industrial complex consisting of related production of processing units) dominated the agriculture sector until 1991 at which time they collapsed and were no longer able to play an important role in agricultural product collection centers, or in the provision of information on prices, or the control of agricultural inputs. Today, sale of agricultural products by rural families is mainly carried out in local markets. The majority of farmers (87.6%) sell their products themselves and only 2.8% of them sell their products through associations or cooperatives.

Importance of Joining Agricultural Cooperatives

Agriculture is a very important sector for the rural population; it is a key activity and the best opportunity to generate income and new jobs in rural areas. The promotion of institutions (organizations) like those that exist in other countries is urgently needed to help the development of agriculture and processing industries.

One of the most important institutions required to promote the sustainable development of agriculture is the Agricultural Cooperative which is controlled and managed by farmers themselves. Agricultural Cooperatives

are established by farmers with the aim to assist in the provision of inputs (seeds, fertilizers, animal food, agriculture equipment, pesticides, etc) and establish better links to help farmers find new markets by collecting, processing, selling and marketing agricultural products, as well coordinating the joint utilization of equipment and machinery.

In addition to these activities, Cooperatives provide other services, such as: 1) training on the application of new agriculture production technologies; 2) establishing links with banking institutions and 3) protection of farmers interests by advocating in governmental decision-making institutions for more favorable development policies.

Rural Development through Agricultural Cooperatives

The agriculture sector in Kosovo is characterized by very small farms, the lack of an inputs supply chain and difficulties in finding access to organized markets.

Development of Cooperatives oriented towards organized markets, may play an important role in the inclusion of farmers in markets by facilitating the sale of their produce. Through Cooperatives the amount of agricultural products on offer will be much larger, and farmers will be able to diversify their products, thus becoming more competitive. In addition to improving the chain of sale, Cooperatives can also organize other important activities for their members and for the region where they operate.

Taking into account the situation of industry in Kosovo and the limited opportunities that currently exist for the creation of new jobs in the services sector, agriculture has the potential to generate new jobs in Kosovo.

As from lessons learned from European Union countries and countries around the world, the development of Agricultural Cooperatives can create a large number of benefits for the rural economy, including the following:

1. Small farms will be able to relate to market requirements much more effectively, through marketing efforts of Cooperatives and higher income generation;
2. Promotion of an important chain of agricultural inputs supply;
3. Establishment of advisory services on the application of new technologies;
4. Establishment of mechanisms for the joint utilization of agricultural equipment and machinery;

5. Easier access to agricultural loans;
6. Promotion of food with protected origins.

¹ From the UNDP Kosovo Human Development Report 2004, page 79.

² This is the most up to date data that was published in 2003.

The Importance of Business Advisory Services Provision in Private Sector Development

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In Kosovo, as in other transition countries, there is a widespread lack of essential business management and technical/production skills such as the ability to perform strategic business planning, organizational and operational management and financial analysis, all of which are vital for starting and successfully operating a business. Due to the absence of these skills, many potential entrepreneurs become reluctant to start their business or tend instead to invest in low profit activities. The availability of information and advice to potential and new enterprises can be of crucial to their survival and their development and success in generating economic growth and employment.

lished in 2001, with financing provided by the European Union (though the European Agency for Reconstruction) until 2004. Following the withdrawal of donor support many of these centres either ceased operation or sought more profitable work and diversified their services. Now, only the Pristina REA is fully active and is in effect acting as an implementing agency for donor-funded activities. Overall, activities in business advisory services have been contracted, largely because it has proved impossible to raise fees from the sole delivery of these services.

Although highly important, the market for business advisory services still does not exist in Kosovo. Start up, early stage or established enterprises are not able or willing to buy business advisory services at market rates. In all transitional countries, there is some reluctance among enterprises to use business advisory services unless these are provided at no cost or at a highly subsidised rate. In this context, business service providers are unlikely to achieve financial sustainability through reliance on commercial fees or charges. Therefore many Regional Enterprise Agencies/Centres have ceased their operations upon withdrawal of donor support. Although the overall goal would be to have business advisory services that are for the most part, self-reliant, there is incontestable evidence that business advisory services are actually a public good and they need public support (either by government or donors) so that they can continue to provide these services into the future.

