

What about Free Trade? Spotlight on Kosovo and SAA!

—
November 2018



GROUP FOR LEGAL
AND POLITICAL
STUDIES



GROUP FOR LEGAL
AND POLITICAL
STUDIES

Group for Legal and Political Studies

is an independent, non-partisan and non-profit public policy organization based in Prishtina, Kosovo.

Our mission is to conduct credible policy research in the fields of politics, law and economics and to push forward policy solutions that address the failures and/or tackle the problems in the said policy fields.

legalpoliticalstudies.org

Policy Analysis 09/2018

What about Free Trade? Spotlight on Kosovo and SAA!

Authors: Delfinë Elshani, Erëza Pula*

November 2018

© Group for Legal and Political Studies, November, 2018.

The opinions expressed in this document do not necessarily reflect those of Group for Legal and Political Studies donors, their staff, associates or Board(s). All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any mean without the permission. Contact the administrative office of the Group for Legal and Political Studies for such requests.

Group for Legal and Political Studies
"Rexhep Luci" str. 16/1
Prishtina 10 000, Kosovo
Website: www.legalpoliticalstudies.org
E-mail: office@legalpoliticalstudies.org
Tel/fax.: +381 38 234 456

* Senior Research Fellows, Group for Legal and Political Studies

INTRODUCTION

The European Union's Stabilisation and Association Process (SAP) was designed as a framework to engage with and pave the way for all the Western Balkan countries towards European integration. The main rationale behind the SAP, launched in 1999, was to provide a perspective for the Western Balkan countries as a driving force for a number of necessary reforms. It provided a detailed agenda for the liberalization of trade and financial support, as well as establishing contractual relations with EU member states. These culminated with the signing of the Stabilisation and Association Agreement (SAA), the backbone of the enlargement policy.¹

The process of signing the agreements between the European Communities and their Member States, on one hand, and Western Balkan countries, on the other hand, lasted for approximately 15 years, Kosovo being the last. Unlike the other Western Balkan countries that signed the SAA with all EU member states, Kosovo only signed an agreement with the Union itself. This was only possible after the Lisbon Treaty granted the EU legal personality and extended its competences to conclude international treaties within the scope of its competences.² At the same time, it facilitated bypassing the thorny issue of recognition, about which the EU remains divided.³ The agreement was signed in November 2015 and entered into force in April of the following year.⁴

The SAA, the first contractual agreement between Kosovo and EU, incorporates obligations for both parties towards its better implementation. This agreement intends to establish and liberalize trade relations with the EU, pinpoint political and economic values and objectives to enhance regional cooperation, and, amongst others, introduce financial opportunities and support for Kosovo. In addition, the SAA entails the commitment to implement a set of reforms, the enhancement of the regional collaboration by adjusting political and economical priorities, the implementation of an adequate institutional framework, and the approximation of the national legislation with the *acquis communautaire*. Regarding trade, it involves widespread trade liberalization with not only the EU but also with other countries in the region. Furthermore, the agreement introduces non-tariff liberalization through the alignment with EU directives regarding standards, certification, customs administration, and amongst others, competition.⁵

Even though the SAA encapsulates various pillars, this policy analysis aims to elaborate the potential positive and negative implications deriving from the Stabilisation and Association Agreement on Kosovo's economy. Thus, it is organized as following: Section II will elaborate further the trade relations of Kosovo with EU member states, CEFTA and other countries; Section III will analyze the potential positive and negative implications that the implementation of the SAA might

¹ Doyle, N. and Garcia Martinez, F.J. (2017) *Political Impacts of the Stabilisation and Association Agreements: A comparative*. Group for Legal and Political Studies Policy Report 06/2017. Prishtinë. Available at: <http://www.legalpoliticalstudies.org/wp-content/uploads/2017/10/Political-Impacts-of-the-SAAs-A-comparative-Study.pdf>

² Amadio Viceré, M.G. (2015) *Beyond the Intergovernmental-Supranational Divide in EU Foreign Policy: Insights from Kosovo*. Istituto Affari Internazionali (IAI). Working paper 15. Available at: <http://www.iai.it/sites/default/files/iaiwpl1501.pdf>

³ Palokaj, A. (2013) *Kosovo – EU Relations: The History of Unfulfilled Aspirations? Last opportunities in Kosovo's European integration process*. Kosovo Foundation for Open Society. Prishtinë. Available at: <https://kfos.org/wp-content/uploads/2013/04/Kosovo-EU-Relations-The-History-of-Unfulfilled-Aspirations.pdf>

⁴ Doyle at al. (2016) *Rule of Law Conditionality in the Stabilisation and Association Agreement between Kosovo and the EU*. Group for Legal and Political Studies Policy Report 03/2016. Prishtinë. Available at: <http://www.legalpoliticalstudies.org/wp-content/uploads/2016/11/Rule-of-Law-Conditionality-in-the-Stabilisation-and-Association-Agreement-between-Kosovo-and-the-EU-F.pdf>

⁵ Zahariadis, Y. (2017) *The Effects of the Albania-EU Stabilisation and Association Agreement: Economic Impact and Social Implications*. Economic and Statistics Analysis Unit Working Paper. Overseas Development Institute; London. Available at: <https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/2527.pdf>

have on Kosovo's economy; and the last sections provides a conclusion and policy recommendations.

TRADE RELATIONS

Kosovo has been running a negative trade balance for almost two decades, as shown by the unsatisfactory performance portrayed in the following table. In the first quarter of 2018 (January – April) exports decreased by 8 percent compared to the same period of 2017 whereas imports raised 8 percent compared to 2017.⁶ Furthermore, in 2017 the trade deficit reached €2,669.0 million, an increase by 7.62 percent compared to 2016. The negative trade balance has been steadily increasing; a consequence of the low production base and stagnant economic development, as exposed by the trend line in Fig 1. This high trade imbalance stems from a disproportional ratio of exports vis-à-vis imports. Put simply, Kosovo is importing ten times the value of its exports.

