MINISTRY FOR FOREIGN AFFAIRS OF FINLAND

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THREE POLICY ASSESSMENTS FOR PRIORITY TRADE AND HUMAN DEVELOPMENT TOPICS

EXPORT CONSTRAINTS

MOVING TO HIGHER VALUE ADDED GOODS AND SERVICES

SKILL COMPOSITION AND PRODUCTIVITY ENHANCEMENT FACTORS OF EXPORTS

2014

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LIST OF ABBREVIATIONS

BoP	Balance of Payment
CBK	Central Bank of Kosovo
CEFTA	Central European Free Trade Agreement
EU	European Union
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GoK	Government of Kosovo
HACCP	Hazard analysis and critical control points
HDI	Human Development Index
HR	Human Resources
HS	Harmonized System
ICT	Information and Communication Technology
IFC	International Finance Corporation
IMF	International Monetary Fund
ISO	International Organization for Standardization
KAS	Kosovo Agency of Statistics
KBRA	Kosovo Business Registration Agency
LLC	Limited liability companies
MAS-Q	Metrology, Accreditation, Standardisation and Quality infrastructure
MoF	Ministry of Finance
MTI	Ministry of Trade and Industry
NACE	Statistical classification of economic activities in the European Community
NTBs	Non-Tariff Barriers
OECD	Organisation for Economic Co-operation and Development
OJT	On-the-Job Training
SAA	Stabilization and Association Agreement
SIA	Sustainable Impact Assessment
SME	Small and medium-sized enterprise
STIKK	Kosovo Association of Information and Communication Technology
TA	Trade Agreement
TAK	Tax Administration of Kosovo
TARIK	Integrated Tariff of Kosovo
TD	Trade Department
TIS	Trade in Services
UN	United Nations
UNDP	United Nations Development Programme
VAT	Value Added Tax
WTO	World Trade Organization

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INTRODUCTION

Exports are one of the important sources of development for small economies like Kosovo[1]. Policymakers usually aim to promote exports as they contribute to employment generation and economic growth. The recent literature links exports with firm and industry productivity levels; according to this line of thinking, only high productivity firms export, whereas non-exporters are by definition low productivity firms. Moreover, increasing exports provides new opportunities for enterprises and entrepreneurs to further increase their productivity levels, expand and upgrade their production, and create more and better jobs.

The current situation in the export activities of Kosovo and the high trade deficit reflect the low level of competitiveness of the domestic market and its lack of diversification. This is a result of various constraints that the exporting sector in Kosovo has been facing since early 2000. They are domestic in nature – primarily institutional – and also barriers specifically related to international transactions – both economic and political. Furthermore, firm specific constraints exist – technology and human resources – that equally affect firm competitiveness levels in foreign markets.

The purpose of this study is to identify the constraints facing current and potential exporters in Kosovo, while providing valuable information on key obstacles related to exporting and concise, practical recommendations on how to tackle them.

An understanding of the barriers to export is essential in understanding and determining why exporters are not able to make use of their full potential and why many firms do not succeed or even incur losses (financially) in their international attempts.[2] Understanding the barriers to export and their impact at a national level helps policymakers to develop key strategic guidelines and provide important insights for preparing national export policies.[3] Furthermore, understanding the barriers to export could lead to minimizing their effect and result in higher export propensity and performance, for both individual firms and countries alike.[4]

As the main instrument to identify these barriers, a survey was conducted with Kosovar businesses and, in particular, with businesses engaging in export activities. In addition to the survey results, an intensive desk research was conducted to identify the particularities of the Kosovar economic environment in order to combine these with the most relevant scientific literature on this topic.

In the following chapters, we will further elaborate the methodology of our main tool - the survey, conduct a review of the most relevant literature on this subject, and then provide a detailed identification of the main obstacles to exporting from Kosovo.

1 For UNDP, all references to Kosovo on this document are made in the context of UN Security Council Resoalution 1244 (1999).

2 Leonidou, L. (1995) and Chung, H. F. L. (2003)

3 Katsikeas, 1994

4 Leonidou, 1995

The findings lead us to the conclusion that, with a few exceptions, the Kosovar industrial sectors lack the ability to compete internationally due to the low level of productivity. We identify the main factors negatively affecting an already low level of productivity, such as deficits in Human Resources (HR) capacities and MAS-Q (metrology, accreditation, standards and quality-infrastructure), the generally small size of firms in Kosovo, the rather low educational level of the workforce and informality in relation to exports.

To tackle these challenges in the most effective way, the ideal tool set should be a combination of actions taken by 1) the private sector, through the support of a better trained work force and implementation of higher MASQ levels, 2) the government, through concrete actions to make finance more accessible, to fight informality and to develop a concise industrial policy and 3) the government should empower women and make finances more accessible for them in order to help the private sector for faster growth.

TRADE BALANCE AND ECONOMIC PERFORMANCE

Since Kosovo's unilateral declaring independence on February 17, 2008, Kosovo has continued to make progress in development, both in terms of its economic performance and as a young, multi-ethnic democracy. Kosovo government has embarked on numerous reforms, outlined in the Kosovo Economic Development Vision Action Plan, as adopted on 18 April 2011, to enhance and sustain economic growth during the medium-term.

In the last four years, Kosovo has had an average Gross Domestic Product (GDP), growth of about 4-5%.[5] Although Kosovo's economy has been shielded to a very large extent from the effects of the European crisis, the signs of economic slowdown have been present in the past year. GDP growth declined from 4.4% in 2011 to 2.5% in 2012. The pace of growth is not nearly enough to have a transformational effect on Kosovo and lower the unemployment rate. Unemployment continues to hover around 30.9%, according to the Labour Force Survey (with female unemployment being even higher at 40%), [6] which, due to methodological changes, does not allow for comparisons with previous years. Labour force participation is among the lowest in the region, at about 36.9%.

The pressing problem for Kosovo's economy is the large current account deficit (15% of GDP in 2012), with revenue composed primarily of aid and remittances. The current account deficit reduction in 2012 was mainly due to higher current transfers and lower imports of goods and services. The European Commission, in its Kosovo 2013 Progress Report, emphasizes that "GDP per capita in Kosovo has reached 2,721 Euros in 2012, equal to 11% of the EU-27 average, almost unchanged over its level in 2011." In addition, it adds that, overall, Kosovo's economic growth has weakened and remains fragile.

The International Monetary Fund (IMF) reports that the trade deficit remains large in Kosovo, at about 35% of GDP. The negative Balance of Goods and Services in Kosovo for 2012 was close to 2 billion Euros. Export of goods in 2012 dropped from 322 million Euros to 289 million Euros, whereas the export of services overall increased to 199 million Euros.

5 IMF Country Report on Kosovo No. 222, July, 2013

6 Statistical Agency of Kosovo, Labour Force Survey, 2013

Table 1: Goods and Services Balance in million Euro

	2009	2010	2011	2012	2013
Goods and services balance	-1,553	-1,710	-1,904	-1,986	-2,030
Goods	-1,673	-1,776	-2,090	-2,185	-2,259
Exports	177	305	322	289	307
Imports	-1,851	-2,081	-2,412	-2,474	-2,566
Services	121	66	186	199	229
Receipts	429	476	608	631	664
Payments	-308	-410	-422	-432	-435

Source: IMF

Goods exported are less than 10% of GDP and concentrated in sectors with a low value-added component, notably metals. This structure poses a number of major problems for the Kosovar economy. It indicates a massive lack of long-term sustainability, by making it dependent on the influx of other capital such as the remittances sent from the Kosovar diaspora. This again bares the risk of massive exposure to the economic fluctuations in the Diaspora's host countries.

The reason that the performance of exports of goods deteriorated in the last two years was due to a decrease in external demand and a decline in prices for metals and metal products - Kosovo's main exports. A trade deficit of 35.1% of GDP reflects an underdeveloped and narrow domestic production base.

In the past, continuous attempts have been made to identify the main obstacles leading to this rather bleak situation in Kosovo's trade balance. The fact that Kosovo has been unable to increase its export capacities has been linked to a number of factors.

Kosovo, including its institutions, needed to be rebuilt after the conflict in 1999. Hence, institutions are rather young, their staff inexperienced and generally exhibit a rather poor institutional quality compared to other countries in the region. Additionally, the inflow of foreign direct investments is the lowest in the region due to a number of issues, such as the unresolved status of Kosovo (it is not a United Nations member), and this also leads to a lack of access to regional initiatives.

Furthermore, despite the latest attempts to improve Kosovo's infrastructure, it is of rather poor quality with only one highway linking it to the south and no functioning international railway system. In addition, due to the aforementioned institutional difficulties and the rule of law issues, specifically in the area of economic courts and contract enforcement, Kosovo is faced with a very high cost of finance. Lastly, corruption is still perceived as very high, which contributes negatively to all areas of trade and economic activity. All of these identified factors can be considered as barriers that lead to a low level of productivity and, thus, to a weak competitive position in potential export markets.

In the medium-term, in order for Kosovo to achieve a real growth of about 4.5%, in line with Kosovo's average performance of recent years, growth should not only remain driven by domestic demand, but it should also be built upon a strengthened export sector. Hence, efforts to enhance competitiveness should become of paramount importance to Kosovo's institutions in order to improve the external balance of trade by increasing exports.

LITERATURE REVIEW

Export development remains one of the main economic objectives of governments and societies around the world, since development and growth usually translate into more jobs, higher income per capita, and greater social prosperity.

Many economic studies indicate that exporting is one of the biggest contributors to growth. In other words, countries that export more have higher economic growth, and usually, the model of growth is more sustainable, especially if exports are well diversified. Krueger (1978), Chenery (1979), Ram (1985) and Fosu (1990) agree that exports promote economic growth. Their argument is that competition in international markets promotes economies of scale and increases efficiency by concentrating resources in sectors in which a country has a competitive advantage.

Feder, in his seminal paper "On exports and economic growth," examines the source of growth during the period 1964–1973 for a group of semi- industrialized, less developed countries. After incorporating the possibility that marginal factor productivities are not equal in the export and non-export sectors of the economy, the study concludes that growth can be generated not only by increases in the aggregate levels of labour and capital, but also by the reallocation of existing resources from the less efficient non-export sector to the higher productivity export sectors.[7]

Furthermore, the recent financial crisis has demonstrated that a need exists for developed countries to shrink current account deficits particularly by reducing imports and increasing exports.[8]

In addition, other research results suggest that exporters perform better than non-exporters, particularly because of exposure to increased competition. Exporting firms tend to be more productive and technologically more dynamic than firms that sell mainly to the domestic market. The reason, as a general rule, is not linked to the benefits that accrue from the activity

7 Feder, G. (1983)

8 Rodrik, D. (2009)

of exporting per se but simply with selection effects: better firms (in all respects) are able to or choose to export (see Tybout 2000 for a survey).

The relationship between governance quality and output fluctuations has also been examined in the economic literature. On the one hand, the contribution of bad governance to the instability of output is evidenced in important cross-country analyses.[9] On the other hand, it has been shown that the ability of governments to handle economic crisis depends on the quality of institutions. Rodrik (2000) shows that democratic institutions foster political consensus around policy responses to external shocks, while Arin (2011) finds that corrupt countries of Organization for Economic Co-operation and Development (OECD) are less likely to rebalance their budget during serious attempts of fiscal consolidation.

Additionally, participation in the export market can be constrained by other numerous factors. As outlined by Melitz (2003),[10] "firms' export participation may depend not only on their characteristics, those of the macroeconomic environment (for example, government export-enhancing expenditures), but also on sunk entry costs, i.e. fixed costs that cannot be recovered," costs that cannot be borne by non-productive firms.

The link between efficiency and exports has been intensively researched in the literature that has analyzed productivity growth. A clear finding of this literature is the existence of significant differences in productivity among exporting and non-exporting firms. Furthermore, it has also been observed that these differences tend to persist.[11]

To explain why exporters are more efficient than non-exporters, the literature on productivity has outlined two main arguments: (a) firms competing in international markets are exposed to higher competition; and (b) exporters have sunk costs to bear as they enter a new market, which does of course not apply for firms operating only in domestic markets. Both explanations share the idea that export markets select the most efficient firms among the set of potential entrants into the export market.[12]

Taking this into account, we can conclude that sunk costs have a crucial role in increasing the probability to engage in exports. Roberts and Tybout (1997) argue that, on the one hand, favourable economic conditions reduce sunk costs and, on the other hand, sunk costs play a decisive role in stabilizing export activities. This is due to the fact that, once an investment in areas like market analysis or administrative costs is made, firms find it more convenient to stay in export markets even when the conditions become less favourable due to macroeconomic developments.[13]

Generally, traditional literature considers the positive relationship between a firm's size and exports a well-established fact. Although exporters can also be found among smaller firms, the probability that a firm exports and its export/sales ratio increases is contingent on a firm's larger size.[14] Therefore, it should be stressed that the aspect of firm size and its relationship to

9 Acemoglu, 2003

10 Melitz, M. (2003)

11 Tybout (1997)

12 Delgado (2002)

13 Bugamelli and Infante 2003

14 Wagner (2001)

exporting has a specific significance for a rather small and young economy like Kosovo's, where companies have simply not yet had the time to grow.

Considering that most small firms have problems financing their export activities (Holmund and Kock, 1998), the cost factor can act as a serious export impediment for many firms (Chung, 2003; DaSilva and Da Rocha, 2000; Katsikeas and Morgan, 1994), as they are not able to cover the sunk costs needed to grow their business and enter exporting markets.

In summary, the point made in the literature is that the relevance of a company's size for its probability to export comes from a number of factors. But all of those are linked to the idea that firm size has a positive impact on all factors that increase productivity. Most prominently, this is of course from advantages in productivity due to economies of scale in production, but it is also from a number of other factors like the ability of bigger companies to fully utilize higher qualified and more specialized executives better, abilities to raise financial capital at lower costs, larger internal sales and marketing capacities, financial capability to take production risks (e.g. developing products specifically for international markets), scale benefits from bulk purchasing, and at least some of the costs for starting to export (e.g. market research) are sunk costs which can more easily be managed by larger companies.[15]

However, this discussion shows the paramount relevance of productivity (and different factors impacting it) in firms when discussing exports and obstacles towards exporting. As obstacles to productivity can therefore also be considered as obstacles to exporting, below we will show how these obstacles manifest themselves within the companies of Kosovo.

METHODOLOGY OF THE STUDY[16]

In order to determine the skill composition of the production of manufacturing firms, the skill composition of exporting manufacturing firms, and the productivity enhancement factors such as technology and trainings, a sampled survey at the firm level in the manufacturing and service sectors in Kosovo was carried out. The purpose of the survey was to identify the skill composition of exports, while testing whether the theory that exporters are in general larger, more productive, hire more workers, and pay higher wages holds for Kosovo. It also looked at the level of technological advancement by exporting and non-exporting firms, as well as their investment in training and new product lines.

This study draws on the findings in the "Impact Assessment document on Liberalizing Trade between Kosovo and the EU" prepared by the Ministry of Trade and Industry of Kosovo. It identified Kosovar products that are deficit-prone and industrial sectors that are seemingly "import-sensitive" following the terminology proposed by Schoeffle.[17]

15 Wagner (1995)

16 **The same methodology of the study was used in the Policy Assessment III: "Skill composition and productivity enhancement factors of exports".**

17 Gregory K. Schoeffle, "Imports and domestic employment: identifying affected industries", *Monthly Labour Review*, August 1982, pp. 13-26.

The report took into account two main factors for each industry as classified by their 2-digit HS chapter:[18]

- the trade balance (does Kosovo import or export more of the relevant goods)
- the tendency (is the deficit growing or decreasing).

This paper particularly considers the cases (Integrated Tariff of Kosovo chapters) where a trade deficit (more of these goods are being imported than exported) exists, but this deficit has been declining in the past few years.

The rationale behind this is that, even though a trade deficit exists, because the deficit has been declining, it might suggest that some import substitution is taking place and/or exports are growing. In addition, this could be interpreted as an indicator that such Kosovar industries, although generally still weak compared to regional standards, have already started a catching-up process with global or at least regional competitors. Products that fall within this category can be recognized as part of industries that show genuine economic potential and relevance (in terms of employment generation and positive GDP contribution).

However, this hypothesis, based only on the above mentioned methodology, has a possible weakness in that the trade deficit might be decreasing due to lower demand for those imported goods or other external effects and not merely due to import substitution and/or increased exports.

However, due to the lack of data on industrial output in Kosovo and given the current state of statistics, we considered this the best possible initial approach. An additional methodological dimension was required, in the form of an economic indicator, in order for us to be able to pinpoint industries with high potential growth, to further strengthen the methodology above.

In the search for an additional economic indicator which would help us narrow down the group of products with the highest potential (import substitution and export growth) based on the data from 2005 to 2011, we discovered that the products representing the top 10 Kosovo exports are either minerals or scrap metals (see Table 2), and they do not represent any higher value-added products worth further research on productivity or industrial policy.

18 The Harmonized Commodity Description and Coding System, also known as the Harmonized System (HS), of tariff nomenclature is an internationally standardized system of names and numbers for classifying traded products which came into effect in 1988, developed and maintained by the World Customs Organization (WCO)

Table 2. Top 10 Kosovo's exports (2005-2011)

Commodity	2005:	2006:	2007:	2008:	2009:	2010:	2011:
7202:Ferro-alloys	0	0	18,957,247	83,733,272	65,374,555	140,925,770	134,071,578
7204:Ferrous waste and scrap	12,159,391	9,122,440	15,235,138	20,161,395	7,562,905	17,598,945	25,168,209
2716:Electrical Energy	1,206,446	8,462,083	12,531,545	8,237,507	6,999,215	10,123,743	15,508,551
7404: Waste and Scrap of Copper	2,636,508	7,537,408	9,400,107	7,021,981	4,710,742	12,117,190	14,299,418
2607: Lead ores and concentrates	0	4,803,169	8,518,432	6,142,986	8,170,079	15,762,902	11,682,634
4101:Raw hides and skins of bovine	5,974,397	7,166,443	6,456,206	4,236,136	4,427,451	9,230,016	9,137,711
4010:Conveyor or transmission belts	219,219	2,343,686	5,204,924	4,774,152	4,228,533	4,695,942	7,541,466
1101:Wheat or meslin flour	5,846	2,450	2,893,068	2,734,801	3,495,450	6,173,510	7,224,259
8406:Steam turbines and other vapour turbines	2,700,000	241,490	9,883,840	98,830	5,000	450	6,522,819
7602:Waste and scrap of aluminum	3,667,110	7,919,820	6,391,930	4,108,876	2,708,959	5,466,028	6,256,464
Total Exports	56,283,282	110,773,625	165,112,350	198,463,128	165,327,587	295,956,755	313,106,692

Source: Kosovo Customs and Kosovo Agency of Statistics

As the literature suggests, exporters are by definition more productive than non-exporters, and they are better endowed with human and technological capacities. Since exports with potential of being higher value-added goods are rare in Kosovo, we opted to utilize the industries from the Sustainability Impact Assessment (SIA) sensitivity analysis that have shown a significant growth in exports over the last seven years. Given the data constraints, coupled with the aforementioned methodology, this was the best available way to identify industries with the highest potential for growth and export.

The table in the annex shows sensitive but improving Harmonized System (HS) 2-digit chapters as identified in the SIA (meaning that the deficit is declining).

After collecting data per HS 4-digit chapters on exports from all products that qualified on the basis of the earlier explained methodology, we identified six chapters (highlighted in the annexed table) within which the exports have been rising significantly over the last seven years.

MANUFACTURING SECTOR

As a result, the following industries were analyzed further through the survey instrument:

- For **plastics**, based on the NACE classification,[19],Division 22 was analyzed;
- For **beverages, spirits, and vinegar**, based on the NACE classification, Division 11 was analyzed;
- For **salt, sulphur, earths and stone, plastering materials, lime and cement**, based on the NACE classification, Division 23 (specifically, Division 23.2 and Division 23.51) was analyzed;
- For **furniture**, based on the NACE classification, Division 31 was analyzed;
- For **edible fruits and nuts**, based on the NACE classification, Division 1 was analyzed;
- For products of the **milling industry**, based on the NACE classification, Division 1.11 was analyzed.

SERVICE SECTOR

The methodology above was unable to capture the service industry as the original SIA was solely based on customs data. Therefore, further analysis was necessary to develop e method to include the relevant service sectors in the methodology of the survey.

In general, the service sector in Kosovo has greatly developed in recent years and is regarded to hold high potential for the development of the Kosovar economy, due to Kosovo's relatively low labour costs and its young population. However, this sector has so far only been marginally studied, and as such, data on the service sector is also lacking.

Nevertheless, based on the data illustrated in the above table, we propose that the industries where Kosovo has a positive trade balance are the ones with a high potential for growth and exporting (see earlier rationale).

The tourism sector is a very specific case and is the subject of a range of other more focused studies; therefore, we excluded it and focused only on the three service sectors below.

- For **ICT services**, based on the NACE classification, Section J – Information and Communication, Division 62 was analyzed;

19 HS codes were matched with the statistical classification of economic activities in the European Community, abbreviated as NACE, which is the nomenclature of economic activities in the European Union (EU). This was necessary because the KAS and TAK record the date using this nomenclature.