Table 1: Business Advisory Centres for selected countries

| | Albania | Bulgaria | Bosnia and Herzegovina | Croatia | FYR of Macedonia | Montenegro | Serbia | Moldova |
|--------------------------|---------|----------|------------------------|---------|------------------|------------|--------|---------|
| Business Advisory Centre | 50 | 24 | 25 | 21 | 12 | 8 | 34 | 25 |
| BACs per 1,000 SMEs | 0.9 | 0.1 | 0.3 | 0.3 | 0.4 | 0.1 | 0.2 | 1.3 |

Source: OECD and EBRD (2003) South East Europe Region: Enterprise Policy Performance and Regional Assessment.

The provision of business advisory services¹ for start-ups and existing enterprises is particularly important for the development of the private sector as these services equip enterprises with the necessary technical and management skills enabling them to expand and grow. For that reason a high level of donor assistance has been invested in the establishment of Business Advisory Centres (BACs) in Kosovo for the provision of free or subsidised advisory services for start ups and existing enterprises. A total of seven Regional Enterprise Agencies/Centres (REAs) all based in the main towns of Kosovo were estab-

Other transition countries are supporting BACs with public funding in order to maintain the financial sustainability of these centres and ensure their focus to service start-ups and early stage business experiences (Table 1). Bulgaria provides large scale government subsidies to cover the basic operating costs of BACs. In Bulgaria, BACs are also charging fees for specific services offered to top up their overall costs. Serbia is promoting private business advisory services through vouchers and subsidies. Here in Kosovo, the Ministry of Trade and Industry is also offering a voucher scheme intended for consulta-

tions and training for potential entrepreneurs and existing enterprises.

A Voucher scheme is a mechanism which enables the potential entrepreneurs and existing enterprises to have access to subsidised services for businesses, usually in the form of a consultation or training. The beneficiary is supplied with a voucher by the Scheme in which it can partially or completely pay the price of the services. A key element of the Scheme is the freedom given to the beneficiary to choose training or consultation offered by any business service provider in the Scheme.

In some other countries, Regional Development Agencies are rapidly becoming established. These Agencies tend to focus on regional and economic development with a strong small and medium size enterprise development dimension including support to start-ups and early stage businesses.

So, which of these models is the most appropriate for Kosovo? The success of the different models largely depends on the local context and the design of the overall model. If in certain parts of the country, there is a complete absence of business advisory services and business advisors, then the establishment of Business Advisory Centres that are equipped to deliver high quality business advisory services to start-ups, early stage businesses and established enterprises, should be a policy priority. But if there are already high quality business advisory services then a rigorous impact evaluation of these different models needs to be conducted to verify which models achieve greater results in terms of enterprise and wealth creation.

¹ The structure of business advisory services mainly consists of the following: provision of information, advice, business networking and training in the areas of legal consulting, financial management, access to finance, marketing, management, business plan development, quality assurance, control and quality system development, product development, public procurement, ICT use, e-business etc.

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Demographics and Migration: Kosovo's Private Sector Development at Crossroads

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A former communist economy and worn out society because of its recent ethnic conflict, Kosovo remains a challenge not only in the field of economic development, but also in that of political status definition in the hands of the international community. Prior to Kosovo's becoming an international protectorate under the United Nations, most of its industries have, of course, been under the control of the state and run by the state. Public and social enterprises have been the major economic drivers in Kosovo just like in the rest of the region during the socialist era of the 1980s and 1990s.

Private sector development has been seen as an important component of Kosovo's overall desired economic growth since UN took over in June 1999. Privatization of POEs and SOEs¹ became a major undertaking of the European Union-led efforts to promote economic growth in Kosovo. While over twenty-five waves of privatization have so far taken place, much remains to be done before most of these privatized SOEs and POEs start to normally function in a productive way.