During the period from 2010 to 2017, exports gradually increased from €295,957 million to €378,010 million, a 27.7 percent increase. On the other hand, imports surged, from €2,157,725 million to €3,047,018 million, a 41.2 percent, further deepening the trade deficit, and thus leading to an even lower coverage ratio (value of exports to imports). The latter depicts the unfavorable economic state of Kosovo, where the highest coverage ratio was only 13.7 percent, recorded in 2010. At the same time, during the following 7 years period the average coverage ratio of exports to imports was 12.26.

Bearing in mind that trade, agricultural, and processing industry sectors account for 12.4, 10.7, and 10.3 percent of GDP, respectively, it can be assumed that the ever-growing imports have not been channeled towards incentivizing the industrial and agricultural production, generating phenomenon tied to economic development.⁷ This is also portrayed by the low average increase of industrial production of only 2.02 percent during the recent years.⁸ Thus, if imports continue to further increase whereas exports and the industrial base remain constant, the economy of Kosovo will be fueling its domestic consumption through imports, thus heavily relying on a service sector that currently accounts for more than 50% of the total GDP.

In addition, heavily depending on imports and having persistent trade deficits is not only a burden for the economic strength of the country but also the accumulated debt and the overall budget. On this note, the income structure of the state reflects the poor economic policies, which tend to rely mostly on the collection of custom revenues rather than other tax schemes.⁹

⁶ Kosovo Agency of Statistics (2018) Statistikat e Tregtisë së Jashtme Prill 2018. Prishtinë. Available at: <http://ask.rks-gov.net/media/4048/tregtija-e-jashtme-prill-2018.pdf>

⁷ Central Bank of Kosovo (2017) Financial Stability Report Number 11. Prishtinë. Available at: https://bqk-kos.org/repository/docs/2017/CBK_FSR_11.pdf

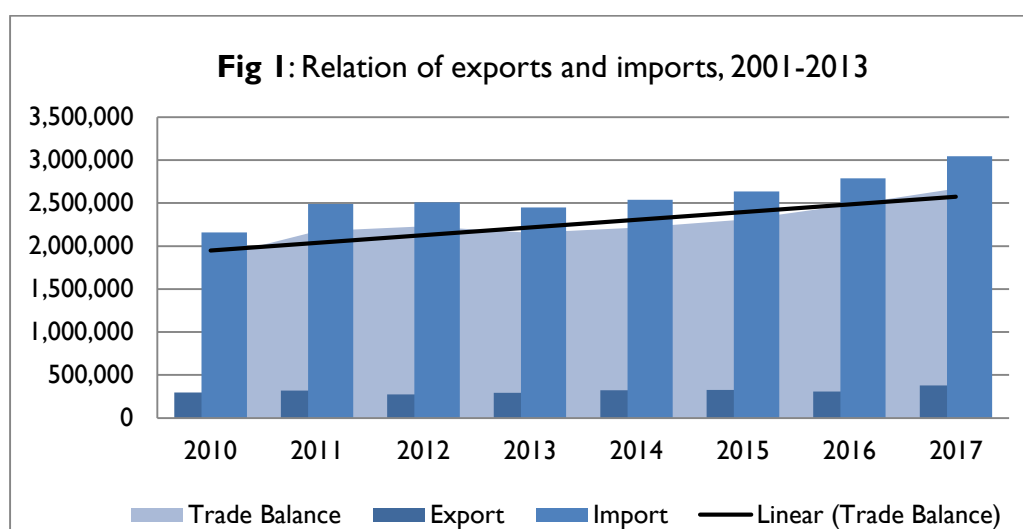
⁸ Trading Economics (2018) Kosovo Manufacturing Production 2013-2018. Available at: <https://tradingeconomics.com/kosovo/industrial-production>

⁹ Uka, F. (2016) The influence of complicated procedures on corruption stimulation in Kosovo Customs. UNDP. Prishtinë. Available at: <http://www.ks.undp.org/content/dam/kosovo/docs/actionpaper/Brendia%20ENG%20Web.pdf>

Table 1: Exports, imports and trade balance, 2010-2017

Year	Export	Import	Trade Balance	Coverage (%)
2010	295,957	2,157,725	(1,861,769)	13.7
2011	319,165	2,492,348	(2,173,184)	12.8
2012	276,100	2,507,609	(2,231,509)	11.0
2013	293,842	2,449,064	(2,155,221)	12.0
2014	324,543	2,538,337	(2,213,794)	12.8
2015	325,294	2,634,693	(2,309,399)	12.3
2016	309,627	2,789,491	(2,479,864)	11.1
2017	378,010	3,047,018	(2,669,008)	12.4

Source: Kosovo Agency of Statistics; Figures are in (000 €)



Trade balance, being one of the main components of GDP, has a direct positive relation to the county's GDP. Thus, the share of negative trade balance to total GDP, amounting to approximately 29 percent in 2016, constitutes an alarming indicator of the poor economic development of Kosovo.¹⁰ Nonetheless, this figure was even higher in 2011, reaching almost half of the GDP.¹¹ To illustrate the unfavorable trade situation in Kosovo, World Bank data shows that Kosovo has the highest negative trade balance to total GDP of the Western Balkans. The latest data (2016) reveal that the average trade deficit to total GDP in Western Balkans is 13.3, with Kosovo having the highest share (28.8) whereas Serbia has the lowest one (6.4). This shows that Kosovo imports the most compared to other WB countries in order to support its domestic consumption, another indicator of an almost non-existent production base. The persisting trade deficit in Kosovo is associated with a lack of adequate economic policies and infrastructure, insufficient local and foreign investments, low production base, and a weak rule of law.¹²

