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Business Climate
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AgCLIR: KOSOVO

Commercial Legal and Institutional Reform
Diagnostic of Kosovo's Agriculture Sector



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of Kosovo's Agriculture Sector

March 2010



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LIST OF ACRONYMS

ABA	American Bar Association
ADR	Alternative Dispute Resolution
AKB	Alliance of Kosovo Businesses
AMCHAM	American Chamber of Commerce of Kosovo
AMIK	Association of Microfinance Institutions of Kosovo
BizCLIR	Business Climate Legal and Institutional Reform Project
CBK	Central Bank of the Republic of Kosovo
CEFTA	Central European Free Trade Agreement
CFF	Crimson Finance Fund
CISG	UN Convention on Contracts for the International Sale of Goods
DCA	Development Credit Authority
DTI	Department for Trade and Industry
EC	European Commission
ECIKS	Economic Initiative For Kosovo
EU	European Union
FBO	Farmer Based Organization
FDI	Foreign Direct Investment
FIC	Foreign Investment Council
FII	Foreign Investment Institution
FSMNS	Federal-State Market News Service
GDP	Gross Domestic Product
GoK	Government of Kosovo
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HACCP	Hazard Analysis and Critical Control Point
ICC	International Criminal Court
ICSID	International Centre for Settlement of Investment Disputes
IMF	International Monetary Fund
IPAB	Investment Promotion Advisory Board
IPAK	Investment Promotion Agency of Kosovo
IPH	Institute of Public Health
IPO	Industrial Property Office
IPPC	International Plant Protection Convention

JSC	Joint Stock Company
KBA	Kosovo Bankers Association
KCA	Kosovo Cadastral Agency
KCA	Kosovo Chamber of Advocates
KCC	Kosovo Chamber of Commerce
KEPA	Kosovo Environmental Protection Agency
KPA	Kosovo Property Agency
KTA	Kosovo Trust Agency
KVFA	Kosovo Veterinary and Food Agency
LC	Letter of Credit
LDK	Democratic League of Kosovo
LLC	Limited Liability Company
MAFRD	Ministry of Agriculture, Forests and Rural Development
MCO	Municipal Cadastral Offices
MESP	Ministry of Spatial Planning
MFI	Microfinance Institution
MOU	Memorandum of Understanding
MTEF	Medium Term Expenditure Framework
MTI	The Ministry of Trade and Industry
NBFI	Non-Bank Financial Institution
NGO	Non-Governmental Organization
NTB	Non-Tariff Barrier
NWFP	Non-Wood Forest Product
OSCE	Organization for Security and Co-operation in Europe
PAK	Privatization Agency of Kosovo
PDK	Democratic Party of Kosovo
POF	Purchase Order Financing
SEE	South Eastern Europe
SOE	Socially Owned Enterprise
SOK	Statistical Office of Kosovo
SPS	Sanitary and Phytosanitary Standards
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNMIK	Interim Administration Mission in Kosovo
UPFL	University of Pristina Faculty of Law
USAID	United States Agency for International Development
VAT	Value Added Tax
WCO	World Customs Organization
WTO	World Trade Organization



INTRODUCTION

This report addresses the conditions and opportunities for doing business in Kosovo's agricultural sector. Through close examination of the relevant policies, laws, institutions, and social dynamics, it aims to inform assistance decisions by the U.S. Agency for International Development (USAID) and other donors in the area of agricultural development in Kosovo. The insight it provides may also be useful for government officials, private sector representatives, and others involved in the Kosovo agricultural sector.

SOWING NEW SEEDS FOR ECONOMIC GROWTH

Kosovo is poised between agricultural success and failure. On the one hand, growth in agricultural commodities such as peppers and potatoes has been steadily improving. There is also an evident desire in most corners of society, government, and the donor community to pursue agriculture as a means for growth. On the other hand, the growth that has been achieved is clearly not enough. As Kosovo's population grows, domestic agricultural production is not keeping pace with the population growth, contributing materially to the enormous trade imbalance. Stakeholders agree that some parts of the system function poorly, but disagree on the degree of dysfunction. Some posit that entire value chains have collapsed, while others suggest that Kosovo suffers only from minor regulatory failures.