Beyond privatization, series of micro-finance programs and institutions have been established in Kosovo (such as Kosovo Enterprise Program, FINCA, etc.) all in an at-

tempt to help private sector development. Yet, Kosovo suffers from a hugely underdeveloped economy and incredibly high unemployment, ranging between 40-60%, depending on the source.² With a population of about two million, half of which is under the age of 25,³ Kosovo is now at a very important stage in its demographic development. Given Europe's rapidly aging population, young people are one of the most valuable resources Kosovo has. It may well be said that Kosovo in about ten to fifteen years from now will be at the peak of its "demographic window of opportunity,"⁴ which represents the best demographic stage for a country's rapid economic progress, given the fact that the labour-inactive and elderly people will only comprise a small percentage of the overall population, whereas the majority will be labour-active, young capable adults. Taking advantage of this demographic window of opportunity has been a major contributor to several emerging Asian countries' economic growth.⁵

Normally, one would expect that just like some Asian countries, Kosovo could too take advantage of its young population when at its peak of the demographic window of opportunity to reach a miracle in economic development. One way to achieve this would be through incentives and programmes that would first enable these young Kosovars become well educated and well trained for the global economy of the twenty-first century and second, create opportunities for their entrepreneurship to be successful – hence, private sector development is the most efficient and sustainable way to not only accommodate such a labour force but to also give it room for further continued growth.

Proving quality education for Kosovo's youth is essential. But, it alone does not guarantee job growth. You simply need both demand and supply. Kosovo, for obvious reasons, cannot compete in labour-intensive manufacturing with China or India for instance, but it can be a strategic source of relatively good quality products and mainly services for its reach European neighbours. To become attractive to the EU market, Kosovo must have a quality educated labour force. To make this labour force active, Kosovo must have fairly well developed free enterprises with a global and especially European outlook. Such enterprises may come into life only when private sector in Kosovo is both strong and sustainable. Some may argue that developing the private sector (which would be attractive to / require educated professionals) in and of itself

needs such professionals to begin with, and as a result this entire strategy seems as a "catch twenty-two." But, this kind of an analogy here is flawed because quality education of Kosovo's young population, just like in other developing countries, must be of elementary focus for general development purposes and as such, it may then only be followed by the development of a particular sector – such as the private sector in this case.

Even though, Kosovo may have the advantage of approaching its demographic window of opportunity, which may be well utilized to promote economic growth through private sector development, it faces another quite significant problem – migration. Historically, Kosovo has been dependent on remittances, which in given particular times of its past, have been a lifeline for Kosovars.⁶ Even today, a vast majority of young Kosovars want to immigrate usually to Western European and North American countries. They see no prospective in their own country. And, the ones who stay here are usually not much enthusiastic about getting educated. Contributing to this mind-set of young Kosovars has been the regular inflow of remittances. Kosovo represents one of the top twenty countries in the world with the highest amount of remittances as share of GDP [see Figure 1]. Generally studies have shown indications that remittances help reduce poverty. A study of 71 developing countries, for instance, showed that a 10 percent increase in per capita official international remittances led to a 3.5 percent decline in the share of people living in poverty.⁷ As for Kosovo, however, it has been shown that while remittances have generally helped the consumption needs of recipients, they have also had a negative impact on young recipients as far as their education attainment and labour force participation are concerned.⁸ Remittances (from family members and others abroad, including foreign pensions) constitute the second largest source of income for households in Kosovo, making up about 16% of household income [see Table 1].

So, while young population is one of Kosovo's major resources for progress, and while the private sector development could be the way to take advantage of its demographic window of opportunity, keeping this resource in and active is particularly challenging because of the negative effects on education and labour-force participation that remittances have on their recipients and the fact that these young people want to immigrate. This challenge brings private sector development in Kosovo at the crossroads of migration and demographics.

DEVELOPMENT & TRANSITION

Therefore, it is of outmost importance for Kosovo policy-makers to rightly decide on a policy or a set of policies that encourage education attainment and discourage further immigration of its young people. To be successful, these policies should not only be technically right, but they should also be politically supportable as well as practically implementable. One recommendation to be considered would be for Kosovo to perhaps establish and develop an investment bank that would attract the savings and other financial transactions of the Kosovo diaspora (by of course providing slightly higher interest rates than the average EU commercial banks given Kosovo's higher risk level, or by providing social and other financial benefits – such as reimbursement of taxation from saving accounts earnings when these funds are invested in Kosovo, for instance). Such a bank, if pursuing policies in line with the above, could be instrumental in helping all of the components of economic growth through private sector development fall into their right places, because:

- it would enable Kosovar migrants to seriously consider having their funds saved and invested in Kosovo (which would create a more sustainable source of income for Kosovars in general, and their family and relatives in particular) as opposed to sending them in the form of remittances used mainly for consumption by their family and relatives in Kosovo;
- it would signal Kosovar youths that their country is rather seen as a potential place for investment (which would in turn create new jobs in the future), which would decrease their ambition to leave Kosovo and increase their ambition for higher education attainment;
- it would finally provide Kosovo with the point where both the supply and demand in terms of its demographic window of opportunity and the investment for private entrepreneurship progress, respectively, would meet – hence, taking advantage of both demographics and migration to ensure economic growth through private sector development.