¹⁰ World Bank Group (2017) Western Balkans Regular Economic Report No.12. Washington. Available at: <http://documents.worldbank.org/curated/en/477511510774559876/pdf/121417-WP-PUBLIC.pdf>

¹¹ Pula, E. (2014) *The Trade Impact of the Kosovo-EU Stabilisation and Association Agreement: An assessment of outcomes and implications*. Group for Legal and Political Studies. Policy Report 03/2014. Prishtinë. Available at: <http://www.legalpoliticalstudies.org/wp-content/uploads/2014/01/The-Trade-Impact-of-the-Kosovo-EU-Stabilisation-and-Association-Agreement.pdf>

¹² Jusufi et al. (2015) Kosovo's International Trade: Balance of Trade. *European Journal of Economics and Business Studies*. Vol. 3 no. 1. Available at: http://journals.euser.org/files/articles/ejes_sep_dec_15/Gent.pdf; Pula, E., Elshani, E., and Loxha, A. (2016) *How 'friendly' is Kosovo for Foreign Direct Investments: A Policy Review of Gaps from a Regional Market Perspective*. Group

Regarding the exports and imports with specific countries, Table 2 depicts trade relations of Kosovo with EU member states, CEFTA, and other countries. During the period 2010 to 2017, Kosovo exported mostly to CEFTA countries, amounting to €930,155 million, or an average of €116,269 million per year. The main export partner in CEFTA is Albania, followed by Serbia, Macedonia and Montenegro. After the CEFTA region, the next destination for exports was the EU, amounting to €870,563 million, or €108,820 million per year. On this note, the main trading partners are Germany, Austria, The Netherlands, Italy and Bulgaria. The remaining balance, €721,823 million, is exported to other countries, including the EFTA, other European (Turkey and Ukraine), non-European (US, Canada, Brazil, and Mexico), and Asian countries (Japan, China, and India).

Table 2: Exports and Imports of Kosovo with EU member states, CEFTA and other countries

Year	EU member states		CEFTA		Other	
	Exports	Imports	Exports	Imports	Exports	Imports
2010	134,555	884,318	66,868	743,989	94,534	529,418
2011	139,440	1,010,619	80,323	809,904	99,402	671,826
2012	109,782	1,050,151	100,268	772,657	66,050	684,801
2013	118,422	1,083,163	104,503	676,320	70,917	689,582
2014	98,086	1,080,968	127,146	720,382	99,312	736,986
2015	106,052	1,112,892	123,747	769,366	95,495	752,434
2016	69,998	1,202,110	144,267	753,183	95,363	834,199
2017	94,228	1,312,241	183,033	856,100	100,750	878,676
Total	870,563	8,736,462	930,155	6,101,901	721,823	5,777,922

Source: Kosovo Agency of Statistics; Figures are in (000 €)

On the other hand, during the same period, Kosovo mostly imported goods from the EU member states worth €8,736,462 million, or an average of €1,092,058 million per year. In this case, the main importing partners include Germany, Italy, Greece, Poland and Slovenia. With regard to the CEFTA region, the total value of imports was €6,101,901 million or €762,738 million per year, coming mostly from Serbia, followed by Macedonia and Albania. The remaining balance, €5,777,922 million, is imported from other countries; EFTA, other European (Turkey and Ukraine), non-European (US, Canada, Brazil, and Mexico), and Asian countries (Japan, China, and India).

Regarding exports in general, table 3 depicts their classification by the SITC sections.¹³ During the 2010-2017 period Kosovo exported mostly these sections: processed goods, raw materials, other processed goods, food and livestock, fuel, and beverages and tobacco. The sectors that experienced a positive trend during the same period include prepared food, beverages, alcoholic beverages and tobacco; plastics, rubber and articles thereof; plant products; leather and articles thereof; and paper and articles thereof.¹⁴ In 2017, those that increased the most include articles of stone, plaster, products of ceramic and glass, plant products, prepared food, beverages, alcohol

for Legal and Political Studies. Policy Report 01/2016. Prishtinë. Available at: <http://www.legalpoliticalstudies.org/wp-content/uploads/2017/03/How-friendly-is-Kosovo-for-Foreign-Direct-Investments-Policy-Report-GLPS.pdf>

¹³ Standard International Trade Classification (SITC) – A classification developed by United Nations for advanced international comparability for foreign trade statistics.

¹⁴ Kosovo Agency of Statistics (2018) *Statistikat e Tregtisë së Jashtme 2017*. Prishtinë. Available at: <http://ask.rks-gov.net/media/4085/tregtija-e-jashtme-2017-shqip.pdf>

and tobacco, paper and articles thereof, and chemical industry products, by 81, 39.7, 33.4, 31, and 25 percent, respectively. At the same time, base metals and articles thereof, and mineral products, amounted for the highest share of total exports, with a respective 35.8 and 19.2 percent of the total. It should be noted that the increase in 2017 was partially attributed to the increase of metal prices in the international market leading to an overall increase of export value.¹⁵

Table 3: Exports according to SITC sections, 2010-2017

Year	2010	2011	2012	2013	2014	2015	2016	2017
Foods and livestock	18,710	17,552	19,843	20,723	25,472	24,341	26,756	35,241
Beverages and tobacco	5,368	8,097	10,264	13,387	12,498	15,981	16,979	24,194
Raw materials	73,944	81,108	77,711	73,836	77,617	56,117	68,934	92,537
Fuel	10,845	16,229	13,359	22,562	17,094	21,010	32,491	35,327
Plant and animal fats	100	45	59	45	19	41	9	179
Chemical products	2,426	4,174	5,803	8,139	10,249	12,681	15,419	18,836
Processed goods	165,993	168,766	123,441	129,437	153,876	153,781	104,522	117,416
Machinery and transport equipment	9,745	16,162	16,682	11,629	13,637	13,607	10,162	10,359
Other processed goods	8,735	6,902	8,912	13,941	14,027	22,367	34,184	39,786
Goods unclassified elsewhere	91	131	81	143	54	5,368	171	4,135