- For **communication services**, based on the NACE classification, Division 61and Division 70 were analyzed;[20]
- For **business services**, based on the NACE classification, Division 70.22 was analyzed.

The purpose of the survey for this assessment was to provide heretofore missing quantitative data on a semi-randomly chosen sample of 497[21] manufacturing and business-to-business service providers. The survey contained questions that provide generic data on: firm size, gender composition and educational attainment of the workforce in the surveyed industries, income per education level, turnover, export data, foreign experience, research and development presence, employee turnover, identification of export barriers by firm or external factors, and knowledge of policy processes.

IMPLEMENTATION OF THE SURVEY

The most prominent target sectors of the methodology included a predesigned list based on a matching of HS codes with the NACE classification. Companies fitting the NACE criteria were identified, and as such, the data generated could be used to draw a map of the existent skill sets and resources necessary to produce goods and/or services in these sectors.

The sample was drawn out based on the predetermined NACE classifications (53 categories) of the business universe in Kosovo. Out of the total number of businesses in the Tax Administration of Kosovo database (64,445 registered businesses), only 3,282 businesses fit in the categories described above.

Therefore, the main sample size was composed of 344 companies from the six categories listed above, all randomly chosen. Proportional sampling procedures were followed; however, in case of refusal or non-contact (business could not be found, long term absence of the person designated for interviewing, respondent never available for appointment) after two call-backs, other firms from the list were used for replacement. This resulted in the following distribution:

20 During the implementation phase it became evident that the division between ICT D62 and communication services D70 was not relevant in the praxis as all consider themselves as ICT

21 The total sample was composed of 500 businesses. However, the achieved sample was 497 due to the fact that only 153 interviews out of 156 were carried out for a subsample of exporters (ex post, 3 respondents declared an NGO status).

Table 3. Projected sample versus achieved sample (main Sample size: 344 companies from the catogories outlined)

	Projected sample	Achieved sample
Milling	14.0%	12.5%
Fruits and Nuts	1.6%	1.5%
Beverages	9.0%	8.1%
Furniture	33.9%	43.6%
Plastics	14.7%	16.6%
Salt, Sulphur, etc.	9.4%	8.7%
ICT	9.5%	5.2%
Business Services	7.9%	3.8%
TOTAL	100.0%	100.0%

Source: Survey data

Additionally, 156 exporting companies were targeted for surveying. Out of these 156 exporters, 100 were to be drawn out by randomized, proportional sampling based on the HS code and customs data, specifically:

- Companies that exported in each of the past 3 years (2010-2012);
- Based on the Sections within Kosovo Customs' HS code determined companies' with 50+% of exports being in one of these predetermined HS sections (also past 3 years).

The remaining 56 exporters were identified by matching HS-2 digit codes with the NACE categories targeted in the methodology. This list included only those companies that had exported in at least three of the four years (2010-2013) and were the 8 largest exporters - by total annual value - for each category.

However, again due to non-response rates, only 18 of the original 56 exporters in the main sample categories could be contacted, and as such, replacement was completely randomized from those remaining on the list of those identified for the 100 Kosovo-wide, targeted exporters. This resulted in 53 companies being interviewed (see Footnote 24). Still, by applying this methodology, we were able to collect data on exporters Kosovo-wide.

FINDINGS

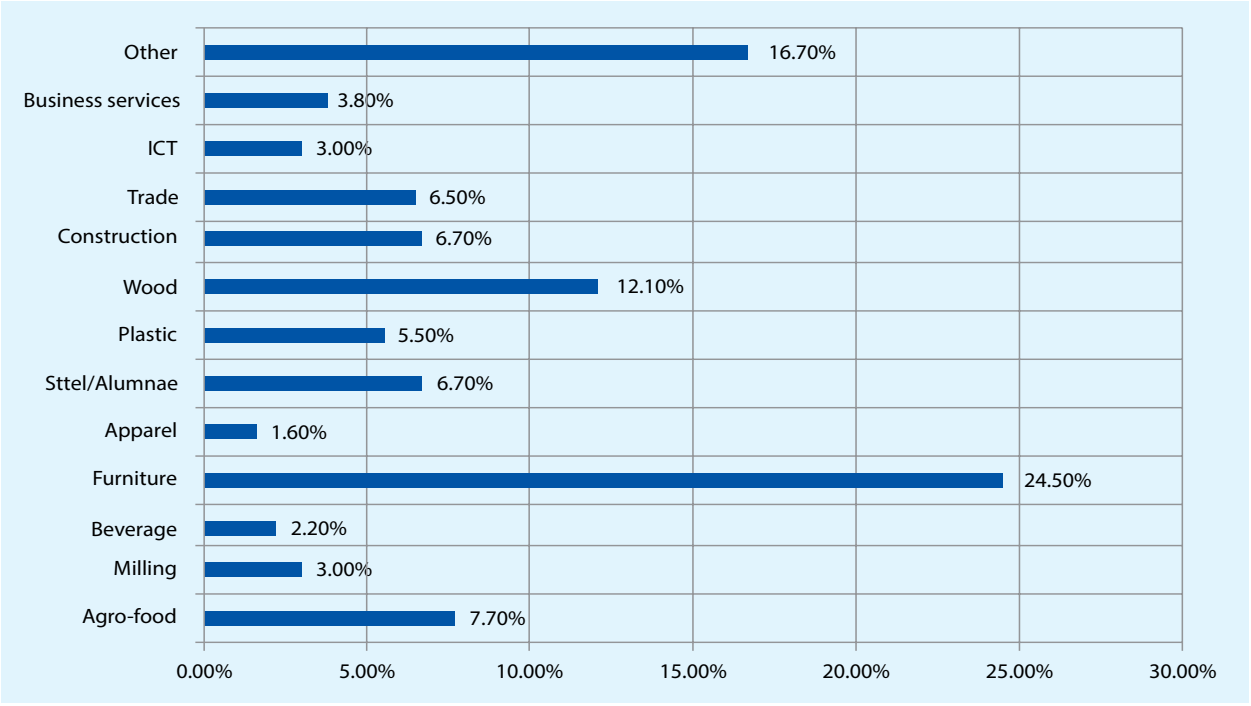
Keeping in mind the hypothesis discussed above in the literature review, that firm productivity is a central factor when discussing exports and obstacles towards exporting, we can now add the important element of Kosovo businesses' perspectives by analyzing the data generated from the survey and so extend the analysis. With the help of the collected data, we will show that the reason for the poor trade balance stems from a number of factors that decrease firms' productivity in Kosovo. All data and statistics referred to in the following sections stem from this survey, if not specifically noted otherwise.

The approach of this analysis attempts to bring together the theories discussed above on productivity impacts for exporting as defined in current literature, with the findings of the survey. We aim to describe the current situation of Kosovar businesses, and specifically exporters, as presented from a business management perspective (the surveyed representatives of businesses were all either owners/CEOs or part of the senior management of companies).

The survey targeted as many exporters as possible in the selected industries. Nevertheless, of the surveyed companies, only around 30% reported to be exporting. Therefore, the sample size for all further presented data related to exporting is based on the 150 surveyed companies with export experience.

This means that from the 150 exporting companies surveyed, the distribution across long term, short term contracts and ad hoc exporters is quite balanced, with long term contracts at 38.9%, short term contracts at 37.6% and ad hoc contracts at 26.1%.

Figure 1: Surveyed companies by industry



Source: Survey data

All targeted industries are represented in the sample. However, if we compare the actual distribution of sectors within the sample according to self-declaration during the survey interviews, we find quite a discrepancy compared to the sector allocation.[22]

The rather large portion of companies which see themselves in the untargeted industries of Trade and Construction can be due to wrong declarations when registering the firms or from multiple occupation registration and then focusing only on other activities. Another reason might lie in the methodological approach, which included in addition to the targeted industries an extra 100 exporters from all sectors. Additionally, some of the companies declaring to be in the wood industry could be associated with the furniture industry (wrong self-declaration, wrong/not updated list of Tax Administration of Kosovo (TAK) or change in core business from the time the company was registered originally). The 15% under *other category* consist of different industries that were not targeted by this survey and did not comprise a large number to be illustrated in the figure individually.

As expected due to the nature of selected industries, most of the exporting firms of the sample are engaged in the export of final products. 84.1%of all exporting companies do export at least as part of their export portfolio final products. 21.0% are engaged in the export of intermediate products and 24.2% export raw materials.

Another significant characteristic of the surveyed firms is that all exporters have engaged in export activities for a relatively short period of time. Over 40% stated to have started engaging in export activities after 2008. This again indicates both a young and rather weak base of exporters, but it can also be interpreted as a positive trend for the Kosovar economy. Even if we take into consideration that some of the previously exporting companies have stopped exporting and the total number has not been growing as strongly as the 40% new exporters might suggest, the overall high number of new exporters should be considered a positive trend. This is especially true when taking into account the sunk cost principle and the fact that once a firm starts exporting, due to sunk costs, it is more probable to keep exporting even in more difficult market situations. Therefore, we can conclude that the 40% new exporters after 2008 are an indicator that the Kosovar economy is becoming more productive and starting to compete in international/regional markets.

PRODUCTIVITY CONSTRAINTS

In the following parts of this paper, we aim to present and elaborate the most relevant findings linked to export constraints from the survey. As stated earlier, after an initial analysis of the collected data, it was striking that the main problems described by exporters seem to show a direct link between productivity deficits and export constraints.

In the following analysis, we aim to break down these productivity constraints into subgroups and identify where the roots of these constraints lie. This is in order to later present options for effectively tackling these problems.

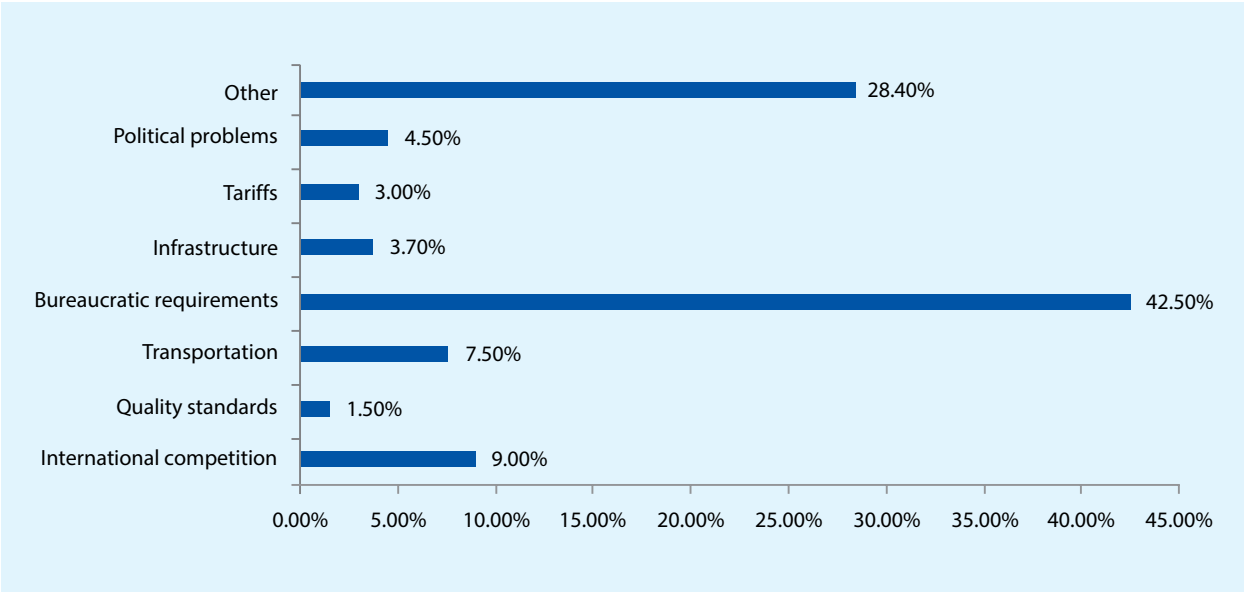
22 Data based on Kosovo Tax Administration information. See Methodology for explanation of the survey sample determination.

DEFICITS IN HR CAPACITIES AND MASQ

When analyzing the answers that exporters gave for what they considered to be the main obstacle when they began exporting, bureaucratic challenges were the most frequently named constraint (see figure below). Furthermore when analyzing the individual answers given under "Other", which has the second highest frequency, one can conclude that roughly one third of the answers given under this category are also related to bureaucratic challenges even if not identified as such explicitly by the interviewee ("preparation of documents", "too many documents required", "customs procedures in general" etc.)

Bureaucratic requirements (such as permits and forms required for exports especially from the destination countries), although a bit surprising in such predominantly high frequency, are closely linked with the concepts of sunk costs and education of the workforce (the latter will be elaborated in detail later in our analysis).

Figure 2: Frequency of constraints as reported by Exporters



Source: Survey data

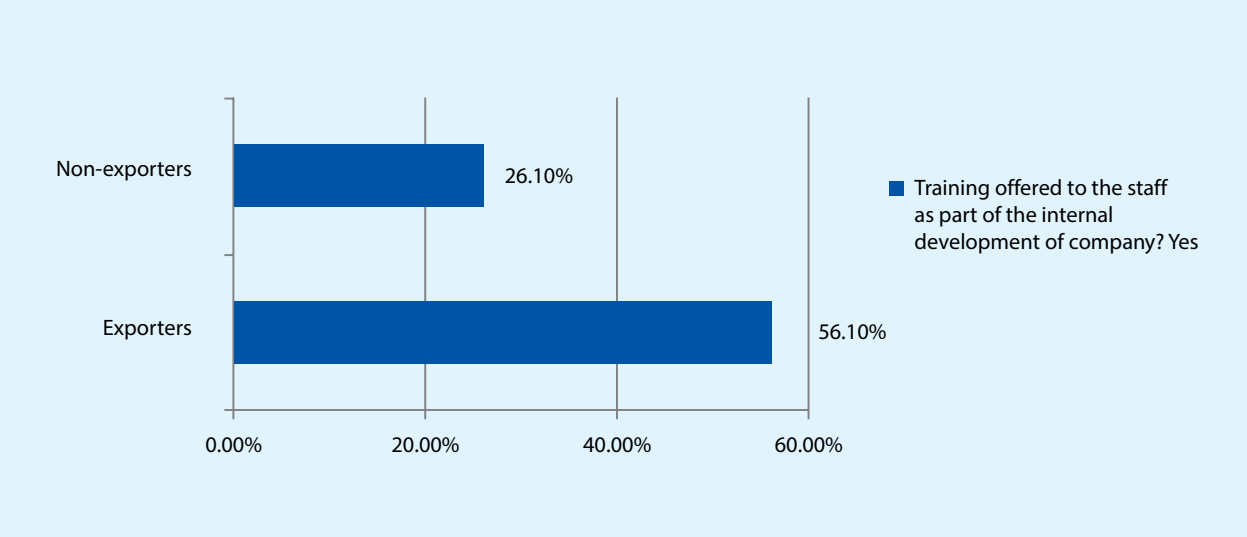
In another open question, we asked what, now that firms have already engaged in exporting, is considered to be the biggest hindrance to exports; transportation costs were the most frequently reported factor by almost 13% of the surveyed firms. The second highest was clearance procedures in importing markets, by 11% of firms. Again was the "Other" category the big with 25%, including individual answers that where mostly related either to procedures at customs or to bureaucratic challenges in general, such as: "long waiting hours at the terminals", "customs procedures in general", "bureaucracy" etc.

This all together with the fact that international competition (9%) and bureaucratic requirements (42.5%) on one question and clearance procedures in importing markets (11%) on another question mentioned as obstacles, suggests that Kosovar companies have difficulties when it comes to research and preparation of documents that require higher analytical skills from firm staff.

Furthermore, it was established by Wagner (1995), among others that a good share of the costs for entering export market (e.g. market research, acquiring knowledge of new bureaucratic procedures, etc.) are sunk costs which can more easily be covered by larger companies.[23] We see here that sunk costs, which by definition once invested ensure export persistence, are precisely the factor that is perceived as the most challenging by Kosovo exporters.

A study on the value of trainings highlights the fact that trainings improve employee performance in numerous areas: notably in problem solving, attitude towards work, ethics, motivation, leadership, and communication. Trainings are also perceived as win-win situations since employees increase their productivity, while at the same time, companies enhance their profits through increased sales, increased referrals, new product ideas, and improved customer satisfaction and retention.[24] This gives the employee an added qualification and a higher skill set, from which he or she might profit in the future, while at the same time having an immediate positive effect on the company's efficiency and revenues. Considering this, it is unsurprising that the number of exporters offering training to their staff is far higher compared to non-exporters (Figure 3).

Figure 3: Percentage of firms offering training to staff



Source: Survey data

To enter foreign markets, firms must establish several managerial and administrative competencies and procedures like new marketing channels, learning bureaucratic procedures, developing new packaging or product varieties, etc. In the presence of these entry costs, expectations about future market conditions can critically affect current behaviour and have a negative effect on the decision to enter new markets.[25]

The fact that only 10% of the exporters in the survey reported that the time to clear customs was less than 1 day also highlights a bureaucratic constraint. Sixty-five percent of the surveyed firms stated that the average time it takes for their products to clear customs takes between

23 Wagner, 1995

24 Dean, P. J., & Ripley, D. "Performance Improvement Pathfinders". Washington, DC: The International Society for Performance Improvement, 1997

25 Sanghamitra Das, Mark J. Roberts and James R. Tybout, 2001

2-5 days. We suggest that a better trained staff in the Kosovar private sector might be able to prepare the necessary documentation for the importing procedures in the export markets faster, which in turn will result in shorter customs clearance procedures.

Metrology, Accreditation, and Standards (MAS-Q) and conformity assessment in general are increasingly recognized as essential tools for promoting global economic growth, especially in developing countries. Accurate measurements, standards, and conformity assessment have become prerequisites for expanding international trade. MAS-Q activities are important to ensure that market transactions can take place, and that consumers and regulators feel confident that the goods being produced -both imported and exported - are safe and of the expected quantity and quality. For Kosovo to compete and succeed in today's global market, traders, producers, and especially exporting firms must meet the requirements of the target markets in terms of quality, safety, reliability, environmental compatibility, hygiene standards, and technical regulations and they must be able to provide credible proof of compliance.

When asked whether their company has an internationally-recognized quality certificate, around 34% of exporters claim to have a quality assurance certificate, compared to only 8.3% of non-exporters.

This shows, in addition to the discrepancy between exporters and non-exporters in the aspect of professional trainings, that a huge gap exists in the area of licensing and MAS-Q.

SMALL FIRM SIZE

As established earlier in the literature review, the size of a firm is one of the main factors affecting a firms potential to export. This factor seems especially relevant to this analysis of a rather young economy like Kosovo.

The size of companies is usually defined in the categories micro-, small and medium enterprises.

The European Union provides a very clear definition of micro-enterprises as those that meet the following criteria: "Within the SME category, a microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million."[26]

26 COMMISSION RECOMMENDATION of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises

Table 4: Reported turnover for 2012*

Turnover	Percentage of Companies
Up to 10,000 EUR/year	21.0
10,001 - 25,000 EUR/ year	13.7
25,001 - 50,000 EUR/ year	5.7
50,001 - 100,000 EUR/ year	4.4
100,001 - 250,000 EUR/ year	3.8
250,001 - 500,000 EUR/ year	4.2
500,001 - 1,000,000 EUR/ year	3.8
Over 1.000,001 EUR/ year	7.5

for 318 that reported their turnover out 497 surveyed firms

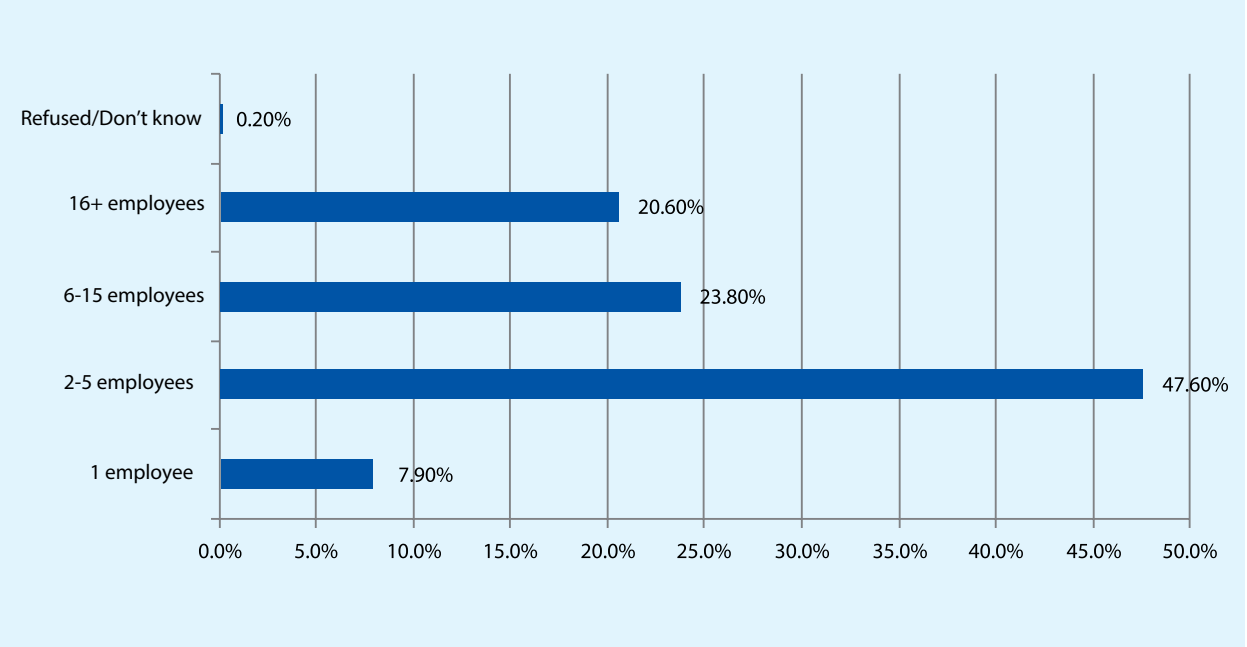
Source: Survey data

Table 4 illustrates that only 7.5% of all surveyed companies declare to have exceeded an annual turnover of 1 million Euros. The threshold of 2 million Euros in turnover per year is only surpassed by very few firms in the selected industries of this analysis. The rather high refusal rate for this question shows that this information is considered to be highly sensitive by firm senior management and it is possibly linked to informalities and tax evasion. [27]

The specifically striking aspect is that nearly 80% of the companies surveyed work with less than a total of 16 employees. These numbers are particularly astonishing when considering the fact that the sample included rather labour intensive industries of manufacturing and that Kosovo can be considered to be an economy of rather cheap labour.