The good news is that agribusiness is happening, often in spite of barriers caused by political, cultural, regulatory, and capacity issues. Rapid response to real issues is now the critical challenge. Whether targeted reforms are prioritized and implemented will determine the trajectory of growth for Kosovo's agricultural sector.

After nine years of United Nations interim administration, countless donor interventions, and two years of independence,¹ Kosovo is a hodgepodge of laws, regulations, and initiatives that provide some solid foundations but have

not yet congealed into the systemic maturity required for substantial commercial progress. This is, to a degree, understandable in a country that has been both the victim of recent war and the subject of subsequent administrative and regulatory experimentation by the United Nations and other international organizations. Kosovo is ready to put the lessons of the past decade to use in building a new economy based on both existing and new products, services, and technologies. The keys to success lie in bringing together the right mix of regulatory facilitation; support institutions for small-holder farms and SME Processors/distributors; and more sophisticated relationships in all stages of the value chain.

The challenges are considerable. To name a few: unemployment hovers around 40 percent; because of political issues no census has been done in more than 20 years; Kosovo's customs stamps are not recognized by many of its neighbors; foreign direct investment hovers near zero; electricity comes and goes with little predictability; and credit is often not meaningfully available where it needs to be.

Recent assessments of Kosovo's economy have been highly critical. Officially ranking Kosovo for the first time, the World Bank *Doing Business* report² puts the country at 113 out of 183 countries assessed—slightly better than Bosnia-Herzegovina and the Russian Federation; but, in some critically important areas, such as

1 At the time of publication, Kosovo is recognized as independent by 63 countries, including the United States. While it has gained World Bank membership, it remains unrecognized by the United Nations, is not yet a member of most major organizations, and is not yet in the World Trade Organization accession process.

2 Available at <http://www.doingbusiness.org/>.

Protecting Investors and Enforcing Contracts, Kosovo produced some of the worst scores in the world, placing it with such countries as The Gambia and Guinea.

Similarly, the European Commission's Kosovo Progress Report for 2009³ criticizes almost all efforts made in the area of economic growth except the basic legal framework, pointing out that the good news of 5.5 percent growth in 2008 was based mostly on increased consumption and government procurement expenditures. These are in turn fueled by Diaspora remittances and donor contributions. Other serious issues raised include the dramatic trade imbalance due to, again, increased consumption of imported products and plummeting exports, the high cost of finance, generally weak rule of law, corruption, and uncertain property rights.

On the bright side, there are a number of positive natural characteristics and new developments in Kosovo that present big opportunities. As suggested above, *agribusiness is happening*. The traditional supply, distribution, trade routes and mechanisms are operating, albeit deeply weakened by political issues and donor behavior that neglects substantial regional interdependence in favor of independent country-specific approaches. In any case, these are foundations upon which to build.

Additionally, Kosovo's young population⁴ values education. Nevertheless, the weak structure and the tragic lack of resources put into strengthening education, especially skilled vocational education, is a tremendous impediment.

Ultimately, Kosovo's success in the highly competitive agriculture sector will be hard won and will come incrementally over time. With a comprehensive approach tailored to the sector, Kosovo's competitive advantages should be easier to leverage. Critically, Kosovo's recent independence has brought an opportunity and motivation for positive change that delivers reform in every aspect of agriculture.

Finally, recent municipal elections indicated some of the national and regional healing process that has gained energy with each passing year. Turnout in the minority communities, typically near zero in the past, was upwards of 25 percent in most places.⁵ The figures for the minority enclaves still lag behind the rest of Kosovo, but progress is visible.

These and other challenges and opportunities will be discussed in detail below through the specific lens of agribusinesses. Through deep analysis of five discrete areas, the AgCLIR assessment will afford a good look at the state of agribusiness as it is influenced by laws, institutions, and the practical reality of business in Kosovo. It will offer prioritized solutions with an eye towards holistic rather than narrow solutions.