Source: Kosovo Agency of Statistics; Figures are in (000 €)

With regard to imports during 2010-2017 period, Kosovo imported mostly processed goods, machinery and transport equipment, foods and livestock, fuel, chemical products and other processed goods. During the same period, sections with the highest share of the total included mineral products, prepared foods, beverages, alcohol and tobacco, machinery, mechanical and electrical equipment, base metals and articles thereof, and, means of transport. Whereas imports which experienced an increase during 2017 consist of mineral products, means of transport, base metals and articles thereof, livestock and products of animal origin, and paper and articles thereof, by 35.2, 21.6, 11.5, 10.5, and 10.4 percent, respectively.¹⁶

¹⁵ Central Bank of the Republic of Kosovo (2018) *Raporti Vjetor 2017*. Prishtinë. Available at: https://bqk-kos.org/repository/docs/2017/BQK_RV_2017.pdf

¹⁶ Kosovo Agency of Statistics (2018) *Statistikat e Tregtisë së Jashtme 2017*. Prishtinë. Available at: <http://ask-rks.gov.net/media/4085/tregtija-e-jashtme-2017-shqip.pdf>

Table 4: Imports according to SITC sections, 2010-2017

Year	2010	2011	2012	2013	2014	2015	2016	2017
Foods and livestock	354,396	413,054	420,982	429,618	460,039	480,112	490,740	517,703
Beverages and tobacco	102,099	114,472	116,808	119,203	123,344.5	117,060.3	127,915.3	136,568.5
Raw materials	65,897	86,309	83,751	63,688	65,265	67,321	51,643	69,534
Fuel	339,225	452,498	457,935	412,309	400,123	337,415	279,241	381,268
Plant and animal fats	17,346	19,292	23,468	22,737	21,870	22,493	24.135	24,313
Chemical products	205,055	256,657	264,181	277,471	284,059	313,331	338,673	351,167
Processed goods	421,836	488,804	520,567	520,610	510,318	557,258	596,187	631,489
Machinery and transport equ.	439,861	422,316	411,112	385,376	417,933	466,853	566,450	620,804
Other processed goods	202,580	226,544	207,024	216,185	252,490	269,997	311,949	311,689
Goods unclassified elsewhere	9,432	12,401	1,779	1,866	2,894	2,854	2,560	2,482

Source: Kosovo Agency of Statistics; Figures are in (000 €)

Despite the fact that trade deficit of goods has negatively affected the economic growth during 2017, it should be noted that other categories of the current account have positively increased their balances, including services. The increasing trend of the WB data and forecasts shows that Kosovo has been enjoying a surplus in service exports, positively affecting trade balance during the recent years.¹⁷ The export of services amounted to €1,330.9 million, increasing by approximately 17.7 percent compared to 2016 whereas the import of services increased only by roughly 7.1 percent, reaching €526.8 million. As a result, Kosovo recorded a positive trade balance of services in 2017, €804.2 million. More precisely, the export of travel and computer services expanded, whereas that of construction and production services contracted.¹⁸ In line with the abovementioned statistics, this also points towards an unbalanced economic development, substantiating the idea of an economy based on a strong third sector unsupported by a solid industrial base.

POTENTIAL IMPLICATIONS OF THE SAA

Trade liberalization and creating outward-oriented economies have constituted a considerable part of the economic policy during the last decades, especially in developing countries. The General Agreement on Tariffs and Trade (GATT) of 1947 and the World Trade Organisation (WTO) of 1995 are considered crucial milestones of the free trade policy regime. The WTO, and GATT before it, contributed to substantially reduce and/or dismantle the major obstacles to trade, both tariffs and non-tariff barriers.¹⁹

There is plenty of literature analyzing the effects that a liberalized trade regime might have on various channels of economic development, especially on imports, exports, and trade balance. The majority claim that liberalized trade is more beneficial for the economy, mainly due to reduction of quotas and the elimination of non-tariff barriers, the access to a wider market, and, amongst others, positive spillover effects. On this note, the two most common scenarios on trade liberalization are trade diversion and trade creation. The latter happens when importing goods becomes cheaper than producing them domestically, while diversion happens when trade is diverted from a more efficient/high cost producer to a less efficient/low cost producer. Trade creation increases economic welfare of the country, whereas trade diversion might have both negative and positive effect on the economy.²⁰

Kosovo, for more than a decade, has moved towards a more liberalized trade through the Central European Free Trade Agreement (CEFTA), of which it is member since July 2007.²¹ Even prior to CEFTA, Kosovo enjoyed preferential treatment in trade by the EU since 2000, through the so-called the Autonomous Trade Measures (ATM), which granted duty-free access to the majority (90%) of

¹⁷ World Bank Group (2017) Western Balkans Regular Economic Report No.12. Washington. Available at: <http://documents.worldbank.org/curated/en/477511510774559876/pdf/121417-VWP-PUBLIC.pdf>

¹⁸ Central Bank of the Republic of Kosovo (2018) *Raporti Vjetor 2017*. Prishtinë. Available at: https://bqk-kos.org/repository/docs/2017/BOK_RV_2017.pdf

¹⁹ Santos Paulino, A. (2005) *Trade Liberalisation and Economic Performance: Theory and Evidence for Developing Countries*. The World Economy. Vol 28, no. 6