27 35,8 % of the businesses that were part of the survey refused to answer to this question

Figure 4: Number of full-time employees in companies (2012)



Source: survey data

In addition, 95% of companies surveyed declared to have only one or no employees in a management position, which also indicates a small company structure.

Together, all of this data shows that the vast majority of companies are to be considered only as micro-enterprises, and conclusively, we can state: not only the Kosovar economy as a whole (GDP below 6.5 Billion),[28] but also this particular sample of export relevant industries is dominated by very small firms.

The above-established fact of the small size of companies in Kosovo reflects the problem described by Wagner (1995). When it comes to exporting, larger companies have a strong advantage over smaller firms. Most prominently through economies of scale in production, but also due to a number of other factors like the better ability of bigger companies to fully utilize higher qualified and more specialized employees, their abilities to raise financial capital at lower costs, bigger internal sales and marketing capacities, financial capability to take production risks (e.g. developing products specifically for international markets), scale benefits from bulk purchasing and last but not least: a good share of the costs for starting an export (e.g. market research, new bureaucratic procedures) are sunk costs which can more easily be raised by bigger companies.[29]

Considering that most small firms have problems financing their export activities (Holmund and Kock, 1998), we can conclude that one of the major constraints regarding exports in the Kosovar economy is the rather small size of companies.

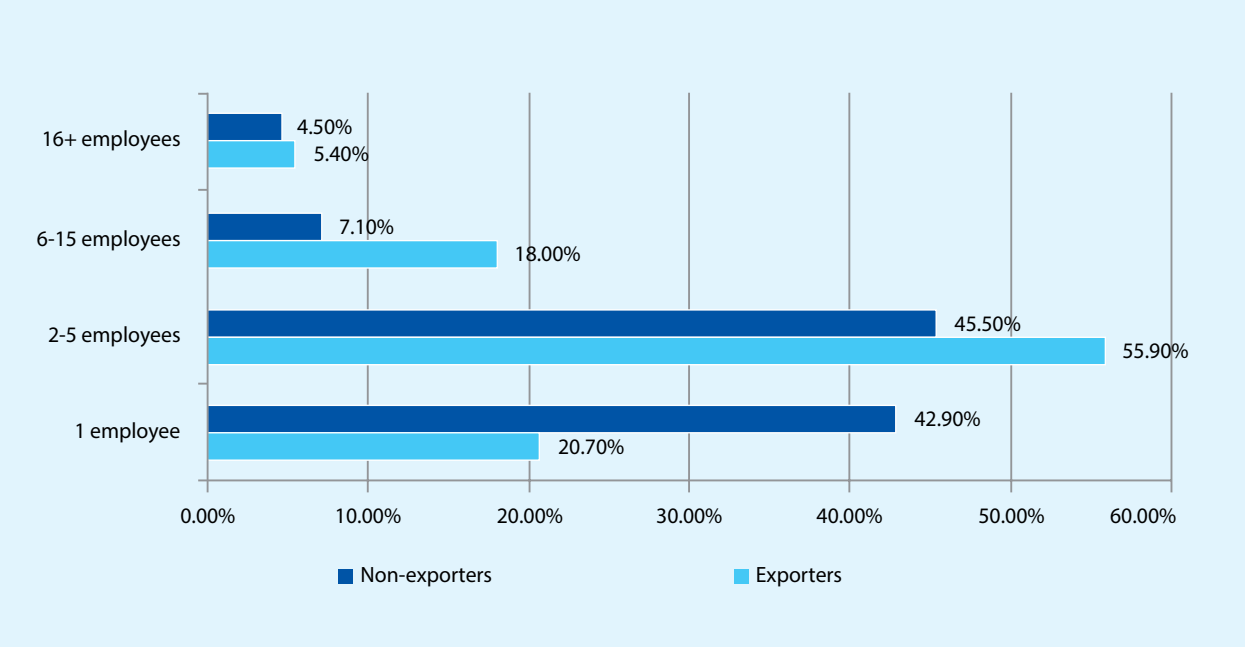
28 The World Bank, GDPs in USD for 2012

29 Wagner, 1995

EDUCATION ATTAINMENT OF THE WORKFORCE

Turning attention once more to data generated through surveying, it is evident in Figure 5 that exporters, in general, utilize a higher number of skilled labourers.

Figure 5: Number of Employees with University Degree - exporters vs. non-exporters



Source: Survey data

It is striking that over 40% of non-exporters employ only one person with a university degree, whereas over 80% of exporters have two or more employees with university degrees in their firms. This shows a clear tendency of exporters to employ a higher educated workforce. This trend can be linked to the fact that exporters are by definition considered more productive than non-exporters, and this productivity level is derived from the capabilities of the workforce.

We established earlier that, when engaging in exporting, primarily research costs of different types have to be borne by firms. Starting from that proposition that researching export-relevant information-such as administrative procedures of exports (e.g. customs, licensing etc.), marketing, and market research-can be researched more efficiently by better skilled (in our case university educated) employees, we can conclude that with an increase in the labour force the challenges and the initial costs of export sink, which in itself makes engagement in export activities more feasible for Kosovar companies and, therefore, more probable. This hypothesis is also supported by other data gathered from the survey.

Entry costs make firms' export supply responses dependent upon their previous exporting status. As such, firms that already export can adjust their volumes at marginal production costs, while those that do not must bear the sunk costs of breaking-in before any exporting is possible.[30]

30 Sanghamitra Das, Mark J. Roberts and James R. Tybout, 2001

Hence, non-exporting Kosovar firms still have to bear the initial sunk costs when starting to export, but with a better skilled work force, these costs become easier to manage.

Taking into account that the vast majority of firms in Kosovo are non-exporters and analyzing the findings above, we can conclude that one of the most important challenges in order to increase exports in Kosovo is finding ways to make it more feasible for firms to bear sunk entry costs. Because once these sunk costs are spent and a company has engaged in non-ad hoc export activities, the sunk cost factor will serve to stabilize the firms' exports.

INFORMALITY IN THE ECONOMY

As elaborated in the literature review, Rodrik (2000), Arin (2011) and Acemoglu (2003) show how better governed states are less prone to economic instability. Thus, according to these studies and in the light of recent economic events, the contour of a vicious circle between bad governance and the instability of output looms: economic shocks are more likely to occur, and their destabilizing effects are more likely to persist, where institutions fostering good public and private governance are weaker. Corruption is one of the most significant impediments to economic growth. Numerous studies have found that corruption reduces human capital, discourages investment, leads to a misallocation of resources, lowers the quality of public infrastructure and services, and thus ultimately hampers economic development.[31]

When asked to name the biggest challenges to doing business in Kosovo, the surveyed companies named informality (together with electricity supply and access to finance) as the most severe problems they face.

Table 5: Factors that affect the current operations of a business in Kosovo

% perceive factors as a "major obstacle" or a "very severe obstacle"	
Corruption	49.5 %
Political instability	41.6 %
Tax rates	40.0 %
Tax administration	35.2 %
Courts	24.3 %
Business licensing and permits	22.1 %
Qualified labour force in the operation area	21.7 %

Source: Survey data

31 Olken and Pande, 2012

Corruption was deemed as either a Major Obstacle or a Very Severe Obstacle by nearly 50% of the surveyed firms. This shows that, even when confronted with a set of factors that can all be considered as obstacles for firms in all business environments, the surveyed Kosovar companies evaluated corruption as the most significant problem by far when doing business domestically. Furthermore, the fact that "corruption" is being perceived as an even bigger problem than the usually notorious factor of "tax rates," reinforces the thesis that informalities and corruption are the biggest problems in doing business for Kosovar companies.

As elaborated above, corruption has been identified also in this survey as a main obstacle of doing business from a Kosovo firm perspective.

The next question aimed to identify whether those very businesses, which stated that corruption is a severe problem do themselves consider it when dealing with trade and business related institutions (customs, tax administration, courts, regulators and other permit and license issuing authorities).

Although they named corruption as a significantly severe problem, when asked about the frequency of unofficial payments/gifts that companies like the one surveyed would make in a given year, the results were rather surprisingly low.

Table 6: Unofficial payments/gifts made to institutions in one year

Institution	% of respondents "frequently, usually or always"
Customs	9.9 %
Courts	8.2 %
Taxes and Tax-collectors	10.3 %
Licenses	8.7 %
Regulators	8.9 %
Utility services	11.3 %

Source: Survey data

The table above shows that there is not much variation among institutions to which the surveyed firms made payments and the frequency revolves at around 10% of firms for each of them. Considering the underlying assumption that the surveyed companies indirectly assessed their own behaviour towards informal payments and active corruption when answering this question, it can be concluded that a culture of informality in dealing with institutions exists and is also accepted by the business community. This is even more evident when considering that, out of all firms surveyed; only one answered that for all the institutions named that companies like his/hers would never consider informal payments/gifts.

POLICY RECOMMENDATIONS

When conducting a study like this, the main aim is usually to provide a set of recommendations or set of specific tools to enable policymakers to create positive impacts with regard to an important topic, in this case: the increase of exports through a reduction in export barriers.

Taking into consideration constraints to exporting identified and elaborated above, we consider the following recommendations as the ideal tool-set to tackle those challenges.

THE COMPANY PERSPECTIVE

Exporting companies need to reform structurally toward exporting. Export competitiveness is not only a question of correctly manipulating a mix of marketing elements, but it is also a function of the commitment of resources and to attitudes. It is especially the latter form of commitment which is not being given adequate attention by managers. Therefore, this implies that, until such attitudinal changes take place, growth and competitiveness in exports will remain constricted.

Taking the fact into account that the vast majority of firms in Kosovo are non-exporters and analyzing the findings, we can conclude that one of the most important challenges in order to increase exports in Kosovo is finding ways to lower firms sunk entry costs. Once these sunk costs are made and a company has engaged in non-ad hoc export activities, the sunk cost factor will serve to stabilize the firms export activities as established by the data and literature analysis above.

Considering that over 90% of the surveyed companies estimate their annual expenditure on human capital at only 10%, this is a strong indication that the important factor of a qualified workforce is being chronically underinvested in by Kosovar companies.

This shows that a mentality shift in Kosovar business is needed. Investment in the workforce needs to grow from the current 10% of the total expenditure. It is important to stress that these investments should not only target the employment of a workforce with a higher level of formal education. Funds should also be made available for more professional trainings aimed at current employees. This recommendation is supported as a higher engagement in trainings was one of the most relevant characteristics within the workforce of Kosovar exporters.

The other striking characteristic was that exporters show a drastically higher level of MASQ and related licenses. It is not only evident from the survey data, but also from the qualitative interviews and the desk analysis, that producers with a large number of implemented MASQ mechanisms and sector relevant licenses are more productive and have a higher chance of competing in international markets.

A higher investment in acquiring relevant MASQ know-how and obtaining sector relevant licensing will be another crucial point in achieving a higher competitiveness for Kosovar firms.

THE GOVERNMENT PERSPECTIVE

In terms of government recommendations, we can focus on three main areas:

- Support higher access to financing;
- Fight informality;
- Develop a strong industrial policy.

Access to Finance

Our recommendation intends to not only specify the extensively discussed topic of access to finance, but it also points out that the modification of fiscal policies can contribute to desperately needed higher liquidity in Kosovo's private sector.

A first step to provide this would be a government exemption from custom duties on main input products (specifically chapters 84 and 85 of TARIK[32]). These products are almost exclusively used as inputs by manufacturing and service providers. Hence, this policy measure would decrease the cost of doing business for firms and offer higher liquidity.

The same goes for VAT (Value Added Tax) Refunds. In a cash-strapped economy such as Kosovo, the mechanism for VAT refunds is of paramount importance for the day–to-day operations of businesses. The general refund rules for Kosovo stipulate that foreign businesses be refunded for their VAT in 1 month, whereas domestic firms are guaranteed refunds within a period of three months. A three-month period for VAT refunds to domestic producers who make investments is too long. It is a high cost for businesses considering the high rates of capital rent.

To remedy sluggish refunding mechanisms that cause long delays and keeps taxpayers perpetually reliant on credit, corrective administrative measures are needed. These should include adoption of a more sophisticated risk audit strategy by the TAK (Tax Administration of Kosovo) that would obviate the need for auditing all refund claimants in lieu of focusing on high-risk fraudulent claims.

We suggest a faster VAT refund – 1 month, especially for capital investment, equipment, and machinery which will contribute to lower costs for production and increase the ease of doing business.

Access to finance-in the form of bank loans-is also considered a constraint to private investment growth in Kosovo. Credit to the private sector in Kosovo is low compared to other countries. Borrowing costs are high compared to other countries, due to higher operational and risk costs of Kosovo banks. Collateral and other conditions for loans are more restrictive than in regional countries. Banks are extremely cautious in lending as it is virtually impossible to collect a bad loan in Kosovo.[33]

32 Integrated Tariff of Kosovo

33 Toci and Tyrbedari 2005

The Kosovo government, through the Ministry of Trade and Industry, will soon kick-off the implementation of the Partial Risk Guarantee Scheme that will enable small and medium enterprises, which are the building blocks of any economy, to have better access to finance and obtain loans with much more favourable conditions. We recommend that a special program within this scheme be designed for exporting firms, so that exporting firms can have access to cheaper loans. Through this, they will have access to new investments that will increase the productivity and international competitiveness of Kosovar companies.

Fight informality

One of the most striking observations from the quantitative data generated through surveying was the private sector's approach to informalities and corruption.

In addition to the fact that informalities and corruption are perceived by a significantly high number of business owners as the main problem of doing business in Kosovo, we can observe another interesting tendency. Corruption seems to be accepted by the business community as a necessary evil. Despite the high awareness of corruption as a problem in their everyday business, almost all those surveyed implicitly confirmed that they had or would be willing to engage in informal payments if necessary. The attitude can best be characterized as resignation towards a corrupt system. This situation is best illustrated by the fact that only one of the 500 surveyed companies reported to never consider giving bribes.

The literature also point out the damaging institutional effects, since corrupt strategies may spread as a substitute for imperfect financial markets and/or a low state resilience to external fluctuations. Moreover, improving access to formal financial markets should yield important anti-corruption outcomes, since the liquidity constraint appears as a key determinant of the direction of export instability upon corrupt transactions.[34]

In addition to the usually suggested measures in strengthening courts and the rule of law, we recommend concrete measures against private sector entities that are involved in corruption and informal activities. With just a few high profile and successful anti-corruption cases against big companies, it might bring a change in attitude by the business community towards corruption and informality.

Therefore, fighting corruption with a set of combined measures, which on the one hand give business the opportunity of a higher access to finance through legitimate channels and on the other hand send a clear message to the business community through strict persecution of high profile cases, will lower the acceptance and the level of corruption. This, as shown above, will have direct positive effects on popularity of Kosovar goods with consumers outside Kosovo.

An additional economic disadvantage is the poor image of Kosovo that comes with a high perception of corruption. Agrawal and Kamakura (1999) have noted that the country of origin has a significant influence on consumers' evaluations of products. Consumers have been observed to use the country of origin as an extrinsic cue to make decisions about quality of products. If consumers hold a positive (negative) image for a given product and country, this image could lead to a generalized positive (negative) evaluation and attitude towards all the brands associated with a country. According to their observation such a country of origin-based equity might even extend to other product categories due to stereotypical bias.

34 Cariolle 2013

Industrial policy

The establishment and implementation of a custom-tailored, comprehensive industrial policy for Kosovo should be considered as the synthesis of all the above findings and recommendations.

Taking into account the importance of productivity for exports as identified and elaborated throughout this paper, we can link it now directly to measures aiming at economic growth. As economic growth is closely linked to an increase in productivity,[35] we can state that measures increasing the economic growth will ultimately lead also to an increase of exports through higher productivity and competitiveness.

Rodrik in his seminal work "Industrial Policy for the Twenty-First Century," claims that countries should get involved in developing industrial policies that maximize the potential to contribute to economic growth while minimizing the risks that it will generate waste of resources and rent-seeking. Rodrik argues in favour of a "strategic collaboration between the private sector and the government with the aim of uncovering where the most significant obstacles to restructuring lie and what type of interventions are most likely to remove them," which means focusing on getting the policy process right.[36]

What should be aimed for is to discover where action is needed and what type of action can bring the ideal governance response. It is pointless to deal exclusively with policy instruments and modalities of interventions. What is much more important is to have a structure in place which helps reveal areas of ideal interventions. A government that understands this will be constantly on the lookout for ways in which they can facilitate structural change and collaboration with the private sector. As such, industrial policy is a state of mind more than anything else.[37]

We see industrial policy not referring to an effort by the government to select particular sectors and subsidize them through a range of instruments (directed credit, subsidies, tax incentives, and so on). Governments must not, as they do not have adequate knowledge, pick "winners."[38] Industrial policy is a process whereby the state and the private sector jointly arrive at diagnoses about the sources of blockage in economic activities and propose solutions to them. It requires building the public-private institutional arrangements, whereby information on profitable activities and useful instruments of intervention can be shared and further implemented.[39]

This approach will, if not completely eliminate, at least improve a number of the above named constraints. By enabling the more productive business to further expand, Kosovo will not only eliminate the challenge of the high number of small sized companies, but it will also enable the increase of the productivity of companies who have the capacities to take advantage of positive structural improvements. Inevitably, this all will lead to an increase of productivity within the Kosovar economy and, through this, to higher export rates.

We see this final recommendation as the central one of this research, as it is considered to be the comprehensive approach the Kosovar economy needs to deal with all of the earlier discussed constraints and finally realize its export potential.

35 Jorgenson 1991

36 Rodrik, 2004

37 Rodrik, 2004

38 Rodrik, 2004

39 Rodrik, 2007

POLICY ASSESSMENT II

MOVING TO HIGHER VALUE ADDED GOODS AND SERVICES

MENTOR MEHMEDI | RRON DALLADAKU | TRIBUN FERIZAJ

INTRODUCTION

Since the unilateral declaration of independence of Kosovo in 2008, Kosovo's real Gross Domestic Product (GDP) has grown 3.4% on average[40]. Even during the worst global financial crisis in 2009 when most of the world economies experienced negative trends, Kosovo's economy grew 3.5%, showing its resilience to external shocks. However, this situation is not necessarily advantageous for Kosovo because it points at the fact that Kosovo's economy remains very isolated. Kosovo-based companies aiming to enter the export markets have faced many barriers making them less competitive in the international markets. As a result, in 2012, Kosovo's total exports were EUR 920 million, accounting for only 18.7% of GDP while imports were EUR 2.9 billion representing 59% of Kosovo's GDP[41]. As such, has the highest poverty and unemployment rates and the lowest GDP per capita in Europe.

Given the significant negative trade balance, the objective of this paper is to examine how Kosovo's manufacturing and service firms can move from the export of low value-added goods and services towards high value-added goods and services, as well as to identify some of the most binding constraints that they face in their operations. Therefore, the goal of this paper is to identify sectors and sub-sectors with potential to move to higher value-added goods and services while providing policy recommendations that would aid this transformation process.

Employing both quantitative and qualitative methods, this paper focuses on: mapping the chain of activities for the selected sectors/activities; identifying pre-requisites (i.e. necessary conditions) for successful adaptation of high value-added product/service strategies; identifying the firm-related factors that encourage or discourage Kosovo–based firms in the selected sectors/activities to move to higher value-added products/services; identifying and recommending actions that firms in selected sectors/activities can undertake to reduce any barriers to moving to higher value-added activities; identifying and recommending policy reforms that may help and encourage companies to move to higher value-added activities and/or reduce the barriers currently exporting companies.

Specifically, this study focuses on the following sectors: ICT (Information and Communication Technology) services, agro-food processing, beverage, furniture and plastics. The following sectors were selected because of the high growth potential and Kosovo is deemed to have a competitive advantage in such sectors. Currently, companies from the selected sectors export large quantities abroad, once again, highlighting the importance of these sectors for Kosovo's economy.