¹ POE – Privately Owned Enterprise; SOE – Socially Owned Enterprise

² Official statistics show unemployment at 39.7% (Statistical Office of Kosovo, Kosovo in Figures 2005), while many other articles and studies claim the rate of unemployment at about 60%.

³ Kosovo in Figures 2005, Statistical Office of Kosovo, Prishtina, 2006

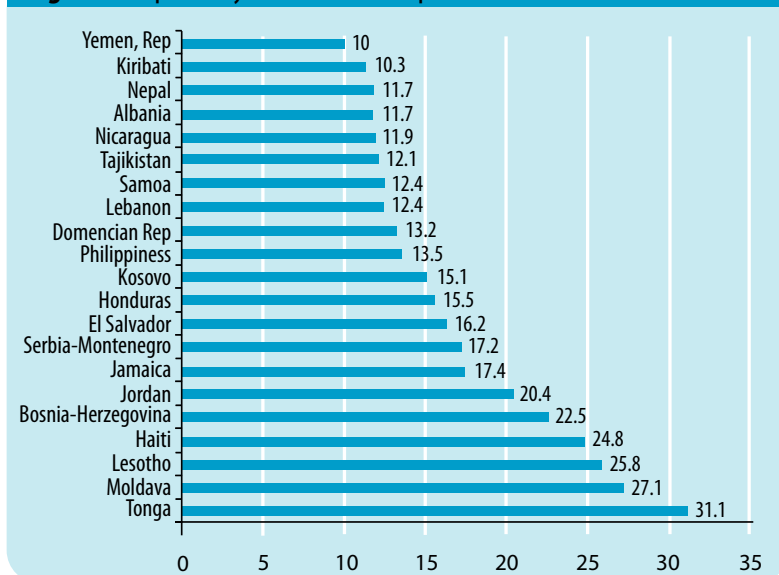
⁴ Bloom, D.E., Williamson, J.G. "Demographic Transitions and Economic Miracles in Emerging Asia," NBER Working Paper No. W6268, November 1997

⁵ Ibid.

⁶ "Cutting the Lifeline: Migration, Families and the Future of Kosovo", European Stability Initiative, Berlin September 2006

⁷ Adams, Richard and John Page, "Do International Migration and Remittances Reduce Poverty in Developing Countries?" World Development 33(10): 1645–69, 2005

⁸ Bislimi, Faton and Ersegun Kayhan, "The Spoil Effect: How Remittances Affect Developing Countries – The Case of Kosovo," MPAID Second Year Policy Analysis Series, John F. Kennedy School of Government, Harvard University, March 2007

Figure 1: Top Twenty Remittance-Recipient Countries as Share of GDP

Source: IMF BoP Yearbook (2004) and World Bank staff estimates (in GEP 2006)

* Position of Kosovo based on data from IMF estimates, IMF Office in Kosovo (2006)

Table 1: Household Income Sources in Kosovo (% of total income)

| Income Source | Men | Women | All |
|----------------------|------------|------------|------------|
| Regular Wages | 51 | 58 | 51 |
| Temporary Wages | 7 | 1 | 6 |
| Business Net | 11 | 1 | 9 |
| Agriculture Net | 3 | 1 | 6 |
| From members abroad | 9 | 12 | 10 |
| From others abroad | 3 | 3 | 3 |
| Kosovo Pensions | 3 | 15 | 5 |
| Pensions frim abroad | 3 | 2 | 3 |
| Remitt's from Kosovo | 1 | 1 | 1 |
| Property Income | 2 | 1 | 2 |
| Social Welfare | 2 | 3 | 3 |
| Lotteries | 0 | 0 | 0 |
| Other | 2 | 1 | 2 |
| Wages in kind | 1 | 1 | 1 |
| In kind from abroad | 0 | 0 | 0 |
| Total % | 100 | 100 | 100 |

Source: Statistical Office of Kosovo (2006)



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