²⁰ Gauto, V.F. (2012) *An Econometric Analysis of Trade Creation and Trade Diversion in Mercosur: the Case of Paraguay*. Department of Applied Economics. University of Minnesota. Available at: <https://ageconsearch.umn.edu/bitstream/126864/2/Gautopaper.pdf>

²¹ GAP Institute (2011) *Kosovo in CEFTA: In or Out?* Policy Brief. Available at: http://www.institutigap.org/documents/72590_CEFTAEng.pdf

goods to the EU, positively affecting the exports.²² This scheme was upgraded once the SAA entered into force in April 2016. It will gradually liberalize trade between Kosovo and the EU, by transitioning to a barrier free regime in a five to ten years period for a number of goods and services that Kosovo currently produce or has the potential to produce, currently or in the mid-term. Furthermore, custom duties for some products were eliminated immediately after the agreement entered into force.²³

In order to reap all the benefits stemming from the SAA, Kosovo has to undertake a number of reforms, including technical and quality requirements, product compliance, and unification of standards. Moreover, given the narrow production base and the underdeveloped private sector, the main focus of the institutions should be on restructuring the domestic market, improving business climate, pinpointing comparative advantages, and enhancing innovation, all of these being main driving forces of exports.²⁴ On this note, EU representatives, as well as governmental officials, have repeatedly claimed that the successful implementation of the agreement strongly depends on efficient institutions and a functional administration, as well as a comprehensive commitment not only from state institutions but also from other interlocutors, amongst others, civil society and business community.²⁵ This said, like every free-trade agreement between countries, the implementation of the SAA for Kosovo incorporates various positive and negative implications.

a) Positive Implications

Financial and Technical Assistance: Since the aftermath of 1999, the European Union played a crucial role in reconstruction and development. One of the many advantages of that engagement has been the financial and technical assistance offered to Western Balkan countries, tailored specifically for reconstruction. Kosovo has been able to benefit from various trade concessions, economic assistance through various schemes, most notably the Instrument of Pre-Accession Assistance (IPA), initiatives like the Stabilisation and Association Agreement, and various grants for economic development to the industrial and agricultural sectors.²⁶

The financial and technical assistance is crucial towards socio-economic development and institutional building, and play a paramount role in the successful and proper implementation of specific reforms related to education, development of trainings, promotion of SMEs, stabilisation of the macro-economic state, and, amongst others, the development of the banking and financial sector.²⁷

²² Pula, E. (2014) *The Trade Impact of the Kosovo-EU Stabilisation and Association Agreement: An assessment of outcomes and implications*. Group for Legal and Political Studies. Policy Report 03/2014. Prishtinë. Available at: <http://www.legalpoliticalstudies.org/wp-content/uploads/2014/01/The-Trade-Impact-of-the-Kosovo-EU-Stabilisation-and-Association-Agreement.pdf>

²³ Simnica, M. (2016) *Benefits of Stabilisation and Association Agreement in Agriculture (Case Study)*. Ministry of Trade and Industry. Division for Trade Agreements / Department of Trade. Available at: <https://mti.rks-gov.net/desk/inc/media/7D516E89-938A-4D47-AC19-5A52F9E15748.pdf>

²⁴ Gashi, P. and Pugh, p. (2015) *Kosovo's Trade with the European Union: Looking beyond the Stabilisation and Association Agreement*. Kosovo Foundation for Open Society. Prishtinë. Available at: http://kfos.org/wp-content/uploads/2015/04/Determinants-of-Kosovo-EU-trade-relations_FINAL.compressed.pdf

²⁵ Panel Discussion (2016) *EU Talks: What is the impact of the Stabilisation and Association Agreement (SAA) on the country's local economy?* EU Information and Cultural Center Kosovo. Available at: <http://euicc-ks.com/monthly-event/eu-talks-what-is-the-impact-of-the-stabilisation-and-association-agreement-saa-on-the-countrys-local-economy/>

²⁶ European Union Office in Kosovo European Union Special Representative in Kosovo (2016) *An overview of relations between the EU and Kosovo*. Available at: https://eeas.europa.eu/delegations/kosovo_en/1387/Kosovo%20and%20the%20EU

²⁷ Gashi, P. and Pugh, p. (2015) *Kosovo's Trade with the European Union: Looking beyond the Stabilisation and Association Agreement*. Kosovo Foundation for Open Society. Prishtinë. Available at: http://kfos.org/wp-content/uploads/2015/04/Determinants-of-Kosovo-EU-trade-relations_FINAL.compressed.pdf

Market Access: One of the most tangible benefits of the European Integration process is access to the European Internal Market, one of the largest trade blocs in the planet.²⁸ Market integration offers key opportunities for any economy, including the increase in export capabilities and firm opportunities, market convergence, free trade, abolishment of trade barriers, and enhanced administrative and institutional capacities stemming from the need of implementing a complex set of institutional reforms.²⁹ In the long run, the agreement is expected to positively impact trade and economic development as Kosovar firms gain an easier access to the internal market, thus producing a gradual increase of exports over the years. According to a survey conducted by Kosovo Chamber of Commerce, 33 percent and 26 percent of the respondents (businesses operating in Kosovo) stated that the SAA positively affected them in finding new business partners, and stimulating and increasing exports, respectively. Moreover, the results suggest that the agreement has facilitated businesses' access to technology and investment opportunities, as well as access to knowledge spillover.³⁰ Another survey conducted with local firms' showed that the agreement positively affected the exporting capacities of 14 percent of local firms, whereas 86% of them were already exporting to the single market before the agreement was signed.³¹