40 http://www.bqk-kos.org/repository/docs/2014/CBK-Q4%202013.pdf

41 Data source taken from BQK Report

OVERVIEW OF KOSOVO'S ECONOMY

Despite the constant economic growth, Kosovo remains the weakest economy in Europe with a GDP per capita of $3,579[42] and unemployment rate of 30.9%[43]. The economy of Kosovo is highly dependent on foreign aid and remittances from Kosovo Diaspora living in Western Europe. The low volume of exports and the large trade deficit are the main factors for a slow economic growth and development in Kosovo.

The International Monetary Fund (IMF) reports that the trade deficit in Kosovo, in 2012, was about 35% of GDP and the negative balance of goods and services were close to 2 billion Euros. In addition, the trade deficit increased continuously since 2009 putting downward pressure in the economy. In 2012, export of goods dropped from EUR 322 million to EUR 289 million. In 2013, the statistics presented in Table 1 show that the exports increased slightly; however, they remain below the export level in 2012. On the other hand, the export of services has shown an increasing trend since 2009 and in 2013; export of services account for twice the export of goods. Furthermore, the balance of services has shown a surplus since 2009 representing an advantageous sector for Kosovo.

Table 1: Kosovo's exports and imports 2009 -2013 (in million EUR)

	2009	2010	2011	2012	2013
Goods and services balance	**-1,553**	**-1,710**	**-1,904**	**-1,986**	**-2,030**
Goods	**-1,673**	**-1,776**	**-2,090**	**-2,185**	**-2,259**
-Exports	**177**	**305**	**322**	**289**	**307**
-Imports	**-1,851**	**-2,081**	**-2,412**	**-2,474**	**-2,566**
Services	**121**	**66**	**186**	**199**	**229**
-Receipts	**429**	**476**	**608**	**631**	**664**
-Payments	**-308**	**-410**	**-422**	**-432**	**-435**

Data Source: IMF, 2013

In 2012, the exports of goods from Kosovo were 5.8% of GDP, concentrated in low value added sectors, notably metals, scrap and other commodities. Although exports of goods increased from 2010, the structure of exports remains the same, mainly comprised of raw materials and unfinished products. The largest part of exports consists of raw metals or scrap metals and mineral products, with the largest exporter in Kosovo in 2012 being Trepça/Trepča, a major mine located in Kosovo. Hence, a trade deficit of 35.1% of GDP in 2012 reflects an underdeveloped and narrow domestic production base.

42 http://www.ks.undp.org/content/kosovo/en/home/countryinfo/

43 http://ask.rks-gov.net/

The study does not focus only on the trade of goods and the respective sectors, but rather takes an intensive look at the service-related sectors and the export activities within these sectors. In addition, in order to capture the trade in services, the analysis presented in this study utilizes the balance of payment statistics as an additional instrument. The balance of payment statistics (BoP), published by the Central Bank of Kosovo (CBK) represent an instrument that monitors the flow of money into and out of Kosovo. It captures the transfer of money but not necessarily the actual transaction of the service. Based on the BoP for 2011 presented in table 2, travel had a positive balance of EUR 251.2 million. The large inflow of money in travel is most likely due to the large Diaspora population that visits Kosovo during the holiday seasons. Additionally, communications and government services have generated a positive balance of EUR 77.1 million and EUR 51.6 million, respectively.

Table 2: Balance of Payment Statistics for Kosovo in 2011 (million EUR)

	Credit (Export from Kosovo)	Debit (Import into Kosovo)	Balance
Transport	28,6	82	-53,4
Travel	352,8	101,6	251,2
Communications services	94,6	17,5	77,1
Construction services	13,7	19	-5,3
Insurance services	13,9	31	-17,1
Financial services	0,3	1,1	-0,8
Computer and information services	2,3	2,6	-0,3
Royalties and licence fees	0	0,4	-0,4
Other business services	74,6	96,6	-22
Personal, cultural and recreational services	1,7	1	0,7
Government services n.i.e	51,6	0	51,6
Total	634,1	352,8	281,3

Source: CBK, 2011

Provided that Kosovo exports constitute mainly of commodities, the crucial question is how can Kosovo move to the production of higher value-added products and services in order compete effectively against international competitors; thus, decreasing the trade deficit through import-substitution and export growth.

LITERATURE REVIEW

The concept of the value chain provides a key starting point in understanding the dynamics of industrial organization, international trade, and regional development. Although the term was first used in the 1960s, it became popular in the business literature in the 1980s, especially due to the work of Michael Porter.

Michael Porter in his three works--Porter1980)[44], Porter (1985)[45], Porter (1990)[46] --proposed two elements now found in modern value chain analysis: the value chain and the value stream. This paper will focus only on the concept of the value chain, as an in-depth analysis also of the concept of value streams would lie beyond the scope of this paper.

The first term, the value chain, referred to the intra-firm activities involved in transforming inputs into outputs, and it included not only the physical transformation processes but also the support functions involved. The support functions included: research and development, procurement, human resources management, and many other activities which can now be regarded as higher value adding activities.

A firm's value chain is part of a larger set of activities, which Porter defines as a value system. Porter's definition of the value system closely resembles the modern value chain, extending the framework of activities to inter-firm linkages. The value system includes the suppliers that provide the inputs, distributors (which have their own value chains), all the way to costumers.

Recently, agile supply chains, which are defined through their ability to rapidly and cost-effectively respond to change as enabled through the seamless flow of information from the market and across the supply chain, have grown in prominence.[47] Agile supply chains require the development of a strong virtual dimension that is made possible by Information and Communication Technology (ICT) infrastructure. It is essential that information is able to drive decisions in real-time across the supply chain. In that sense, a defining characteristic of agile supply chains is that they are real-time, demand-driven instead of forecast-driven.[48]

A policy brief from Organisation for Economic Co-operation and Development (OECD) states that, "One reason for the speeding-up of the whole globalization process is the rapid emergence of 'global value chains.' The whole process of producing goods, from raw materials to finished products, has increasingly been "sliced" and each process can now be carried out wherever the necessary skills and materials are available at a competitive cost.[49] It adds that the development of global value chains also offers new opportunities to small and medium enterprises (SMEs), due to the fact that, as suppliers, SMEs are often given more responsibilities in the value chain and more complex tasks than in the past. What this means is that SMEs are under pressure to achieve the critical mass required to support research and development (R&D), training of personnel, control firms at lower levels of the chain, and to fulfil requirements in terms of standards and quality. Moreover, the OECD suggests that, as firms reallocate resources towards

44 Porter, M (1980) "Competitive Strategy: Techniques for Analyzing Industries and Competitors", The Free Press: New York

45 Porter, M. (1985) "Competitive Advantage: Creating and Sustaining Superior Performance" The Free Press: New York.

46 Porter M. (1990) "The Competitive Advantage of Nations", The Free Press: New York.

47 Liz, B., and Greenwood, L. (2006) "Fast fashioning the supply chain: shaping the research agenda", Journal of Fashion Marketing and Management, pp.259-271.

48 Martin, C., and Towill, D. (2000) "Supply chain migration from lean and functional to agile and customised", Supply Chain Management, pp. 206-213.

49 OECD "Moving Up the Value Chain: Staying Competitive in the Global Economy" July, 2007

higher value-added activities (be they goods or services) and move out of lower value-added activities, a country will increase productivity growth. The effects of this increase in productivity will translate into spikes in real incomes and wealth, and will allow firms to create jobs in other parts of the economy and to invest more heavily in new technologies.[50]

Two crucial elements aid firms in moving to higher value-added activities: innovation and technology. Both innovation and technology are essential for increasing the added value and productivity of the manufacturing and service industries. Innovation may take many different forms. It may be manifested in new products or services; improved quality; new ways of production, packaging, marketing or distribution; new markets; new supply sources; new organizations or systems and other areas.[51]

In their seminal work, Normann and Ramirez argue that success depends on the way firms identify their business and link this with knowledge, competencies and customers.[52] It is crucial for firms to position themselves in the right place on the value chain and to ensure continued and sustainable value creation (Walters and Lancaster, 2000).

Adopting efficient means of production (i.e. new technologies) and 'best practice' is often considered a necessary step to maintaining and improving the value of products and services that are offered to customers. Usually, developing and delivering products and services in novel ways can create new value. In addition, value is also created through adopting promising practices, improved skills and training, product, process and service development while focusing on value innovation.[53]

Additionally, the limits to buyer-promoted upgrading have been emphasized by Humphrey and Schmitz. They start by distinguishing between types of upgrading that can occur in different parts of value chains. According to the authors, firms can engage in higher value activities in three ways:

1. Process upgrading: firms can upgrade processes, transforming inputs into outputs more efficiently by re-organizing the production system or introducing superior technology.
2. Product upgrading: firms can upgrade by producing products generating more value added per employee. This upgrading involves changing the firm's position in product markets or through a repositioning of the value chain, shifting the whole chain to higher value products.
3. Functional upgrading: firms can acquire new functions in the chain, such as design or marketing.

Both getting into and moving to higher value added activities in vertical supply chains can be difficult, especially for companies that come from a developing economy. A supplier must demonstrate the capability to produce at high standards of quality and timeliness in delivery. Secondly, strengthened technological capabilities are required. [54]Usually, these requirements are unbearable for the firms within a developing economy.

50 OECD "Moving Up the Value Chain: Staying Competitive in the Global Economy" July, 2007

51 Morrison, A., Carlo, A., and Rabellotti, A. (2008). "Global value chains and technological capabilities: a framework to study learning and innovation in developing countries", Oxford Development Studies.

52 Norman, R and Ramirez, R(1993), " From Value Chain to Value Constellation: Designing Interactive Strategy", Harvard Business Review, 71, July/August.

53 How can firms in the UK be encouraged to create more value? A discussion and review paper. Advanced Institute of Management Research, 2004.

54 Dahlman, C."Technology, globalization, and international competitiveness: Challenges for developing countries"

As such, several economists see a role for government institutions in shaping policies which assist companies in moving to higher value activities. Dani Rodrik, in his important work "Industrial Policy for the Twenty-First Century, "claims that countries should get involved in developing industrial policies that maximize the potential to contribute to economic growth, while minimizing the risks that it will generate waste and rent-seeking. Rodrik favours a government role in assisting firms in coming up with new technology, a particular kind of training, or a new good or service, rather than focusing on one particular sector per se. It is activities that are new to the economy that need support, not those that are already established, he argues.

In a study prepared by Pricewaterhouse Coopers titled "Central and Eastern Europe: Moving up the value chain," Alisa Simkova examines the investment incentive frameworks which have been widely used in the Central and Eastern Europe region as a supply-side measure to attract and accommodate high value-added projects. CEE countries have done so by introducing new schemes for small businesses by reducing the size of eligible projects and schemes for cross-border mergers and acquisitions (since high value-added firms are often new and innovative and have steep costs). The study reports that the region has seen a surge in the development of new industrial parks focusing explicitly on sophisticated business process outsourcing and software development or biotechnology. Investment agencies haves witched from stressing low labour costs to promoting the high quality of the workforce (volume of science graduates, high numbers of PhD researchers and advanced language skills of the population), and meanwhile, traditional manufacturing fairs have been replaced by events like nanotechnology colloquia.[55]

METHODOLOGY OF THE STUDY

The main objective of this study is to examine how Kosovo's manufacturing and service firms can move from the export of low value-added goods and services towards high value-added goods and services, as well as identify some of the most binding constraints that they face in their operations. The methodology of this study relies heavily on qualitative research. This research question is relatively new and challenging for Kosovo and has not been specifically discussed in previous literature. Due to the complexity and the nature of the research question, it was very problematic to find supporting historical data; hence, a qualitative study was deemed more appropriate. As such, the methodology of this study is comprised of desk research and qualitative discussions through two focus groups with various export-oriented companies in Kosovo.

The desk research was mainly based on data collection related to Kosovo's economy with a special focus on the trends in the trade balance of Kosovo. IMF, CBK, UNDP and KAS were among the main sources of information. Moreover, during this phase, the authors had also reviewed various studies presented in the literature review.

The focus group discussions intended to apply a participatory approach aiming to gather information from Kosovo companies currently engaged in exports of high value-added products. Two focus groups were organized. The first focus group discussion included participants from manufacturing and food processing sector. Five of the largest exporting companies participated in the first focus group discussion representing different sectors, namely agriculture/food processing, furniture, beverage and construction materials (salt, sulphur etc.). The focus group participation was dominated by men.

55 Price Waterhouse Coopers "Central and Eastern Europe: Moving up the value chain"

There were no women present at this focus group discussion, which shows that there are no women in managerial positions of large manufacturing companies. However, there are small-scale, family owned agro-food processing companies that are run and managed by women. Such companies are very common in Krusha e Madhe/*Velika Kruša*. Nevertheless, those companies mainly produce for the domestic market. The agro-food processing companies offered much insight from the sector, pointing out at Kosovo's comparative advantage in the sector.

The second focus group was organized with firms from the service sector: ICT and business service providers. There were only three participants in the focus group meeting, one of who was female, showing that females play an important role in presenting and managing companies in this sector. The service sector is quite important to Kosovo's economy as shown by a positive trade balance of services. Additionally, the sector is considered to have a high potential for growth in the future, especially since Kosovo has a young and educated population that speak several western languages and a high internet penetration rate.

It must be pointed out that the research process for the second focus group was hindered by numerous obstacles. In addition to the very limited number of exporting businesses, the few companies that were identified as fitting the profile did not show much interest in participating in the research. The dates for the focus groups had to be moved twice due to a lack of participation. When the focus group was finally held the turnout was limited and the participation weak. However, the participants provided a lot of insight, pointing out the advantages that the sector offers. ICT companies were very keen on participating in the research because most of them are already engaged in exports or have a strategic goal to do so in the future. Given the positive trade balance in services and the fruitful discussions during the focus group, the focus of the paper will lean towards the ICT sector.

MANUFACTURING SECTOR AND AGRO FOOD PROCESSING (TRADE IN GOODS)

The manufacturing sector in Kosovo has declined greatly since 1999. According to figures of the Kosovo Agency of Statistics, the manufacturing sector in Kosovo represented 14% of GDP in 2011, a 4% decrease from 2010. Most manufacturing firms are engaged in the manufacture of wearing apparel, manufacture of textiles and leather products. Production in this sector has declined mainly because of aging equipment and insufficient investments.

Fifty-three percent of Kosovo's land is arable. The agriculture sector contributes to 13% of total GDP in Kosovo[56], making it an important source of income. In addition, agricultural products constitute 18% of exports.[57] The main subsectors of this industry focus on vegetables and fruits, cereals, decorative plants and medicinal herbs, vineyards, meat, and dairy. The agriculture sector is characterized by low productivity, while informality within the sector remains an important challenge. The government of Kosovo has recently conducted the "Impact Assessment document on Liberalizing Trade between Kosovo and the EU" prepared by the Ministry of Trade and Industry (MTI) of Kosovo. It identified Kosovar products that are deficit-prone and industrial sectors that are seemingly "import-sensitive" following the terminology proposed by Schoeffle.[58]

56 http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2012/05/07/000406484_20120507085250/Rendered/PDF/668770IDA0R201001400MIGA0R201200024.pdf

57 MAFRD , 2009

58 Schoeffle,G. (1982) "Imports and domestic employment: identifying affected industries", Monthly Labour Review, pp. 13-26.

The report took into account two main factors for each industry as classified by their 2-digit Harmonized System (HS) chapter.[59]

- the trade balance (does Kosovo import or export more of the relevant goods)
- the tendency (is the deficit growing or decreasing)

This paper particularly considers the cases (Integrated Tariff of Kosovo chapters) where a trade deficit (more of these goods are being imported than exported) exists, but this deficit has been declining in the past few years.

The rationale behind this is that, even though a trade deficit exists, because the deficit has been declining, it might suggest that some import substitution is taking place and/or exports are growing. In addition, this could be interpreted as an indicator that such Kosovar industries, although generally still weak compared to regional standards, have already started a catching-up process with global or at least regional competitors. Products that fall within this category can be recognized as part of industries that show genuine economic potential and relevance (in terms of employment generation and positive GDP contribution).

However, this hypothesis, based only on the above-mentioned methodology, has a possible weakness in that the trade deficit might be decreasing due to lower demand for those imported goods or other external effects and not merely due to import substitution and/or increased exports. However, due to the lack of data on industrial output in Kosovo and given the current state of lack of statistics in general, we considered this the best possible initial approach.

The following sectors (among others) have been preliminarily identified through the Sustainable Impact Assessment (SIA) as sensitive or as products sectors with export potential:

- Agro-food industry – (e.g. vegetables, fruits, wine)
- Beverage industry – (e.g. beer & juice - trade offensive relevance)

SERVICES SECTOR (TRADE IN SERVICES)

The Trade Department of the MTI has recently established a comprehensive Trade in Services Database based on the Central Bank Data and has added firm level data. This database offers up-to-date information on the different services industries operations in Kosovo. Considering the limited activities with high export potential in the service sector in Kosovo, the ICT and business service providers were identified as having the highest growth potential and conditions to move towards higher value activities. The selection of firms within the sector for the focus groups was based on a mix of criteria such as:

- Exporting history of the firm or potential to export in the future by showing significant growth rates in an export intensive industry;
- Mix of industries within the sector;
- Variety in size, measured by value of export.

59 The Harmonized Commodity Description and Coding System, also known as the Harmonized System (HS), of tariff nomenclature is an internationally standardized system of names and numbers for classifying traded products which came into effect in 1988, developed and maintained by the World Customs Organization (WCO)

FOCUS GROUP NO.1 ON MANUFACTURING AND AGRO FOOD PROCESSING

The focus group on manufacturing and agro-food processing has produced interesting observations and findings, especially on agro-food and beverage subsectors. The information gained through the focus group highlights the fact that the agro-food industry and the beverage sector are dominated by microenterprises that operate in a traditional manner and employ outdated technology.

However, a few exceptions exist that provide evidence of the potential of the industry. For instance, ASK Foods, an agro-food processing company established in 2008 in the region of Gjilan/Gnjilane has managed to successfully penetrate into the international markets. Currently, ASK Foods employs 157 Kosovars from rural areas of the region and it uses the most up to date technology. The company produces a range of products including fruit juices and jams, which are all-natural, without any additives, preservatives, aromas or flavours.

In addition, ASK Foods has obtained all the required food safety certifications, including International Organization for Standardization (ISO) 9001 and Hazard analysis and critical control points (HACCP), which have enabled them to successfully exploit export opportunities. Compliance with food safety regulations is crucial for export markets for two reasons. First, it is impossible for a Kosovo-based producer to export to EU if the company is not certified. Second, ISO and HACCP certifications increase the consumer confidence on their brand as they are perceived to offer high quality products. Furthermore, the production of bio products represents a niche market in the EU. There is an increasing awareness and demand for bio/organic products throughout the European markets. Therefore, ASK Foods and other producers specializing in 100% bio products have managed to create their own brand and successfully penetrate in the European markets. Thus, the strategy of the Kosovo-based companies is to respond to the increasing demand for bio products in the abovementioned markets.

The production of organic ago-products should serve as a model example of how abundant agricultural resources, fertile soils and the favourable climate of Kosovo can be harnessed to create successful commercial enterprises; a model that could be replicated by other Kosovar companies. In order to fully exploit the aforementioned opportunities, there is need for more active government support and policy reform. Currently, agro-food processing companies are treated very similar to all the other industries in Kosovo: constrained by paying customs tariffs on most of their imported inputs as well as paying upfront VAT for their essential agricultural equipment and machinery. In addition, the food and beverages sector is very sensitive to food security, quality standards and trace ability requirements, which puts increasing pressures on government to build the necessary quality mechanisms that can facilitate and respond to the stringent conformity requirements of the sector.

Even at the EU level, the sector is threatened by a lack of skilled workers with few graduates choosing to pursue careers in the agro food processing and beverage industry. Policies that incentivize universities to develop food engineering courses and students to pursue careers in this sector should be encouraged in Kosovo.

FOCUS GROUP NO.2 ON THE SERVICES SECTOR

The service sector in Kosovo, especially the ICT and business service providers, has developed rapidly in recent years. ICT usually includes software development; while business services activities include multimedia services and business solution (such as mobile entertainment services and enterprise solutions).The largest number of export service providers in Kosovo is divided into two main industries: ICT and Call centre services.

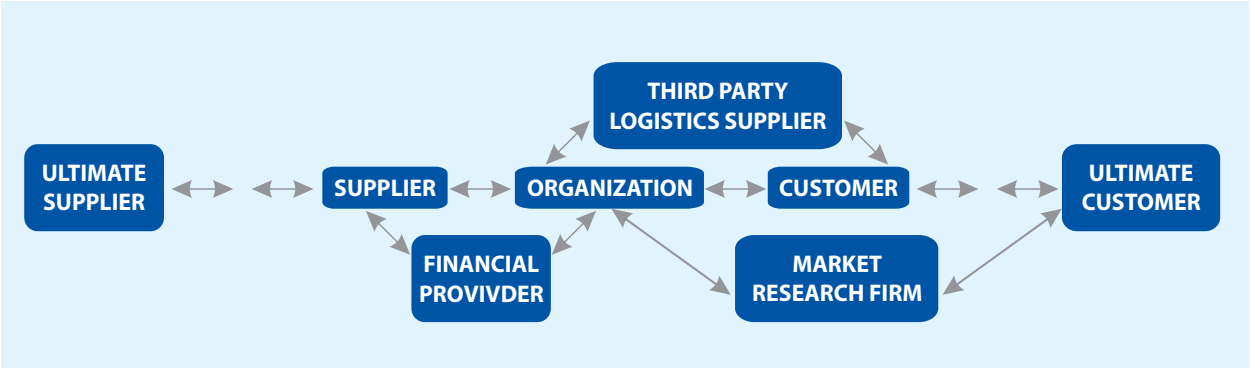
The focus group with the ICT firms reveals that the ICT sector is already involved in the high value-added activities. On the other hand, as indicated in the MTI Scoping Study "Developing a Trade in Services Database", a significant part of the workforce in the service sector is employed by the business service providers, namely call centres. The already established call centres provide exclusively low added value services. Their main business focus is advertising, sales calls and market research surveys. Furthermore, there is not much room for such companies to add more value to their existing services. As such, they were not included in the focus group discussions.

VALUE CHAIN OF THE ICT COMPANIES IN KOSOVO

ICT supply chains are fairly complicated. ICT is created, supported, and integrated into complex, globally distributed networks of ICT supply chains.[60] Within the supply chain, the nature of the firms is also classified as either primary or supporting. Primary organizations directly add value to the specific output to be consumed. Supporting organizations add value indirectly by supporting the primary organizations.

Looking at the supply chain in the ICT sub-sector, both primary and supporting types of firms exist in Kosovo. The large Kosovo ICT companies that serve Kosovo market fall within the categorization of primary organizations since they add value directly to the specific output produced and fulfil the demand of the ultimate users. Usually, in the case of exporting ICT services, Kosovo companies generally serve as supporting firms, mainly helping and supporting the primary organizations on specific activities or parts of the project.

Figure 1: ICT Supply Chain



Source: Mentzer et al. (2001)

60 Booz, Allen, Hamilton "Managing Risk in Global ICT Supply Chain"

The focus group with the ICT companies revealed that Kosovo could offer a competitive advantage on services related to testing of ICT products. Usually in a higher value service market, firms tend to test their products in some small market before they launch them in a wider market and/or introduce it globally.[61] This is done for the purpose of gaining feedback on the product and improving it before its launch. Kosovo's companies have already started performing the initial product testing for several foreign companies, hence providing a supporting role in the ICT value chain.

MAIN OBSERVATIONS

All the ICT companies participating in the focus group claim to target both domestic and foreign markets for high value-added services. Since Kosovo is a relatively small economy, and the demand is not very high for specialized ICT products or services, ICT companies usually look also for opportunities in other markets to produce and export high value-added products and services.

It is interesting to note that according to the focus group discussions, Kosovo's ICT products and services offered (outsourced) to foreign clients are not the cheapest in the market. In fact, the cheapest market for ICT products and services is India. However, Kosovo ICT companies claim to offer the cheapest products in Europe, and hence are competitive in the sector. Focus group participants stated that ICT companies in Kosovo are usually preferred by companies located in Western Europe to perform outsources services. The proximity of Kosovo to Western Europe and the high quality of products and services offered are reported to be the two main advantages of Kosovo's ICT firms. Another advantage for the Kosovo ICT sector is the young population in Kosovo that is very creative, technologically advanced and speaks multiple languages.

The focus group revealed that, compared to regional countries, the quality of ICT products and services offered in Kosovo are on par with regional peers. The main competitive threat for Kosovo companies seems to come from companies in the Former Yugoslav Republic of Macedonia (FYROM). A couple of years ago, FYROM implemented a wide range of policies that aim to strengthen and promote the ICT sector. One policy that has had a huge impact in FYROM was the removal of custom duties for ICT products.[62] As a result, the price of ICT products fell significantly. In turn, the low prices attracted buyers from the whole region. Therefore, due to rapidly increasing sales in FYROM, many international ICT companies considered FYROM as the main ICT hub for the region. Hence, even when it came to purchasing related services, FYROM became a preferred destination and Skopje an ICT centre. Numerous ICT companies in Kosovo have emerged as serious partners for numerous international clients and have begun attracting ICT services from big corporations.

The representatives of the industry in the focus group stated that there is a high number of individual ICT specialists in Kosovo who do not necessarily work for big brands, but they poses the necessary expertise to develop very complex products and services. ICT companies in Kosovo claim to hire these ICT specialists from time to time based on their specific needs. Kosovo ICT companies seem to have tapped into this market niche by being very good at producing very high quality products and services.

61 Ministry of Foreign Affairs of Denmark - Invest in Denmark, "Denmark as your new test market"

62 Customs Administration of the Republic of Macedonia: News Section: http://www.customs.gov.mk/en/DesktopDefault.aspx?tabindex=0&tabid=120

BINDING OBSTACLES IN OFFERING HIGHER VALUE ADDED GOODS AND SERVICES

During the focus group discussions, the participants highlighted some of the binding obstacles to high value-added exports of goods and services which are discussed below.

HUMAN CAPITAL IN THE AGRO-FOOD PROCESSING AND BEVERAGE INDUSTRY

When it comes to the human capital in the agro-food processing and beverage industries, some of the participants in the focus group stated that it was necessary to recruit food experts since some of their clients had complained about the quality of their products. As a result, one of the companies in the food industry has hired a foreign expert to manage its production of mushrooms. Accordingly, the yield and quality of the produce has improved significantly. Therefore, it was necessary to hire international experts that would closely monitor the production and produce uniform, high quality products. The employment of international experts has also contributed to raising consumer confidence, especially for the international clients. Thus, the companies in the food industry pay particular attention to employment procedures, especially for technical experts. Other participants also confirmed that it was difficult to find local technical experts that could offer technical insight on product quality or product differentiation. Hence, international experts are usually preferred by local production companies.

HUMAN CAPITAL IN THE SERVICE SECTOR

Many studies, such as the "Growth Diagnostic Study on Kosovo 2012" and the World Bank's Kosovo Unlocking Growth Potential: Strategies, Policies, Actions - A Country Economic Memorandum from 2010,"indicate that human capital, both the lack and quality of education, is a binding constraint to private investment growth and private sector growth in Kosovo. Kosovo experiences a very high skills premium. The skills premium is defined as a rise in wages with the attainment of more skills and education.[63] As an example, in terms of educational attainment, which is often associated with being highly skilled, the salaries of postgraduate degree holders in Kosovo is almost double that of those holding a first level university degree. On average, a person with a postgraduate degree in Kosovo earns EUR 607per month compared to a person with a bachelor/university degree, who earns about only EUR 319 per month. The high skill premium implies that there is a shortage of highly skilled workers in Kosovo. A high skills premium in wages (mentioned above) would indicate that there is high unmet demand for skilled workers. The lack of human capital among the work force implies that there is a lot of competition among firms for talent/highly skilled labour.

While job creation is low, the evidence in Kosovo suggests that the lack of skills is a constraint on growth, especially for sectors with high-growth potential such as services (namely ICT). According to focus group participants, Kosovo's labour force is perceived to be less educated and skilled compared to other countries in the region and even Eurasia. This is combined with somewhat high labour costs and a high reservation wage, partly due to the level of remittances. Demand for workers is high in categories requiring the most highly qualified individuals, where there is an insufficient supply.

63 Burstein A., and Vogel, J. (2012). "International Trade, Technology and the Skill Premium." Columbia Universitya

ICT companies which participated in the focus group revealed that they experience problems regarding the quality of the labour force that they hire. The majority of the university graduates in the field of ICT have a decent educational base but lack the expertise in specific fields. Therefore, when ICT companies post a job with very specific requirements, it is almost impossible for them to find the right local expert. Part of the problem is that the ICT curriculum of Kosovo's universities is very general and not field-specific. The most demanded skills, according to the focus group, missing in graduates are the combination of technical/engineering and soft (team/ person management, communication, interpersonal, problem solving) skills. The employers are filling this gap with additional training – inside and outside of the companies. ICT companies seem to organize some training in their own specific fields, but those trainings are too expensive to attract a large number of participants. As such, it is necessary for institutions to support and improve the quality of education related to the ICT sector. On a positive note, it is encouraging that a large number of students and young professionals at the entry level are interested in pursuing a career in the field of ICT. The potential is there, but these young professionals need to develop in order to be competitive with their peers.

A study from Kosovo Association of Information and Communication Technology (STIKK) and Kosovo Private Enterprise Programme (KPEP) from 2011 also confirms the findings of the focus group. They conclude that a gap exists between demand and supply of sufficiently qualified graduates in the ICT industry. According to another research by STIKK, which analyses data to explain this gap, did not find any evidence of a systematic shortage of ICT employees in Kosovo; although it is likely that an undersupply of some skills, particularly in the areas of software development and programming, exists. In addition, it is crucial that not only the quality of the general education of engineers should be improved, as suggested earlier, but also the study of English or another foreign language relevant for the EU market should become an integral part of the curriculum of the engineering students.

RECOMMENDATIONS

The service sector, especially ICT sector, as well as the agro food processing and beverage sub-industries demand more highly skilled workers which Kosovo currently lacks. Thus, inadequate human capital is a binding constraint to the future growth of the service sector and agro-food processing and beverage industry. Therefore, some of the recommendations to deal with this constraint are as follows:

1. Improve the engineering Curriculums: the Government of Kosovo should be committed in improving the curriculum of the universities as to reflect the market demands in both of these sectors.
2. Provide voucher schemes, where government would subsidize part of the cost, for the trainings of ICT and agro-food processing & beverage companies – as to assist these companies to train their staff.
3. Establish programs which will promote university-business collaboration (such as collaborative research) with these two sectors.

INSTITUTIONAL OBSTACLES IN THE AGRO-FOOD AND THE BEVERAGE INDUSTRY

According to the Kosovo Agency for Statistics (KAS), in 2011, the total number of employees in the general agriculture sector was 12,363 as shown in table 3 below.

Table 3: Employment in the Agriculture Sector

Industry –Year 2011	Total	Male	share (%)	Female	share (%)
Agriculture, hunting and forestry	12,363	11,744	95.0%	619	5.0%

Data Source: Kosovo Agency of Statistics

The UNDP report on Human Development 2012 titled *"Private Sector and Employment"* shows that in 2010, the employment in general in the agriculture sector increased by 19 percent compared to the previous year. According to the report, the rate of employment in the agriculture sector is higher than in 2009, which means that a slight increase in the employment rate occurred. In addition, the number of employed for the agro-food sector and tobacco products (beverages not included), shows that the employment in this sector is also growing. [64]

With regard to the value added for the sector of agro-food, the information provided by the UNDP report 2012 shows that, in general, the workforce in Kosovo is highly unskilled and lacks innovation. According to the report, "A situation has developed in which under-performance is the norm and businesses no longer crave or miss the absent skills that have the potential to contribute so significantly to driving their growth". As a consequence, incomes for the household are reduced; pessimism is spread among the young people and many other things that contribute to the continuation of low GDP rate in Kosovo. However, in the sector of agro-food and some other agricultural sub-sectors, there is a high potential to enhance skills that could, in turn, have an effect on the growth of value added in this sector[65].

Focus group participants emphasized that one of the major obstacles to exporting are the extensive bureaucratic procedures required for obtaining licenses and certificates. In the food industry, exporting companies face delays in obtaining the phytosanitary certificate because the inspectorates at regional levels are understaffed. Moreover, another company representative stated that for more than over three years his company is in the process of obtaining a license to expand their business. Two of the companies in the agriculture/food industry emphasized the lack of official and credible certification bodies and testing laboratories as a major obstacle to exporting. Oftentimes, as a result of this problem, their exported goods are either undervalued or their orders are cancelled.

The participants argued that there are several reasons why the imported goods are traded in Kosovo at a lower price than locally produced goods. The participants argued that the manufacturing companies in the region receive a lot of subsidies from the state. As such, the foreign companies lower the cost of production and can supply their products at a very low price. For instance, in the wine industry, the vineries in the region receive large subsidies to expand their vineyard and are eligible to purchase subsidized fuel. Other participants argued

64 EU/MTI - Sector study: Agro-food and beverages sector, 2013

65 (UNDP 2012)

that another contributor to the low price of imported goods is low quality. In addition, participants expressed their doubts about the content and expiration date of such products. Since there are no technical controls in the border, these products are dumped in Kosovo and can be marketed at a very cheap price. Yet, the traders in Kosovo favour such products because the turnover is very high and the profit is also larger.

Based on the information above, we recommend the following:

1. Simplify the bureaucratic procedures for the issuance of licenses and permits especially related to the agro-food processing;
2. Strengthen the internal market mechanisms/inspectorate in order to ensure that foreign products sold in Kosovo follow the rules and procedures.

ACCESS TO FINANCE FOR ICT AND AGRO-FOOD PROCESSING & BEVERAGE COMPANIES

Overall the banking sector in Kosovo has been a success story in terms of sector stability. However, access to credit is considered as a constraint to private investment growth. Credit to the private sector in Kosovo is low compared with other countries. More than 80% of companies do not borrow at all and use only their own funds or help from family and friends. Borrowing costs are high compared to other countries, due to higher operational costs and risks in Kosovo. Collateral and other conditions for loans are also more restrictive. Banks are extremely cautious in lending as it is virtually impossible to collect a bad loan.[66]

Both agricultural and ICT companies reported to face numerous problems related to access to finance and the high cost of financing.

Firms participating in both focus groups claimed that access to finance and the high cost of financing are among the main barriers toward their future growth. Firms confirmed that although they are interested to invest in the training of their employees, they lack financing to support such activities. When it comes to expanding, faced with difficulties in accessing cheap financing, ICT companies in the focus group discussions confirmed that they have also looked at the opportunity of issuing equity, which is the sale of new equity or stock by a firm to investors, as a financial instrument to raise funds for the firm in order to support specific projects or the overall operation of the company. In absence of financial markets, companies seek equity financing directly from friends, businessmen and other foreign investors willing to diversify their portfolio by investing a small stake in Kosovo. Nevertheless, they were not successful in this regard. It was revealed that part of the reason for lack of equity investments is that the ICT companies in Kosovo are not large enough to attract foreign equity investors, while the interest of local investors lacks significantly. Agricultural companies, both in the agro-food processing and the beverage industry, claimed that high interest rates and the high cost of financing in Kosovo disallows them from accessing finance sufficiently to fuel their growth.

66 Central Bank of Kosovo & USAID Growth Diagnostic Study on Kosovo 2012

Both, ICT companies and agro-food processing and beverage companies, require access and low-cost financing in order to grow and become more competitive. Thus, the high cost of financing in Kosovo and the lack of it hinder the development of these industries. Therefore, our recommendations are as follows:

1. Establish an Innovation and Technology Fund to finance innovation and technology related projects (in coordination with donors) in the ICT sector and agro-food processing & beverage industries;
2. In coordination with the donors, create two grant funds/schemes, in ICT and agriculture with a focus on the agro-food processing and beverage industry, in order to provide funding to companies that wish to expand their production lines and link them to employment; and
3. Expand the current agricultural credit guarantee scheme as to support a larger number of businesses.

FISCAL BARRIERS

ICT companies in the focus group pinpointed the particular problems that exist with the implementation of the laws regulating the ICT industry. They encounter numerous problems with the Customs authorities and the Tax Administration of Kosovo (TAK) regarding the implementation of the legislation. These institutions have not completely understood the nature of the products that the companies in this sector offer in order to apply appropriate tax and custom duties, according to the ICT businesses. As such, the laws that regulate the sale/export of the ICT services and products contradict themselves. In turn, customs and tax agents often tax ICT companies for services that are perceived to be tax-free. In addition, another problem regarding the legislation is with the custom duties on IT equipment.

In order to promote local service providers and boost competitiveness, the government should exempt several IT products from custom duties (specifically from chapter 84 and 85 of Integrated Tariff of Kosovo - TARIK). These products are usually used as inputs by service providers. Hence, this policy measure, similar to the one followed by the FYROM authorities, would decrease the cost of doing business for the both the service providers and ICT companies and would make them more competitive.

Thus, based on the identified problems, the following is recommended:

1. The current draft law on Zero Custom Duty, which exempts several products from the custom duty, should be expanded as to provide zero customs rate form to IT equipment & inputs. This would promote production and competitiveness through lowering the cost of inputs by imposing zero custom duty on inputs;
2. Update the law on services and eliminate ambiguities in terms of import and export of services and their taxation; and
3. Organize trainings and draft educational material for public officials (e.g. tax inspectors, custom officers) on ICT services and their trade.

CONCLUSION

In conclusion, despite facing many challenges and obstacles, both agro products and beverage sub-sectors analysed in this report have managed to successfully penetrate the export markets to some extent. Focus group participants emphasized that one of the major obstacles to exporting are the extensive bureaucratic procedures required for obtaining licenses and certificates. In addition, internal market mechanisms, especially related to inspection, lack significantly. Human capital and technology also represent a very important aspect for producing high quality value-added products. The imported goods are usually cheaper because in Kosovo the food safety controls at the border lack significantly.

As for the service sector in Kosovo, it is growing with excellent prospects. The location of Kosovo, the high quality of the products and services offered by the ICT sector, and the low price compared to the ICT firms of Europe represent a huge potential for the sector to grow. Other advantages include the young population and the interest of Kosovo youth in IT products. Finally, with regard to obstacles, the participants identified the access to finance and lack of skilled and specialized labour force to be the main barriers to offering high quality value-added services for export markets.

POLICY ASSESSMENT III

SKILL COMPOSITION AND PRODUCTIVITY ENHANCEMENT FACTORS OF EXPORTS

MENTOR MEHMEDI | RRON DALLADAKU

INTRODUCTION

Exports are one of the important sources of development for small countries like Kosovo. Policymakers usually aim at promoting exports, as the latter contributes to employment generation and economic growth. The recent literature links exports with firm and industry productivity levels; according to this line of thinking, only high productivity firms export, whereas non-exporters are by definition low productivity firms.

In addition, the empirical results indicate that exporting has important effects on labour markets, particularly on relative employment of skilled versus unskilled workers. In this context, this paper, which has been prepared as part of the UNDP Aid for Trade Project, investigates the skill composition of exports, while seeking to determine whether high quality products that are exported from Kosovo to the member countries of the Central European Free Trade Agreement, the EU and U.S. require more intensive skill utilization than goods that it sells domestically. In addition, this paper looks into the productivity enhancement factors of exports in Kosovo. In short, the aims of this study are to determine: the skill composition of the production of manufacturing firms; the skill composition of Kosovo exporters and non-exporters; the gender composition of labour employed in export firms; investment in technology, trainings and quality standards by exporting and non-exporting firms; and investment plans for both groups of firms.

The methodology of this paper draws on the findings of the "Impact Assessment document on Liberalizing Trade between Kosovo and the EU," prepared by the Ministry of Trade and Industry of Kosovo, that identified Kosovar products which are deficit-prone and industrial sectors that are seemingly "import-sensitive," following the terminology proposed by Schoeffle. A firm level, sampled survey of manufacturing and service sectors was carried out with 497 businesses spread throughout Kosovo.

The findings suggest that Kosovo's companies which are engaged in exporting activities hire more highly skilled workers. That is, the level of educational attainment of employees working for an exporting firm is typically much higher than that of employees working for a non-exporting firm. Exporters also tend to grow in size after their first year of operation, which translates into employment of more people and more government revenues. In addition, as exporters grow, they tend to invest both in technology and in human capital. Exporters also employ more women than do non-exporting firms. However, the findings suggest that exporters, the same as non-exporters, have a very low number of internationally-recognized quality certificates.

BACKGROUND INFORMATION ON KOSOVO'S ECONOMY

Since declaring independence on February 17, 2008, Kosovo has continued to make progress in development, both in terms of its economic performance and as a young, multi-ethnic democracy. Kosovo has embarked on numerous reforms, outlined in the government of Kosovo Economic Development Vision Action Plan, as adopted on 18 April 2011, to enhance and sustain economic growth during the medium-term.

In the last four years, Kosovo has had an average Gross Domestic Product (GDP) growth of about 4-5%[67]. Although Kosovo's economy has been shielded to a very large extent from the effects of the European crisis, the signs of economic slowdown have been present in the past year. GDP growth declined from 4.4% in 2011 to 2.5% in 2012.[68] The pace of growth is not nearly enough to have a transformational effect on Kosovo and lower the unemployment rate.

The International Monetary Fund (IMF) reports that the trade deficit remains large in Kosovo, at about 35% of GDP in 2012. The negative Balance of Goods and Services in Kosovo for 2012 was close to 2 billion Euros. Export of goods in 2012 dropped from 322 million Euros to 289 million Euros, whereas the export of services overall increased to 199 million Euros.