The implementation of the SAA also provides benefits for the business community. The industrial and agricultural products will be exported to the EU without (zero) custom tariffs. Nonetheless, certain quotas remain, for instance trout and carp are exempted from custom tariffs up to 15 and 20 tons per year, respectively. Similarly, the wine export quota has increased from 20,000 hectoliters to 50,000 hectoliters.³²

Production Capacities: Trade liberalization with the EU has the potential to generate a capital and investment inflow that can fuel the creation of new job opportunities, economic growth, and social welfare. On this note, the European Commission has foreseen to invest in Kosovo around €600 million by 2020, through the Instrument for Pre-Accession (IPA) funds. Therefore, experts on the field as well as local producers perceive that the inflow of funds will positively impact and expand production and processing capacities of local producers. Moreover, an owner of a local company engaged in the production of soft and energy drinks claims that the implementation of the SAA has eased the penetration and placement of these products in some EU countries, as well as other countries in the region.³³

Positive Spillover Effects: The implementation of the Stabilisation and Association Agreement will offer a wide range of possibilities for Kosovar firms, businesses, and producers. First, it will open new opportunities for businesses in the EU, which in turn allows for greater access to technology and expertise, exchange of knowledge and ideas, a wider range of products, and more qualitative and cheaper consumer goods. Second, the SAA expands trade and investment opportunities for local producers, increases competition and thus the need for innovation and a more advanced technology to keep up with the latest developments. Third, free trade enables local producers to

²⁸ Also called Single or Common market. All three terms are used interchangeably.

²⁹ Qorraj, G. and Jusufi, G. (2018) The EU Stabilisation and Association Agreement for the Western Balkans: Between Challenges and Opportunities. *Croatian International Relations Review – CIRR*. pp. 51-68.

³⁰ Ceni, O. (2018) "SAA impact on trade". [Email]. Message to: Pula, E. and Elshani, D. 20th June 2018

³¹ Qorraj, G. and Jusufi, G. (2018) The EU Stabilisation and Association Agreement for the Western Balkans: Between Challenges and Opportunities. *Croatian International Relations Review – CIRR*. pp. 51-68.

³² Dervisholli, S. (2018). "SAA impact on trade". [Email]. Message to: Pula, E. and Elshani, D. 22th June 2018

³³ Veseli, L. (2016) Zbatimi i MSA-së ulë për 10 milionë euro të hyrat doganore. Radio Evropa e Lire. Available at: <https://www.evropaelire.org/a/27934141.html>. [Accessed 10 June, 2018].

connect with global value chains and attracts foreign direct investors (FDI). These prospects in turn contribute to create new job opportunities, alleviate poverty, and improve the citizens' welfare.³⁴

b) Negative Implications

Lower custom revenues: One of the main effects of the SAA on the domestic economy will be the decline of custom revenues, as imported products originating in the European Union will be exempted from customs duties.³⁵ More precisely, custom duties of more than 1044 agricultural and 487 fishery products imported from the EU were lifted, whereas those of industrial imports will be gradually phased out over a transitional period of 10 years.³⁶ According to Kosovo Customs, the decline in revenues stemming from the SAA has been accelerating since it entered into force. In 2016 custom revenues decreased by €16.45 million, which would become €31.84 in 2017.³⁷ In the first half of 2018 alone this lost income amounted to €21 million, a 46.3 percent more than in the same period the previous year.³⁸ The negative impact of the SAA on custom revenues had already been forecasted also by various institutions. According to Ministry of Finance and Kosovo Customs, the estimated losses during the first year of SAA implementation would be roughly €24 million.³⁹ Moreover, World Bank estimates in 2015 have foreseen that around 70 percent of custom revenues will be impacted by SAA implementation.⁴⁰ Given Kosovo's budget is highly depended on custom revenues, the decrease in collection due to SAA will create budget gaps which should be substituted through other income channels, such as domestic revenues. This implies that tax administration in Kosovo should be more rigorous towards collecting taxes and consequently substituting these budget losses. This could be achieved through: a) strengthening capacities of the judicial and tax administration to reduce tax evasion; b) creating incentives for firms and employees to increase tax collection and reduce informal economy; c) drafting policies to strengthen private sector and domestic production, thus tax revenue collection.

Table 5: The negative impact of SAA on custom revenues (in millions)

Year	2016	2017	2018 (Jan-June)
Lower custom revenues	16.45	31.84	21

Source: Kosovo Customs Report 2017

³⁴ Ministry of Trade and Industry (2017) *Efektet e Marrëveshjes së Stabilizim Asociimit Kosovë - BE: Ndikimi në Tregti*. Prishtinë. Available at: <https://mti.rks-gov.net/desk/inc/media/6A8CE0E5-202D-4C98-92B1-153E4353C9A7.pdf>; Dervisholli, S. (2018). "SAA impact on trade". [Email]. Message to: Pula, E. and Elshani, D. 22th June 2018

³⁵ Ceni, O. (2018) "SAA impact on trade". [Email]. Message to: Pula, E. and Elshani, D. 20th June 2018

³⁶ U.S. Department of Commerce. (2017). *US Country Commercial Guides: Kosovo*. International Trade Administration. Available at: <https://xk.usembassy.gov/wp-content/uploads/sites/133/2017/08/KosovoCCG2017.pdf>

³⁷ Kosovo Customs. (2018). *Raporti Vjetor 2017*. Prishtinë. Available at: <https://dogana.rks-gov.net/wp-content/uploads/2018/04/Raporti-vjetor-2017-alb.pdf>

³⁸ Kosovo Customs. (2018) Lajme: Dogana kalon 500 milion euro të hyra doganore në gjashtë mujorin e parë të vitit. Available at: <https://dogana.rks-gov.net/dogana-kalon-500-milion-euro-te-hyra-doganore-ne-gjashte-mujorin-e-pare-te-vitit/> [Accessed 5 July 2018].