Table 1. Goods and Services Balance (in million EUR)

	2009	2010	2011	2012	2013
Goods and services balance	**-1,553**	**-1,710**	**-1,904**	**-1,986**	**-2,030**
Goods	**-1,673**	**-1,776**	**-2,090**	**-2,185**	**-2,259**
Exports	**177**	**305**	**322**	**289**	**307**
Imports	**-1,851**	**-2,081**	**-2,412**	**-2,474**	**-2,566**
Services	**121**	**66**	**186**	**199**	**229**
Receipts	**429**	**476**	**608**	**631**	**664**
Payments	**-308**	**-410**	**-422**	**-432**	**-435**

Source: IMF, 2013

In 2012, goods exported were less than 10% of GDP and concentrated in sectors with a low-value added component, notably metals, while the GDP contribution of remittances is 9.3% or a total of EUR 457million[69]. This structure exposes the economy not only to developments in Diaspora's host countries, but it also casts doubt on the current growth model's long-term sustainability.

67 IMF Country Report on Kosovo No. 222, July, 2013

68 IMF Country Report on Kosovo No. 222, July, 2013

69 UNDP Kosovo Remittance Study, July 2012 ,

The reason that the performance of exports of goods deteriorated in the last two years was due to a decrease in external demand and a decline in prices for metals and metal products, Kosovo's main exports. A trade deficit of 35.1% of GDP in 2012 reflects an underdeveloped and narrow domestic production base.

HUMAN CAPITAL IN KOSOVO

Many studies indicate that both the lack and low quality of human capital in Kosovo is one of the top three binding constraints on private investment growth in Kosovo,[70] which ultimately affects firm performance in the domestic market and potentially raises the cost of hiring higher skilled labour for companies.

Education is one of the top priorities of the Government of Kosovo. According to the Economic Development Vision Action Plan 2012-2014, development of human capital in Kosovo is one of five strategic objectives. The government is drafting policies which aim to increase the quality of human capital in order to better adapt to labour market demands. These include a special focus on the educational and vocational training sectors for human capital development in all sectors. Kosovo ranks 87th in the world in UNDP's rankings using the Human Development Index (HDI).[71] HDI measures the state of human development in three fundamental categories: a long and healthy life, access to knowledge and a decent living standard. The UNDP Kosovo Human Development Report for 2010 reveals that the HDI for Kosovo improved significantly during the 2007-2010 period, but it still lags behind regional countries. The HDI value improved from 0.678 in 2007 to 0.700 in 2010.[72]. [73] The improvement of HDI for Kosovo during this period was mainly attributed to a rise in GDP and a significant increase in the number of high schools and university education facilities; this in turn led to a high increase in enrolment rates in secondary and tertiary education.[74] The UNDP Kosovo Human Development Report for 2012 suggests that Kosovo HDI has increased from 0.700 in 2010 to 0.713, albeit the lowest in the region, lagging behind Serbia, Albania, Bosnia and Herzegovina, and the former Yugoslav Republic of Macedonia.

According to the same report and the Riinvest Enterprise Barriers Survey 2011,[75] Kosovo experiences a very high skills premium. The skills premium is defined as a rise in wages with the attainment of more skills and education.[76] As an example, in terms of educational attainment which is often associated with being more highly skilled, the salaries of postgraduate degree holders in Kosovo is almost double that of those holding a first level university degree. On average, a person with a postgraduate degree in Kosovo earns €607 per month compared to a person with a graduate/university degree who earns about only €319. On the other hand, there are not sufficient official data that indicate the difference between women and men earnings.

70 USAID Growth Diagnostic Study on Kosovo, September, 2012

71 UNDP Kosovo Human Development Report 2012 – Private Sector and Employment

72 HDI sets a minimum and a maximum for each dimension, called goalposts, and then shows where each country stands in relation to these goalposts, expressed as a value between 0 and 1

73 UNDP Human Development Reports, Human Development Index (HDI), http://hdr.undp.org/en/statistics/hdi

74 UNDP Kosovo Human Development Report 2010

75 UNDP Human Development Report 2012 and the Riinvest Enterprise Barriers Survey 2011

76 Burstein A. and JVogel J. (2012). "International Trade, Technology and the Skill Premium." Columbia University

The existing few studies indicate that the gender gap is almost inexistent in the public sector whereas there is small gap of 6% in the wages of the private sector disfavouring women.[77]

This high skills premium implies that a shortage of highly skilled workers exists in Kosovo, as a high skills premium in wages indicates that a high unmet demand for skilled workers exists, as well. Therefore, this lack of human capital among the work force implies that firms compete for talent/highly skilled labour. This, in turn, would be reflected in markedly lower unemployment rates for skilled workers, as well as in the "so called" skills premium which we see in Kosovo. The wage data provided above suggest that the demand for skilled workers is high and it is not being fully met by supply, either because of lack of it or an inadequate supply of skilled labour. The lack of supply and/or inadequate supply of skilled labour ultimately affects the level of exports of Kosovo firms.

LITERATURE REVIEW

Economic literature shows that economic growth and human development are closely interrelated.[78] While economic growth provides the resources to facilitate a sustained increase in human development, improvements in the quality of a labour force contribute greatly to economic growth. The education and skills of a labour force have a sustained effect on the composition of a country's trade.[79]

The evidence from papers, such as in Bustos (2009)[80] and Matsuyama (2007),[81] suggest that when firms export they adopt better technologies and utilize more skilled labour. Bastos and Silva (2010),[82] Gorg, Halpern and Murakozy (2010),[83] Hummels and Skiba (2004),[84] Manova and Zhang (2009),[85] Martin (2010)[86] and Verhoogen (2008)[87] all show that firms utilize more skilled labour while exporting. In addition, they show that certain features of the country of destination for exporting, such as income, quality valuation, distance and transportation costs, affect what degree of skills are being utilized by the exporting firms. As an illustrative example, exporting to a higher income per capita country implies that the exporting firm utilizes more labour than an exporter shipping goods or providing services in a lower per capita income country.

77 F.Pastore et al (2013), Gender differences in earnings and labour supply in early career: evidence from Kosovo's school-to-work transition survey

78 Weil, D.(2009) a"Economic Growth, 2/E," Brown University

79 OECD Centre for Educational Research and Innovation, "The Well-being of Nations: The Role of Human and Social Capital" 2001

80 Bustos, P. (2009). "Trade Liberalization, Exports and Technology Upgrading: Evidence on the impact of Mercosur on Argentinean Firms," American Economic Review

81 Matsuyama, K. (2007). Beyond Icebergs: Towards A Theory of Biased Globalization," The Review of Economic Studies, 74 , pp. 237-253.

82 Bastos, P. and J. Silva (2010). "The Quality of a Firm's Exports: Where you Export to Matters, "Journal of International Economics.

83 Gorg, H., L. Halpern and B. Murakozy (2010). "Why do within firm-product export prices differ across markets?," Kiel Working Paper No. 1596.

84 Hummels, D. and A. Skiba (2004). "Shipping the Good Apples Out? An Empirical Confirmation of the Alchian-Allen Conjecture," Journal of Political Economy, 102, pp. 1384-1402.

85 Manova, K. and Z. Zhang (2009). "Quality Heterogeneity across Firms and Export Destinations," mimeo Stanford University.

86 Martin, J. (2010). "Markups, Quality and Transport Costs," CREST Working Paper, 2010-17.

87 Verhoogen, E. (2008). "Trade, Quality Upgrading, and Wage Inequality in the Mexican Manufacturing Sector," Quarterly Journal of Economics, Vol 123, No. 2, pp. 489-530.

The production of goods that target export markets require certain specific skills that pertain to business support services such as marketing, distribution and a continuous need for information regarding foreign markets demand. These tasks differ in their skill intensity, so the act of exporting becomes a skilled intensive activity, even when the act of manufacturing is not skill-intensive per se.

The act of exporting to high-income destinations may require technologies and business processes that are yet even more skill-intensive. Consequently, economies that trade with high-income countries will utilize relatively higher levels of skills and they will pay higher wages than economies that are either closed or specialized in trade with middle- or low-income countries or, even worse, do not export at all.[88]

Bernard and Jensen in their seminal paper "Exporters, skill upgrading and the wage gap" found that demand variables, particularly export sales, are strongly correlated with increases in movements of skilled labour between plants, while technology variables positively affect within plant changes in the composition of the workforce.

In addition, Bernard, Jensen, Redding and Schott (2007) have established that exporters are larger, more productive, hire more workers, and pay higher wages.

The OECD paper "Trade and Gender: issues and Interactions" written by Jane Korinek finds that trade creates jobs for women in export-oriented sectors. The paper elaborates that jobs that bring more household resources under women's control lead to greater investments in the health and education of future generations.[89]

In regard to gender, a group of Ottawa University professors (Barbara Orser, Martine Spence, Allan Riding, Christine Carrington) in their study called Gender and Export Propensity, indicate that the role of gender in the international trade context remains virtually unexplored. Gaining a better understanding of the role of gender may further our understanding of SME exporting in general.[90]

In this paper, we expand on this work by investigating the association between exports and skill utilization by firms. In addition, this paper explores the level of gender composition of labour of export firms; investment in technology, trainings and quality standards by exporting and non-exporting firms; and investment plans for both groups of firms.

FINDINGS

In order to assess the skill composition, level of technological advancement, trainings provided and gender composition of workers employed by exporters and non-exporters, we examined the data of 497 companies, chosen semi-randomly and compared the aforementioned aspects between exporters and non-exporters.

88 Brambilla, I., Lederman, D. and Porto, G. (2010) "Exports, Export Destinations, and Skills," Economic Review, American Economic Association, vol. 102(7), pp. 3406-38

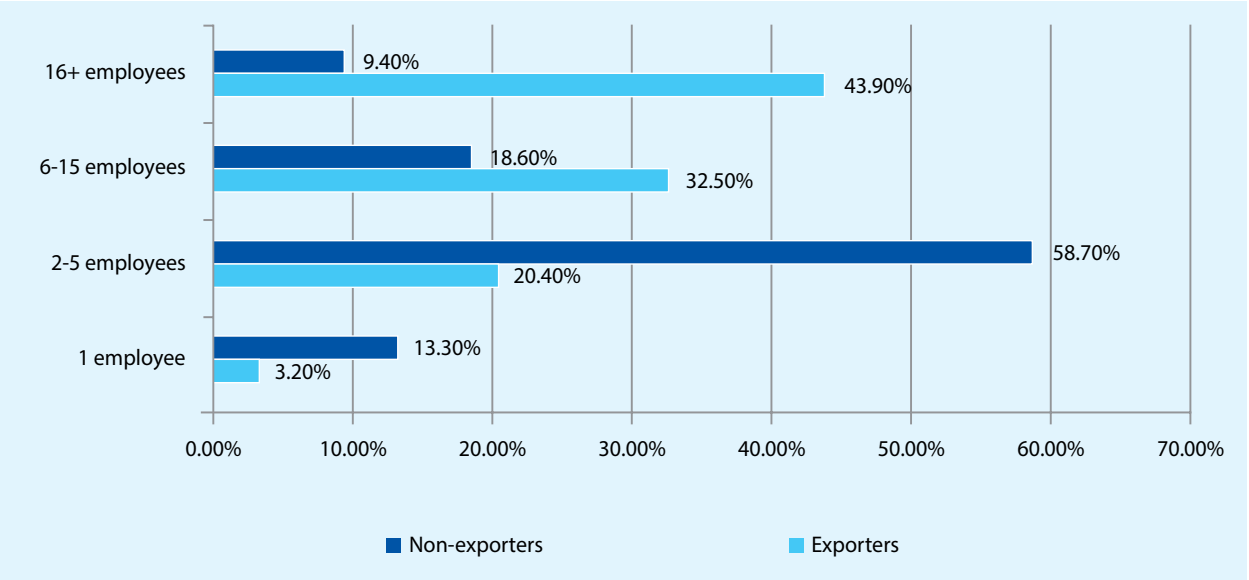
89 Korinek, Jane. *Trade and gender: Issues and interactions*. No. 24. OECD Publishing, 2005.

90 Orser, Barbara, et al. "Gender and export propensity." *Entrepreneurship Theory and Practice* 34.5 (2010): 933-957.

The survey interviewed 497 businesses around widespread throughout Kosovo in 36 municipalities with 19.5% being located in Prishtina/Priština, 10.3% in Prizren, 10.1% in Ferizaj/Uroševac, 7% in Gjilan/Gnjilane and 6.4% in Peja/Peč. Out of the total survey sample, 337 companies were micro enterprises, 115 small, 41 medium and 4 large. Relating to the legal status of the businesses surveyed, 20% of them were limited liability companies (LLCs), 71% sole proprietorships and 7% partnerships. Around 7.88% of those surveyed claimed to have at least one woman owner, with the rest being owned only by men. Only 2% of the surveyed businesses were owned by foreigners or claimed to be a foreign-owned company.

The survey data show that non-exporters usually employ a lower number of workers. Three percent of exporters employ 1 employee, compared to 13.3% of non-exporters. 20.4% of exporters hire 2-5 employees, compared to 58.7% of non-exporting firms. Thirty two per cent of exporting firms hire 6-15 employees, whereas only 18.6% of non-exporters do so. The same holds true for companies with 16+ employees. Almost 44% of exporters said that they hire 16+ employees, while the figure is 9.4% for non-exporters. As such, the sample survey indicates that exporters in Kosovo tend to be larger than non-exporting firms.

Figure 1. Current full-time employees: exporters vs. non-exporters



Source: Survey data

In order to see the trends of employment for exporters and non-exporters, we examined the number of employees that Kosovo's exporters employed throughout the years. During the first year of operations, about half of exporters (47%) reported that they employed 2-5 employees, whereas 28% said that they employed 6-15 employees. Additionally, 18.5% of exporters reported that they employed over 16 people in their first year of operations.

Table 2. Full time employees of exporting firms based on the number of employees throughout the years

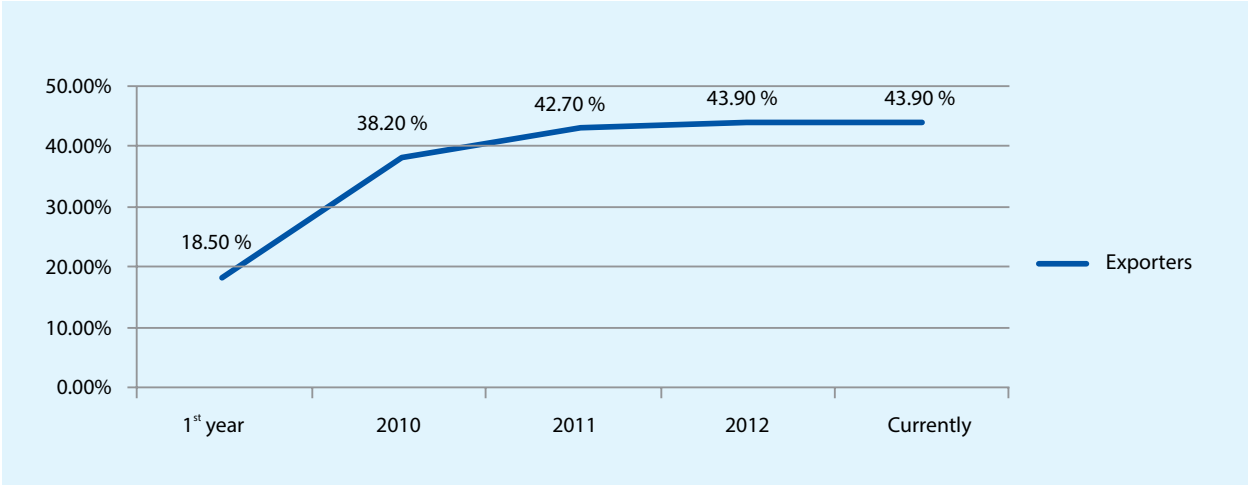
	No. of employees	1st year	2010	2011	2012	Currently
Number of full-time employees among exporters	1	3.8%	1.3%	1.3%	1.3%	3.2%
	2-5	47.1%	28.0%	24.2%	22.3%	20.4%
	6-15	28.0%	31.2%	30.6%	32.5%	32.5%
	16+	18.5%	38.2%	42.7%	43.9%	43.9%

Source: Survey data

Now, regarding the data on how many employees these exporters currently employ, it is clear that the group with over 16 employees is the highest. 43.9% of exporters currently employ more than 16 workers, whereas 32.5% employ 6-15 workers, 20.4% employ 2-5 workers and 3.2 % employ one worker.

As noted earlier, exports are crucial for the economic development and social prosperity of a country, as an increase in exporters is positively correlated with the number of jobs created. The data on exporters indicate that exporters have continuously increased the number of workers they hired after their first year of operations. While only 18.5% of exporters hired more than 16 people in their first year of operations, currently 43.9% of them employ more than 16 workers. This is a positive outcome indicating that exporters tend to grow substantially after their first year of operations, while simultaneously employing a greater number of people.

Figure 2. Employment of over 16 workers by exporting firms



Source: Survey data

Examining data on the employment of workers by non-exporters provided some insights into the labour market dynamics of Kosovo, as well.

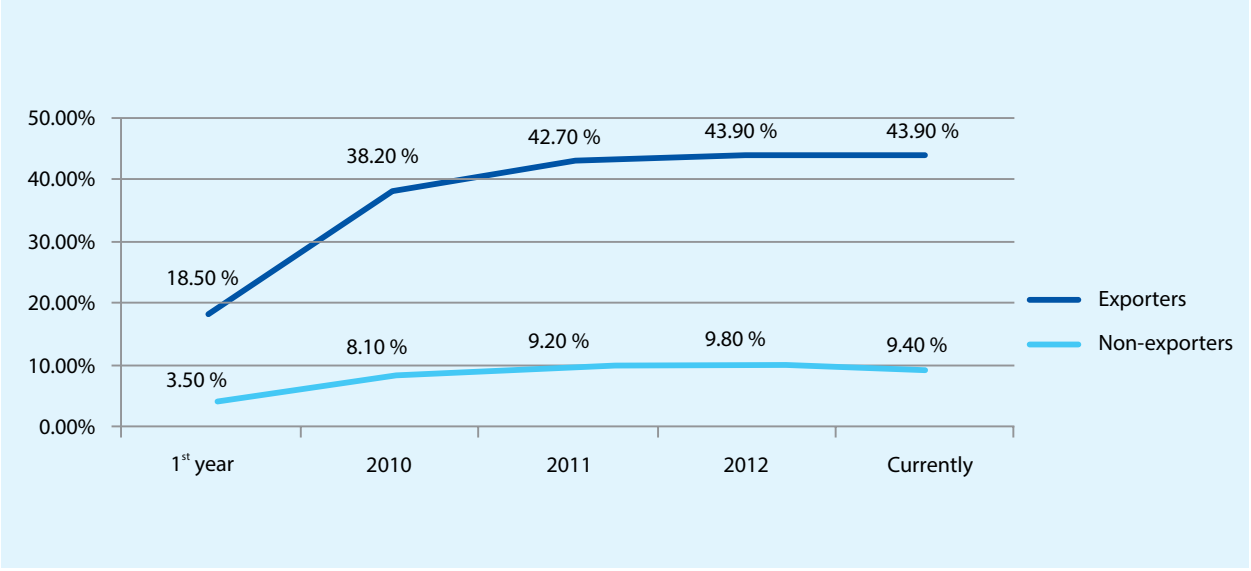
Table 3. Full time employees of non-exporting firms based on the number of employees throughout the years

	No. of employees	1st year	2010	2011	2012	Currently
Full-time employees of non-exporters	1	13.3%	11.0%	11.8%	10.9%	13.3%
	2-5	65.8%	56.7%	58.6%	59.2%	58.7%
	6-15	15.9%	18.2%	18.9%	19.8%	18.6%
	16+	3.5%	8.1%	9.2%	9.8%	9.4%

Source: Survey data

In the first year of operations, 13.3% of non-exporters reported that they employed only 1 person, while 65.8% reported that they employed 2-5 employees and 15.9% said that they employed 6-15 employees. The latter being a much lower percentage than the 28% reported by exporters. The data on non-exporters indicates that non-exporters did not sustainably increase the hiring of workers after their first year of operations, as was the case with exporting firms. Currently, most non-exporters (58.7%) employ 2-5 workers. This data indicates that non-exporters have not gotten bigger and are not employing a higher number of people, as is the case with exporting firms.

Figure 3. Employment of over 16 workers by exporters vs. non-exporters in percentages



Source: Survey data

The graph above highlights the employment of workers (16+) by exporters and non-exporters. The findings are very interesting and thought-provoking; however, they pinpoint what general economic theory would suggest. To summarize, exporting firms in Kosovo are larger and employ a greater number of people than non-exporters. The difference between exporters and non-exporters in hiring more than 16 people is not only evident during the first years of operations but also over time. This data suggests that, if Kosovo's economy is to generate jobs and provide

employment opportunities, increasing the export base can aid in increasing employment and alleviating the country's high unemployment rate.

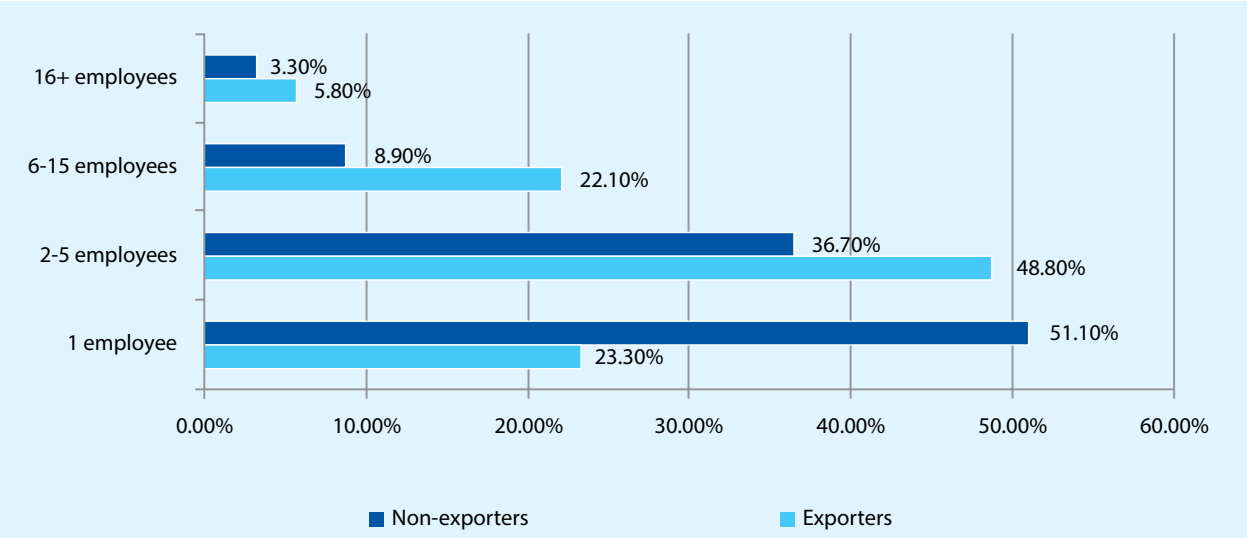
GENDER COMPOSITION OF EXPORTERS VS. NON-EXPORTERS EMPLOYEES

One great challenge of Kosovo for achieving sustainable economic growth is that women have remained a socio-economically excluded group, facing discrimination in many aspects of life. This is especially the case for the labour market and economic activities as they face mounting obstacles in opening and growing businesses. Only about 10.5% of businesses are owned by women based on Kosovo Business Registration Agency (KBRA). Even worse, findings of a recent Riinvest report indicate that women find it very difficult to become employed in the private sector since the employers regard them as expensive labour because of their reproductive rights guaranteed by the labour law.

According to the Kosovo 2012 Labour Force Survey, published in September by the Kosovo Agency of Statistics,[91] fewer than one-in-five (17.8%) working age women are active in the labour market, compared to more than half (55.4%) of men of the working age population. Unemployment is much higher for women than it is for men (40.0% compared to 28.1%). In addition, the employment rate among working age women is only 10.7%, compared to 39.9% for men. If Kosovo is to improve its economic conditions and ensure sustainable development, then empowering women and increasing the participation of women in the labour force is of paramount importance.

The findings on the gender composition of employee base in our sample survey are thought-provoking. Exporters that employ either 2-5 employees, 6-15 employees, or over 16 employees hire more women than non-exporters. Exporters that hire 2-5 employees report that on average, 48.8% of their employees are women compared to only 36.7% among non-exporters. Among exporters that hire between 6 and 16 employees, on average 22% of their workers are women, while this figure is only 8.9% for non-exporters. Lastly, as noted, exporters employing over 16 people also hire more women than non-exporters even through the difference is rather meager.

Figure 4. Number of women employed by exporters vs. non-exporters



Source: Survey data

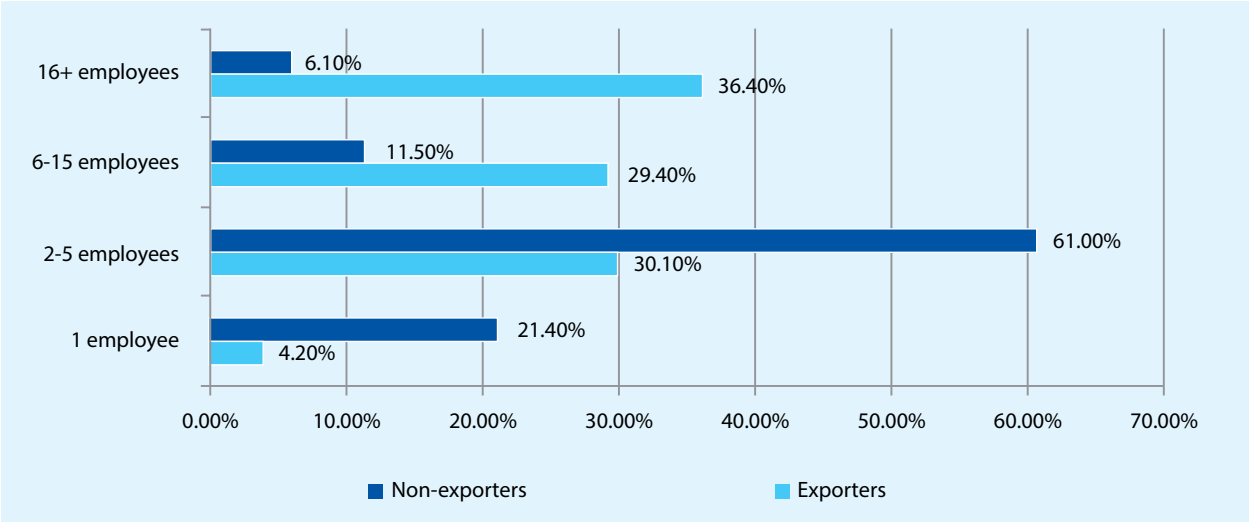
91 Kosovo Agency of Statistics, Labour Force Survey 2012

These findings suggest that Kosovo exporters, in general, hire a greater number of women than non-exporters. As such, the results of our study suggest that exports in Kosovo not only create jobs, but a portion of those jobs are going to women in export-oriented sectors, as well. As Kosovo increases exports and export-led industries expand, women will particularly benefit from it. What this means is that jobs generated by exports bring more household resources under women's control, which in turn has a positive effect on investments in the health and education of future generations.[92] Therefore, strong, export-led growth in Kosovo, coupled with appropriate policies, can help strengthen gender equality in Kosovo.

SKILLS AND EDUCATIONAL ATTAINMENT: EXPORTERS VS. NON-EXPORTERS

As noted earlier, empirical results have shown that exporting has important effects on labour markets, particularly on relative employment of skilled versus unskilled workers.[93] To recapitulate, theory suggests that exporters, since they are more productive and apply more advanced technology in the business processes, hire higher skilled labour and, as such, that their labour is equipped with a higher degree of educational attainment compared to companies that do not export and only serve a domestic market. Hence, the skill utilization of exporters is much higher than the skill utilization of non-exporters.

Figure 5. Employees with secondary education - exporters vs. non-exporters



Source: Survey data

Examining the data for employees with a secondary education, we found that as exporters grow larger, in general, they tend to hire a greater number of employees with secondary education degrees compared to non-exporters. For exporters who hire 6-15 employees, an average of 29.4% of their employees have completed secondary education, while only 11.5% of employees among non-exporters have attained this level of education. A similar trend is seen for exporters who hire over 16+ employees. In this case, on average, 36.4% of the workers hired by exporters have a secondary education degree, while non-exporting firms that fall into that category, and have a rate of only 6.1% of employees with high school degree. This data

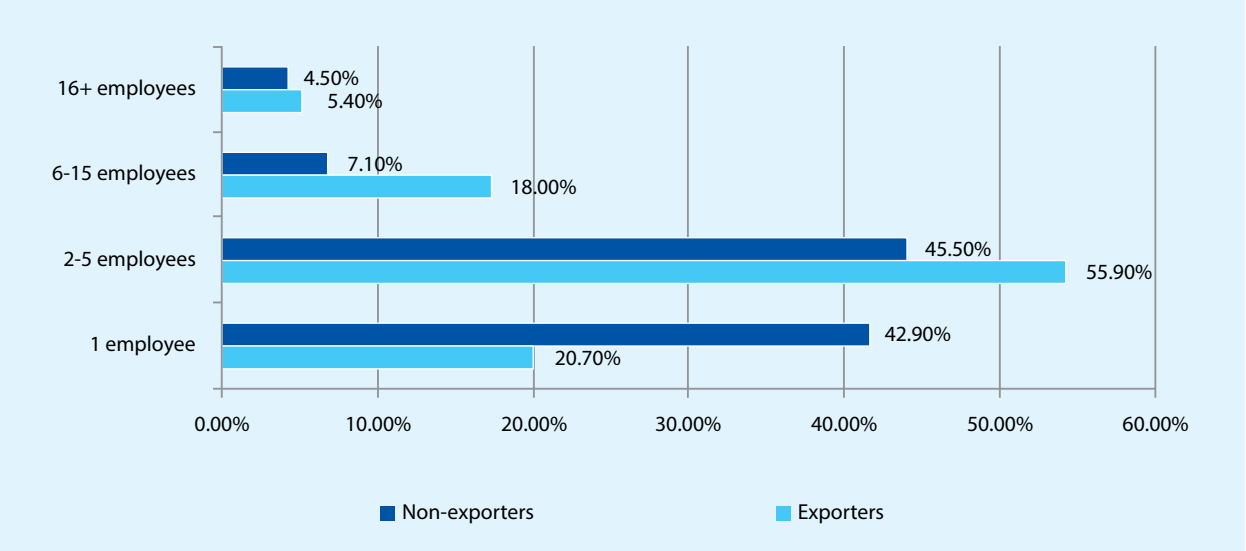
92 Korinek. J, OECD. "Trade Policy Working Paper No. 24 Trade and gender: Issues and Interactions."

93 Bustos, P. (2009). "Trade Liberalization, Exports and Technology Upgrading: Evidence on the impact of Mercosur on Argentinean Firms," American Economic Review

suggests that exporting firms tend to utilize more employees with secondary education and vocational schooling than non-exporting firms.

Data on the number of employees with university and master degrees hired by exporting and non-exporting firms can reveal a great deal of information on the skill utilization of these two groups, as well as whether exporting is a skill-intensive activity in Kosovo or not.

Figure 6. Employees with a university degree - exporters vs. non-exporters



Source: Survey data

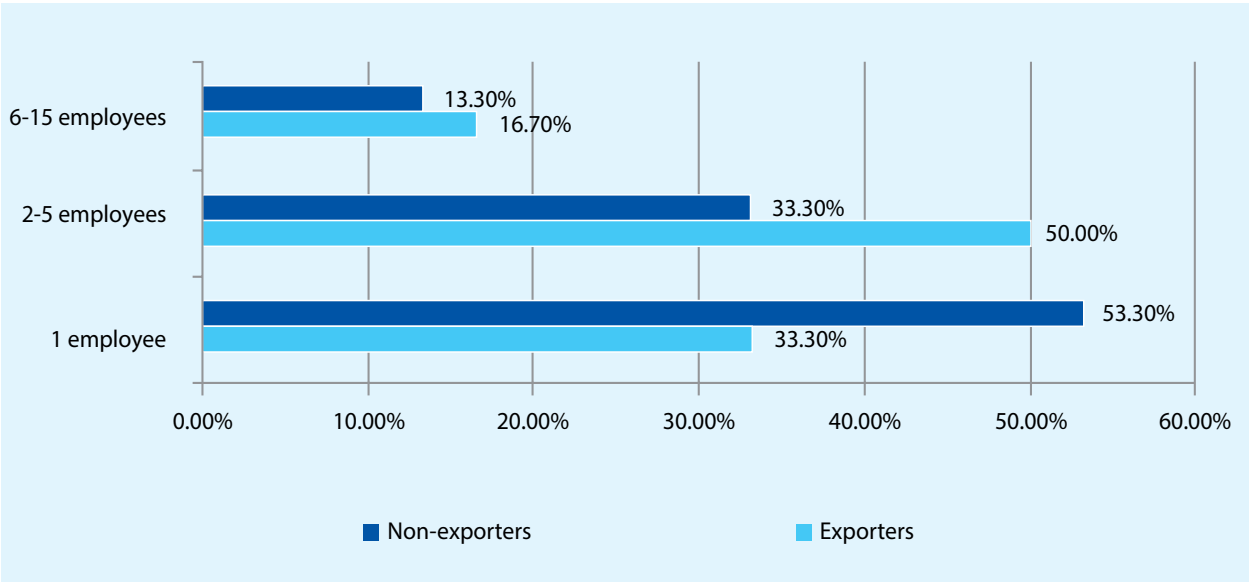
The data on employees with a university degree hired by exporters and non-exporters reveals that exporters, in general, utilize a higher number of skilled workers.

Exporters who employ either 2-5 employees, 6-15 employees, or over 16 employees hire more employees with a higher educational attainment than do non-exporters. For the group 2-5 employees, on average, 56% of employees hired by exporters have a university degree compared to an average of 45% of those working for non-exporters. For firms with 6-15 employees, on average 18% of employees working for exporters have a university degree, while on average 7.1% of those hired by non-exporters hold such a degree.

Data on the number of employees with master's degrees hired by exporters and non-exporting firms largely reaffirms the hypothesis that skill utilization by exporting firms is higher compared to non-exporters.

Half of the employees of exporting firms that hire 2-5 employees hold a master's degree, compared to 33.3% of non-exporting firms. The same discrepancy is evident for firms with 6-15 employees. On average, 16.7% of employees of exporters have a master's degree, while only 13.3% of non-exporting firms do.

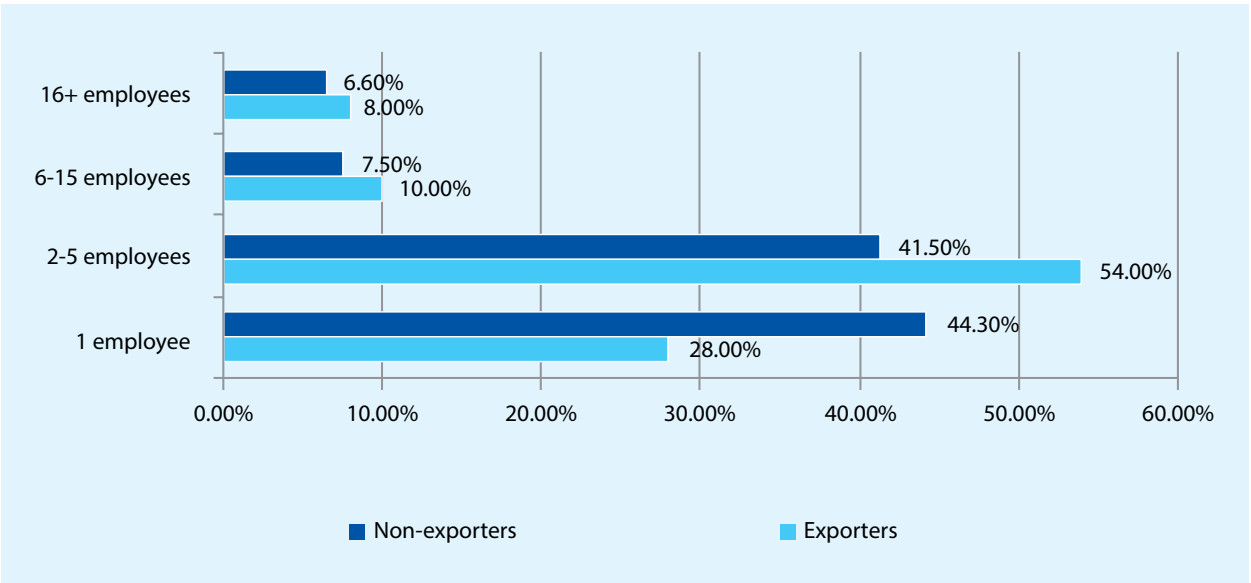
Figure 7. Employees with a master's degree - exporters vs. non-exporters



Source: Survey data

Turning to the production process, we examined the data to determine whether a difference exists in education attainment of employees of exporters and non-exporters. Again, exporters tend to hire more competent people in the production process compared to firms that do not export. This is true for exporters who hire 2-5, 6-15 or 16+ employees. For those with 2-5 employees, on average 54% of workers in the production process of exporters have a university degree, compared to 41.5% of employees of non-exporters, on average. Among firms employing 6-15 people, on average 10% of employees working on production lines of exporting firms have a university degree, while only 7.5% of similarly engaged employees do in non-exporting firms.

Figure 8. Employees with university degree in production line - exporters vs. non-exporters



Source: Survey data

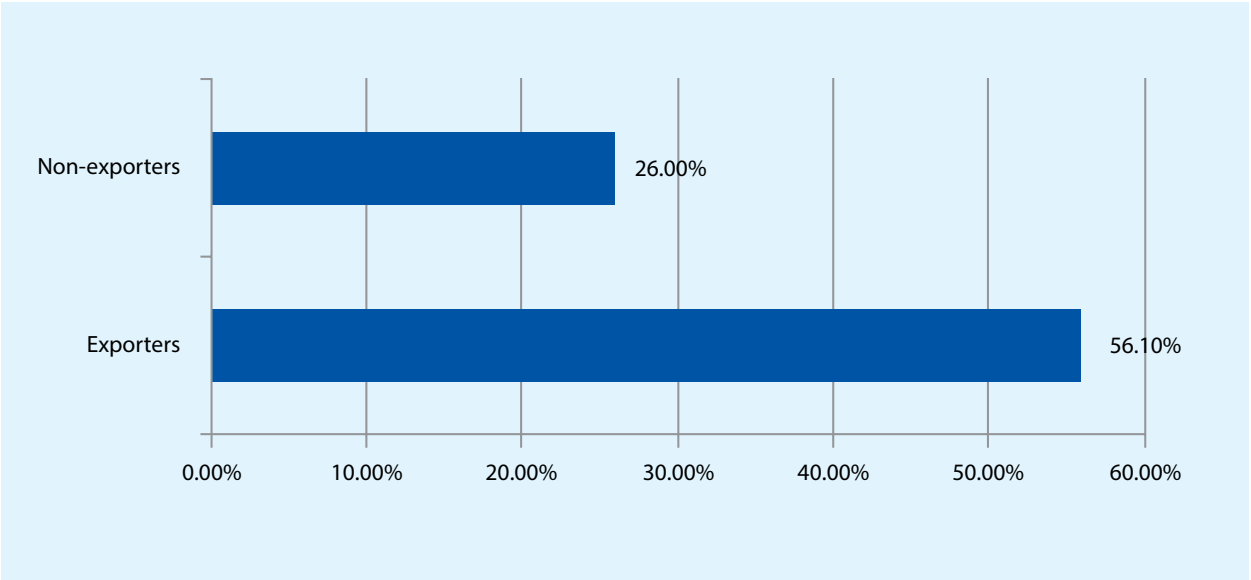
From the evidence provided on this section, it can be concluded that exporting firms use more skills and hire employees with a higher educational attainment than firms that do not export and only serve the domestic market. In particular, exports are positively correlated with the skill premium, which supports recent trade models linking exports with wages and the demand for skills.

INVESTING IN EMPLOYEES

Firms are able to grow, hire more employees, become more competitive and spur innovation only when they are able and willing to invest - both in their production/service processes and their employees. Investment in capital equipment and labour are the foundations of the company growth model; hence, a lack of at least one of them indicates a lack of modernization, which in turn impacts productivity, quality, and ultimately, the competitiveness of a firm.[94]

A study on the value of trainings highlights the fact that trainings improve employee performance in numerous areas: notably in problem solving, attitude towards work, ethics, motivation, leadership and communication. Trainings are also perceived as win-win activities since employees increase their productivity, while at the same time, companies enhance their profits through increased sales, increased referrals, new product ideas and improved customer satisfaction and retention.[95] In order to assess the level of trainings offered by companies in Kosovo, exporting and non-exporting firms were asked whether they offered any training to their own staff, as part of the internal development process of their company.

Figure 9. Percent of exporters vs. non-exporters offering training to staff



Source: Survey data

Around 56% of exporters claimed that they do offer trainings to their employees compared to 26% of non-exporting firms. The vast majority of the trainings offered by both, exporting

94 IBM. "The value of training and the cost of doing nothing". 2008

95 Dean, P. J., & Ripley, D. "Performance Improvement Pathfinders". Washington, DC: The International Society for Performance Improvement, 1997

and non-exporting firms, were conducted in house, 84% and 83%, respectively. Only 10% of exporters and 11% of non-exporting firms outsourced their training modules domestically, while roughly 5% of trainings were outsourced internationally by both exporting and non-exporting firms.

The difference in the prevalence of trainings offered by exporters and non-exporters is immense and significant. Less investment in the training and skill development of workers by non-exporting firms is directly correlated with lower productivity and the inability of non-exporting firms to upgrade their production and service lines effectively. The findings from this study suggest that only half of all exporters provide trainings to their employees. In order for Kosovo's current exporting firms to increase their efficiency and remain competitive, they will also have to increase the investment in their employees. The same applies to non-exporting firms. If they are to increase the productivity of their employees and become more efficient, which would potentially lead to them becoming exporters, non-exporting firms will have to increase investments in their human capital.