³⁹ Simnica, M. (2016) *Benefits of Stabilisation and Association Agreement in Agriculture (Case Study)*. Ministry of Trade and Industry. Division for Trade Agreements / Department of Trade. Available at: <https://mti.rks-gov.net/desk/inc/media/7D516E89-938A-4D47-AC19-5A52F9E15748.pdf>

⁴⁰ Ramaj, Rr. (2016) *Kosovo Customs Earnings Rise Despite SAA*. Balkan Insight. Available at: <http://www.balkaninsight.com/en/article/saa-costs-kosovo-customs-its-first-5-million-euros-06-27-2016> [Accessed 25 June 2018].

Decrease in exports: Although some countries such as Serbia, Bosnia, and Macedonia expanded their exports - hence their market share in the EU - due to a higher production base, other Western Balkan countries thus far have recorded an unsatisfactory integration into the internal market. Yet, Kosovo's goods and services exported account for only 19% of GDP, suggesting an insufficient and poor integration into the common market.⁴¹

When analyzing data before and after the entrance into force of the SAA, the results show a negative trend of total exports to the single market. More precisely, when comparing the period April - December of 2015 and 2016, the latest data reveal that the total exports decreased by €26.8 million or roughly 34 percent. Nonetheless, the trade exchange between Kosovo and EU in total increased by approximately 3 percent. The decrease in exports after the SAA entered into force could be argued on different grounds. First, Kosovo has been facing various difficulties to comply with international standards which improve the quality of products to be exported. Enhanced quality of products is paramount for Kosovar businesses which aim to penetrate and survive in the EU market. Second, it lacks institutional experience and know-how to support the export of domestic products and services. Third, local producers lack necessary state assistance to license and standardize their products, and comply with conformity assessments. This poses challenges for them to achieve standards in the field of product and service management, and quality.

Table 6: Exports and Imports 2015-2016 (in millions)

Period	April – December 2015	April – December 2016	% Change
Exports	78.9	52.1	33.96 ↓
Imports	907.2	962.5	6.09 ↑

Source: Ministry of Trade and Industry

To illustrate some of the challenges of local producers, it is worth noting that products of animal origin are unable to be exported to EU markets, since Regulation no. 206/2010 did not include Kosovo as a suitable country for specific exports of such products. This can be considered a worrying fact given the signing of the SAA might not bring the desired benefits if Kosovo still faces exports restrictions for certain products. On the other hand, EU products will be fully liberalized over a period of 5, 7, and 10 years.⁴²

Inability to compete in the EU market: Evidence has shown that small firms in Western Balkan countries are unable to compete in the common market due to high transaction and adaption costs, limited capabilities and lack of adequate cooperation with EU firms. The current economic state of Kosovo is characterized with weak rule of law and enforcement mechanisms, unfavorable business climate, and above all, widespread corruption and weak contract enforcement. On this note, additional impediments for the private firms operating in Kosovo include lack of qualitative infrastructure such as electricity, transports, and amongst others, logistics, and the high costs

⁴¹ World Bank Group (2015). *Western Balkans: Regional Economic Integration Issues Notes*. Washington DC. Available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/28316/1/17236-REVISED-x-WB-Regional-Economic-Integration-Issues-Notes-5-July-2017.pdf?sequence=1&isAllowed=y>

⁴² Dervisholli, S. (2018). "SAA impact on trade". [Email]. Message to: Pula, E. and Elshani, D. 22th June 2018

related to it.⁴³ Adding to those, Kosovo faces several other challenges such as delays in the implementation of the SAA, lack of specialized human resource and production capacities, low access to financial means, and regional political disputes.⁴⁴

Consequently, unless a more favorable economic environment is created, an uneasy endeavor that requires both public and private initiatives, trade liberalization might not bear fruit.⁴⁵ The benefits steaming from trade liberalization are usually conditioned by supply factors, and even though Kosovo's production base has been low, the commitment and dedication of local producers will provide better and new opportunities of trade, hence an expanded production base. Thus, in order for businesses and producers to attain the desired results, higher skills and more apt competences are necessary, which entails appropriate policies on education; also, a more advanced infrastructure is necessary, and amongst others, financial stability is essential.⁴⁶

Inability to comply with international standards: Since the SAA foresees substantially higher market openness; the increased competition also means raised costs for local producers to ensure compliance with the required standards, such as technical requirements, sanitary and phytosanitary standards, and even quality standards. Consequently, it is debatable whether Kosovar producers and businesses will be able to fully benefit from access to the single market.⁴⁷ On this note, similar problems appeared during the implementation of the CEFTA agreement, when difficulties encountered during the harmonization with international trade standards prevented enjoying the full benefits of the agreement. There is a perception that the situation has worsened after the entrance into force of the SAA, as 21.3 percent of the businesses surveyed by the Kosovo Chamber of Commerce stated that Kosovo producers are encountering problems to comply with international standards.⁴⁸ According to the Kosovo Chamber of Commerce representatives, Kosovar producers encounter various challenges mainly in the field of product quality management; yet, those companies that targeted the European market have already met such standards and managed to export their products.

Furthermore, there are various trade costs related to regulatory and compliance burden, as well as border crossing issues which diminish the competitive ability of Kosovar businesses/producers compared to other CEFTA countries (which largely subsidize the export). According to World Bank, Kosovo has the highest exporting costs among Western Balkan countries, which mainly stem from compliance and regulatory burdens. More precisely, the border and documentary compliances last for 42 and 38 hours, respectively, whereas the same procedures for other Western Balkan

⁴³ World Bank Group (2015). *Western Balkans: Regional Economic Integration Issues Notes*. Washington DC. Available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/28316/1/17236-REVISED-x-WB-Regional-Economic-Integration-Issues-Notes-5-July-2017.pdf?sequence=1&isAllowed=y>

⁴⁴ Qorraj, G. and Jusufi, G. (2018) The EU Stabilisation and Association Agreement for the Western Balkans: Between Challenges and Opportunities. *Croatian International Relations Review – CIR*. pp. 51-68.