INVESTMENT IN TECHNOLOGY BY EXPORTING VS. NON-EXPORTING FIRMS

Export level, growth and market share depend on a number of factors: notably, the diversification of exports, their quality and sophistication, firm participation, and ultimately, export survival.[96]

Bustos (2009) suggests in his paper that firms which upgrade employees' skills also upgrade technology. Therefore, firms can be sorted into three groups: 1) the most productive which utilize skill-intensive technology and export, 2) an intermediate group that exports but uses non-skill-intensive technology and 3) the least productive firms which only serve the domestic market making use of non-skill-intensive technology.[97]

It follows that, in order for firms to diversify, offer quality products and services and participate fully in the international market, they have to invest in technology, innovation and human capital. This allows them to come up with new and competitive products and services, ensuring that they not only are able to export but once they export, they are also able to ensure their export survival.

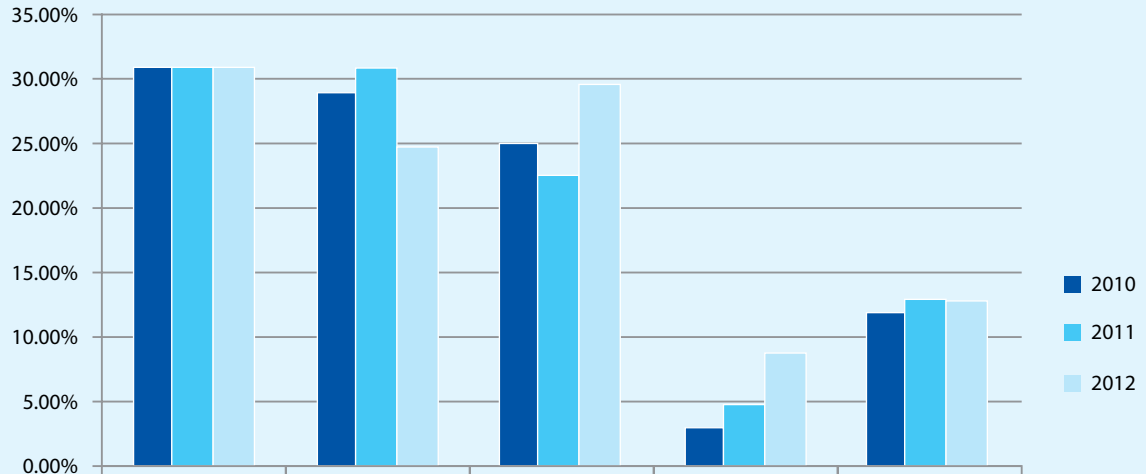
Therefore, we believe that investment in technology is intrinsically linked to skill utilization; that is, firms that hire more skilled labour can also employ more advanced technology. In order for firms in Kosovo to increase their productivity and participate in exporting, they must employ higher skilled labour and utilize more advanced technology.

In order to determine and assess the technological sophistication of all Kosovo's businesses, we examined the value of technology (machinery and equipment) that exporters and non-exporting firms reported over the period 2010-2012.

96 Manova, K. and Z. Zhang (2009). "Quality Heterogeneity across Firms and Export Destinations," mimeo Stanford University.

97 Bustos, P. (2009). "Trade Liberalization, Exports and Technology Upgrading: Evidence on the impact of Mercosur on Argentinean Firms," American Economic Review

Figure 10. The value of technology (machinery and equipment) of exporters in EUR



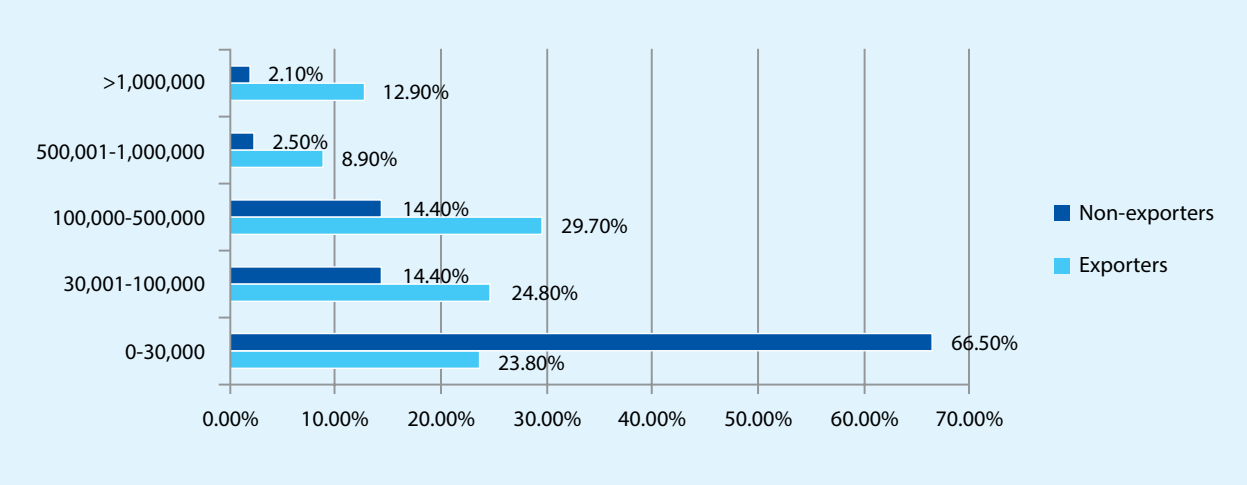
	0-30,000	30,001-100,000	100,000 - 500,000	500,001 - 1,000,000	>1,000,000
2010	31.60%	29.00%	25.00%	3.00%	12.00%
2011	28.60%	31.00%	22.60%	4.80%	13.10%
2012	23.80%	24.80%	29.70%	8.90%	12.90%

Source: Survey data

Our survey data shows that in 2012, 29.7 % of exporters the value their technology (machinery and equipment) from €100,000 to 500,000 which presents a 4.7 percentage point increase from 2010 when only 25% of exporters fell under this category. A similar increase of the number of exporters is observed with the category which valued their technology in the range of €500,000 to €1 mil and above €1 mil. These findings suggest that exporters have 1) increased their investment in machinery and equipment and 2) the value of the technology that they utilize is increasing at a good pace.

Comparing the value of technology (machinery and equipment) in 2012 between exporting and non-exporting firms suggests that exporters possess a much higher value of machinery and equipment than non-exporting firms. This holds true for technology valued above €30,000.

Figure 11. The value of technology in 2012 - exporters vs. non-exporters in EUR



Source: Survey data

When asked to assess how their technology compares to that of their closest competitor, about half of all exporters claimed to have newer technology than their closest competitor, while 49% claimed to have older but functional technology. Different answers were given by non-exporting firms. Only 36% of non-exporters claimed to have technology newer than that of their closest competitors, while 63% said that they employ older but functional technology as compared to their closest business rival.

This data also show that exporters get their supplies of production technology mostly from Europe (56%), whereas non-exporters largely attain it within Kosovo (65%).

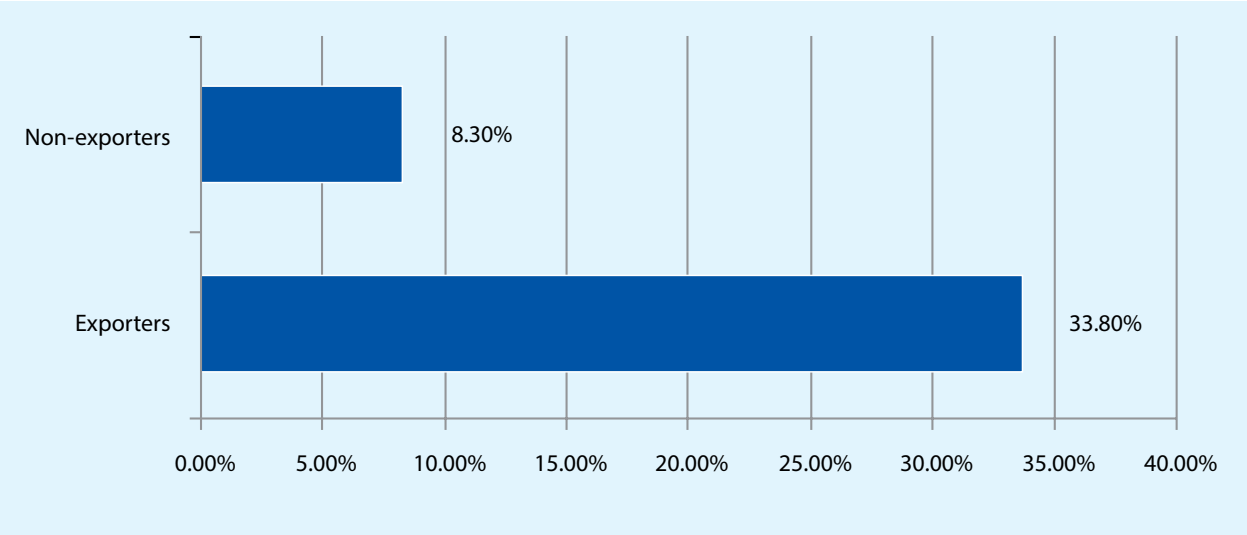
QUALITY STANDARDS AS A WAY TO ENHANCE PRODUCTIVITY

In addition to determining the skills utilized by firms in Kosovo, we looked into the utilization of quality standards since metrology, accreditation and standards (MAS-Q) and conformity assessments are, in general, increasingly recognized as essential tools for promoting global economic growth, especially in developing countries.[98] Hence, quality standards, which are closely linked with the use of information technology, are crucial for improving the quality of the products and profitability of firms. The pace of change in business, driven by new technologies and technological advances, means that existing skills in most areas of the workplace need to be frequently upgraded and the process of obtaining quality standards is one way of doing that. As such, accurate measurements, standards and conformity assessments have become prerequisites for expanding international trade and increasing a country's export base. MAS-Q activities are important to ensure that market transactions can take place and that consumers and regulators feel confident that the goods being produced, imported and exported are safe and are of expected quantity and quality. For Kosovo to compete and succeed in today's global market, traders, producers, and especially exporting firms must meet the requirements of target markets in terms of quality, safety, reliability, environmental compatibility, hygiene standards and technical regulations, and they must be able to provide credible proof of compliance.

98 USAID Vietnam, "Standards, Metrology, Conformity Assessment and the TBT Agreement"

When asked whether their company has an internationally-recognized quality certificate, around 34% of exporters claim to have a quality assurance certificate, compared to only 8.3% of non-exporters.

Figure 12. Internationally-recognized quality certificate: exporters vs. non-exporters



Source: Survey data

Still, this data suggests that even exporters have a very low number of internationally-recognized quality certificates.

INVESTMENT PLANS

The sample surveyed, both exporting firms and non-exporting firms, were also asked about their investment plans and specifically, in what production line/s or sectors they are planning to invest. The largest share of exporters (19.4%) said that they plan to invest in the agro-food industry (including vegetables, fruits and wine), compared to only 8.3% of non-exporting firms. This finding indicates that the agro-food industry in Kosovo is gathering pace, commercial viability is improving and demand in the market is increasing. The furniture industry is also another field where both exporting firms and non-exporting firms expect to invest in the coming months. About 14.3% of exporters and 29.4% of non-exporters affirmed that they plan to invest there. This can be interpreted as an indicator that the furniture industry companies who are not exporting yet, are planning to increase their capacities and productivity in order to become as competitive as their exporting competitors.

The steel/alumnae, wood, and construction industries, as well as machinery/new technology, provide the order of subsequent investments.

Table 4. Investment plans of surveyed businesses

Sectors/Fields	Exporters	Non-Exporters
Agro-food industry – (e.g. vegetables, fruits, wine)	19.4%	8.3%
Beverage industry – (e.g. beer & juice)	2%	0.9%
Furniture	14.3%	29.4%
Apparel industry	4.1%	1.8%
Steel/Alumnae industry	12.2%	6.4%
Plastic	9.2%	5.5%
Wood industry	11.2%	8.3%
Construction	12.2%	11.9%
Trade	1%	5.5%
ICT	n/a	1.8%
Machinery/new technology	9.2%	13.8%
Quality standards	5.1%	5.5%
Other	0%	0.9%

Source: Survey data

CONCLUSIONS

In this paper, we elaborated several theories linking productivity and exports, specifically analyzing one of the important productivity-enhancing factors (i.e. Human related factors). Through a firm level study of 497 companies spread throughout Kosovo, we studied the behaviour of firms that export and those that do not, in terms of the utilization of skilled labour; investment in technology, trainings and quality infrastructure; and gender composition of the workers. Based on the data and the findings, we conclude that firms in Kosovo which are engaged in exporting activities hire more highly skilled workers. That is, the educational attainment of employees working for an exporting firm is much higher than that of employees working for a non-exporting firm. This is largely because of the following reason: Kosovo firms that export either to regional countries or European markets have to be competitive and provide quality goods and services. Hence, they engage in quality upgrades, which are skill-intensive.

The evidence from Kosovo manufacturing and service firms shows that exporters tend to get bigger after their first year of operation, which translates into employment of more people and more government revenues. In addition, as exporters grow, they tend to invest both in technology and in human capital. In their subsequent years of operations, exporters increase investments in machinery and equipment and the value of the technology that they employ grows at a good pace. A similar trend is seen in the training of employees. Fifty-six percent of exporters claimed that they do offer trainings to their employees, whereas only 26% of non-exporting firms confirmed that they do the same.

The gender composition of the workforce of exporting firms is also different from non-exporting firms. In general, exporters employ more women. Around 22% of the workforces of exporters that hire 6-16 employees are women, compared to only 8.9% among non-exporters. The results of our study suggest that exports in Kosovo not only create jobs, but a portion of those jobs are going to women in export-oriented sectors. Strong export-led growth in Kosovo, coupled with appropriate policies, could help strengthen gender equality over the medium-term.

The data also suggests that exporters are looking into opportunities to invest in both the agro-food industry (including vegetables, fruits and wine) and furniture/wood industry and more investment in these fields will potentially further improve their productivity.

In conclusion, a typical exporter in Kosovo is more productive, uses a higher level of skill utilization, has a more balanced gender composition and invests more in technology and employees than a typical non-exporting firm.

In order to increase the export base and assist these exporters to become larger and more competitive, Kosovo's authorities will have to draft policies which tackle constraints faced by exporters and non-exporters as they relate to the import of technology, duty free raw materials, financing, quality assurance and the like.

POLICY RECOMMENDATIONS

EDUCATION, IMPROVEMENT OF CURRICULUM AND TRAININGS

As suggested above, Kosovo suffers from both a lack of education and a low quality of education which is manifested in a high skills premium. Demand for workers is high in the most highly qualified categories, where insufficient supply exists. As we have seen, exporters utilize high skilled labour. In order for the current exporters to grow larger and expand into other markets, as well as for would-be exporters to realize their potential, it is of paramount importance that there is a sufficient supply of highly skilled labour in the market.

It is recommended that the government of Kosovo reviews and further develops the state's secondary and tertiary curricula to align with the economic and social development needs of Kosovo (reforms in curricula based on competence, textbooks and learning materials and evaluation) and on industry and service needs where Kosovo has a competitive advantage.

The data suggests that only 56% of exporters offer trainings to their employees. This is worrisome taking into account the lack of skills, as well as the fact that trainings are one of

the mechanisms for improving employee performance, which then translates into increased productivity, enhanced profits and a long-sustainable future for a company.

It is recommended that the Ministry of Trade and Industry, through its Investment Promotion and Small and Medium Enterprise Agencies, designs a special program for the training of exporting companies' employees while focusing on increasing the export promotion capacities of all businesses.

ACCESS TO FINANCE FOR EXPORTERS AND POTENTIAL EXPORTING FIRMS

The data suggests that, in the subsequent years following the establishment of operations, exporters tend to expand their operations and increase the hiring of employees. It is crucial that some instruments are developed in order to aid exporters in having access to cheap financial means in order for them to increase investments and expand means of production for their investments. In the meantime, potential exporting firms require financial resources to investment in employees and new technologies in order to be competitive and be able to export.

Kosovo will soon kick-off the implementation of the loan guarantee scheme for borrowers who have difficulty accessing credit, by covering a share of the risk of loan defaults. This mechanism will foster better access to credit for small and medium enterprises. We recommend that a special program within this scheme be designed for exporting firms to have access to cheap credit.

MAS-Q INFRASTRUCTURE

MAS-Q and conformity assessments are increasingly recognized as essential tools for promoting economic growth, especially in developing countries. The data from our survey reveals that only 34% of exporters claim to have a quality assurance certificate. In order for Kosovo's exporting firms and potential exporters to increase their presence in international markets, through their products and services, they must meet the requirements of the target markets in terms of quality, safety, reliability, environmental compatibility, hygiene standards and technical regulations and they must be able to provide credible proof of compliance.

As it stands, Kosovo's exporters do no put great emphasize on MAS-Q and quality assurance certificates. However, it is of paramount importance for them to recognize the fact that accurate measurements, standards and conformity assessment are the prerequisites for them to increase their exports.

First, it is recommended that the Government of Kosovo put more emphasis on strengthening the Kosovo MAS-Q mechanism, by having qualified laboratories that test and certify products, improve conformity assessment bodies, and adopt quality standards and the like. Programs that encourage businesses to test and certify their products should be designed so that the link between MAS-Q and global trade, export, competitiveness and trade policy is understood by businesses.

Second, exporting firms will have to invest more in quality assurance and control certificates if they are to penetrate into international markets. Government institutions can also assist with this, either through a voucher scheme or a tax credit for trainings on quality assurance certifications. It is of paramount importance, especially for Kosovo's exporting firms, to adopt ISO standards to ensure their partners that their products, processes and services are competently developed and implemented, according to best international practices, and that they can provide credible proof of compliance.

ANNEX

Table 1. Sensitive but improving HS 2-digit chapters as identified in the SIA document

Rank	HS code	Name	Value (Euros)	Share in total imports %
1	27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	452,779,016.62	18.1668
2	84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	155,098,906.95	6.2230
3	39	Plastics and articles thereof	114,429,528.05	4.5912
4	22	Beverages, spirits and vinegar	57,899,831.77	2.3231
5	69	Ceramic products	57,082,854.78	2.2903
6	44	Wood and articles of wood; wood charcoal	53,674,015.65	2.1536
7	30	Pharmaceutical products	50,756,961.44	2.0365
8	25	Salt; sulphur; earths and stone; plastering materials, lime and cement	50,702,058.87	2.0343
9	94	Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; lamps and lighting fittings, not elsewhere specified or included; illuminated signs, illuminated nameplates and the like; prefabricated buildings	48,386,199.55	1.9414
10	19	Preparations of cereals, flour, starch or milk; pastry cooks' products	43,562,693.45	1.7479
11	48	Paper and paperboard; articles of paper pulp, of paper or of paperboard	40,131,035.45	1.6102
12	62	Articles of apparel and clothing accessories, not knitted or crocheted	29,011,625.79	1.1640
13	64	Footwear, gaiters and the like; parts of such articles	25,798,941.65	1.0351
14	32	Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring matter; paints and putty and other mastics; inks and varnishes;	25,433,406.39	1.0205
15	90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof	23,677,890.67	0.9500
16	8	Edible fruit and nuts; peel of citrus fruit or melons	23,388,920.62	0.9384
17	40	Rubber and articles thereof	23,133,078.22	0.9282
18	31	Fertilisers	20,631,660.92	0.8278
19	70	Glass and glassware	15,610,014.37	0.6263

20	11	Products of the milling industry; malt; starches; inulin; wheat gluten	13,294,230.24	0.5334
21	23	Residues and waste from the food industries; prepared animal fodder	12,749,306.12	0.5115
22	99	Other Products	12,400,508.43	0.4975
23	83	Miscellaneous articles of base metal	10,954,804.72	0.4395
24	57	Carpets and other textile floor coverings	8,515,537.36	0.3417
25	82	Tools, implements, cutlery, spoons and forks, of base metal; parts thereof of base metal	7,503,283.59	0.3011
26	96	Miscellaneous manufactured articles	4,358,709.49	0.1749
27	28	Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes	3,641,858.09	0.1461
28	35	Albuminoidal substances; modified starches; glues; enzymes	3,076,071.69	0.1234
29	3	Fish and crustaceans, molluscs and other aquatic invertebrates	1,775,435.10	0.0712
30	86	Railway or tramway locomotives, rolling stock and parts thereof; railway or tramway track fixtures and fittings and parts thereof; mechanical (including electromechanical) traffic signalling equipment of all kinds	1,768,499.37	0.0710
31	52	Cotton	1,632,815.52	0.0655
32	37	Photographic or cinematographic goods	1,355,343.11	0.0544
33	93	Arms and ammunition; parts and accessories thereof	1,346,266.14	0.0540
34	91	Clocks and watches and parts thereof	1,308,961.97	0.0525
35	60	Knitted or crocheted fabrics	650,271.50	0.0261
36	92	Musical instruments; parts and accessories of such articles	224,873.00	0.0090
37	89	Ships, boats and floating structures	141,581.76	0.0057
38	97	Works of art, collectors' pieces and antiques	100,656.56	0.0040
39	80	Tin and articles thereof	95,773.15	0.0038
40	13	Lac; gums, resins and other vegetable saps and extracts	95,229.76	0.0038
41	88	Aircraft, spacecraft, and parts thereof	91,307.01	0.0037
42	45	Cork and articles of cork	87,111.59	0.0035
			TOTAL	**56.01**

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