⁴⁵ Muja, A. and Mahmudi B. (2015). *Përmbledhje e Shkurtër mbi Tregtinë Dimensioni Tregtar i MSA-së me BE-në dhe Ekonominë e Kosovës*. Ministria e Tregtisë dhe Industrisë. Available at: <https://mti.rks-gov.net/desk/inc/media/6B1569D5-3C27-431B-98C7-6E6AAB786E3D.pdf>; Telegrafi (2018) *Kosova nuk ka çka të eksportoje në vendet e BE-së*. Available at: <https://telegrafi.com/kosova-nuk-ka-cka-te-eksportoje-ne-vendet-e-se/> [Accessed 15 June 2018].

⁴⁶ Dervisholli, S. (2018). "SAA impact on trade". [Email]. Message to: Pula, E. and Elshani, D. 22th June 2018

⁴⁷ Qorraj, G. and Jusufi, G. (2018) The EU Stabilisation and Association Agreement for the Western Balkans: Between Challenges and Opportunities. *Croatian International Relations Review – CIR*. pp. 51-68.

⁴⁸ Kosovo Chamber of Commerce (2018) *Paving the Way for Better Business in Kosovo: What are the growth obstacles for businesses in Kosovo?* Edition 4. Available at:

https://www.oek-ccc.org/uploads/files/2018/May/24/2014_PAVING_THE_WAY_FOR_BETTER_BUSINESS_IN_KOSOVO1527160952.pdf

countries last, on average, for 7 and 4 hours.⁴⁹ In addition, the transit problems with Serbia further increase the trade costs, as reflected in the final price of local products, which in turn cannot be equally competitive with products of other countries.⁵⁰

CONCLUSION

The Stabilisation and Association Agreement represents an important milestone for Kosovo's economy and the business community. SAA, the first contractual agreement with the EU, facilitates the access of businesses to one of the largest trading blocks. Beyond trade, the SAA provides many other positive advantages. It offers a wide range of opportunities to overcome the current obstacles hindering economic development by increasing productivity, reducing trade barriers, enhancing competitiveness and market penetration, attracting foreign investments, and increasing exports. All the legislative requirements, compliance standards, and technical conditions stemming from the SAA pave the way to a more sustainable and transparent environment for trade and market development, including public procurement, competition policy and, intellectual property.

Nonetheless, the Stabilisation and Association Agreement entails also many risks whose effects on economic development should be carefully analyzed during the short, mid and long term dimensions. As elaborated, one of the immediate economic effects of the implementation of the agreement is the burden on custom revenues as a result of the (gradual) exemption of duties for imported products from the EU; mid-term, the inability of businesses and products to compete in the single market due to an inferior quality and higher transaction costs reduces to a large degree the benefits of free trade; and, amongst others, the inability of local producers and business community to comply with standards, technical and legislative requirements all contribute toward higher export costs.

Kosovo faces a very fragile economic state characterized by an unfavorable business climate, weak rule of law and enforcement mechanisms, widespread corruption, a lack of skillful workforce, limited access to finance, and weak contract enforcement. Therefore, in order to be able to reap all the benefits deriving from the Stabilisation and Association Agreement, all stakeholders should dedicate their capacities and resources to comply with all the requirements of the SAA. More precisely, Kosovo should focus on:

- developing the private sector as one of the main drivers of economic development;
- improving the business climate in order to attract domestic and foreign investors, especially export oriented ones;
- offering financial and technical support to local producers in order to increase their competitiveness, and thus the Kosovar share in the single market;
- enhancing cooperation between the institutions and the business community and producers to expedite reaching sufficient quality standards, adopting technical requirements and ensuring product compliance;
- improving the quality of institutions in order to ensure an effective justice system and rule of law in fighting corruption;

⁴⁹ World Bank Group (2015). *Western Balkans: Regional Economic Integration Issues Notes*. Washington DC. Available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/28316/1/17236-REVISED-x-WB-Regional-Economic-Integration-Issues-Notes-5-July-2017.pdf?sequence=1&isAllowed=y>

⁵⁰ Ceni, O.(2018) "SAA impact on trade".[Email]. Message to: Pula, E. and Elshani, D. 20th June 2018

- adopting the legislative framework to enhance the quality infrastructure regarding the standardization, accreditation, conformity assessment, and market surveillance;
- strengthening the Tax Administration to increase the collection of taxes from the existing tax scheme;
- adopting economic policies which rely more on other income generating channels rather than custom revenues;
- adopting policies in increasing competitiveness and productivity not only of the producers and business community, but of the entire economy; and,
- offering institutional support to enhance the absorption rate of the IPA funds, especially in the following sectors: competitiveness and innovation, agriculture and rural development, regional and territorial cooperation, and, education, employment and social policies.

Policy Analysis

Policy Analysis in general is a policy advice paper which particularly aims to influence the key means through which policy decisions are made in both local and central levels of government. The purpose of Policy Analysis is to address, more in-depth, a particular problem, to examine the arguments related to a concerned policy, and to analyze the implementation of the policy. Through Policy Analysis, Group for Legal and Political studies seeks to stimulate wider comprehensive debate on the given issue via presenting informed policyrelevant choices and recommendations to the key stakeholders and parties of interest.



**GROUP FOR LEGAL
AND POLITICAL
STUDIES**

legalpoliticalstudies.org