This diagnostic is organized so that five components of a healthy and prosperous environment for agricultural enterprise are considered individually and in relation to each other where appropriate. Certain issues and dynamics, however, are so prevalent across this analytical framework that they warrant special mention. Some may seem obvious at first glance, but a closer reading should lead to some new insights. These cross-cutting themes include the following:

1. Corruption
2. The lack of information and dialogue
3. The region's race to Europe
4. General legal uncertainty
5. Donor dogma

In the next several pages, AgCLIR Kosovo introduces the reader to the AgCLIR methodology, provides a summary of the findings, and outline the crosscutting themes.

AgCLIR: A TOOL FOR UNDERSTANDING OBSTACLES TO START-UP AND GROWTH OF AGRIBUSINESS

In 2007, incorporating lessons learned from its first-generation legal, institutional, and

3 Available at http://www.euractiv.de/fileadmin/images/Kosovo_Fortschritt_sbericht_2009_en.pdf.

4 Approximately 70% under the age of 35, and 50% under 25.

5 The unfortunate exception being the minority-dominated northern portion of Kosovo, where turnout was very poor.

trade diagnostic tool called CLIR, USAID sponsored the redesign of CLIR through its Business Climate Legal and Institutional Reform (BizCLIR) project.⁶ The BizCLIR focus areas were designed to align with the World Bank's enormously influential *Doing Business* country reports. Based on the *Doing Business* analytical structure, BizCLIR employs a multi-indicator, diagnostic process that closely examines 10 different topics. At the request of USAID Kosovo, this report covers 5 of the 10 *Doing Business* categories: Registering Property, Getting Credit, Protecting Investors, Trading Across Borders, and Enforcing Contracts.⁷ *Doing Business* is a useful tool for identifying the ease of certain legal and regulatory processes necessary for the private sector to engage in the global economy; it provides vital information for potential investors as well as motivation for the assessed country to make important reforms. It does not, however, provide a deep analysis of the business environment that would lead to a detailed roadmap to reform. For each of the topics it covers, *Doing Business* considers a few key indicia of whether and how the environment for enterprise is "working," measured by such means as the number of procedures involved in achieving a goal (for example, to legally transport goods across borders or to enforce a contract), the number of days it takes, and the

costs of the procedures in relation to per-capita income. *Doing Business* now gathers data from 183 countries and ranks each, thereby demonstrating how their respective regulatory environments compare to others throughout the world. In the most recent *Doing Business* report, issued in September 2009, Kosovo ranked 113 out of 183 countries surveyed.⁸

USAID's BizCLIR initiative takes most of the *Doing Business* topics and delves deeper into their respective legal frameworks, implementing institutions, supporting institutions, and social dynamics. That is, after *Doing Business* delivers a key "snapshot" of the conditions for enterprises in 183 countries, BizCLIR subjects the same issues to an expanded analysis of factors feeding in to these essential findings and then reports on the entire, more complex scenario. BizCLIR seeks to understand the important contextual differences among countries, and identifies strengths and weaknesses within economies that provide key opportunities for long-term development. A summary of the BizCLIR methodology, including its use of a comprehensive set of indicators, is provided in an appendix to this report.

Recognizing that economic growth in many developing countries turns significantly on the agricultural sector, this diagnostic shifts the BizCLIR focus on economies generally to the specific and critical issues pertaining to agriculture. The focus on agriculture stems from the assertion in recent years that GDP growth in agriculture delivers more than twice the impact in reducing poverty as growth in other sectors.⁹ Yet, while 75 percent of the world's population lives in rural areas, most working in agricultural-related pursuits, only 4 percent of official development assistance goes to agriculture in developing countries.¹⁰ Thus, the goal of this diagnostic is to better understand why Kosovo's agricultural sector functions as it does; what policy, legal, and institutional changes could lead the sector to greater productivity and economic growth; and who among Kosovo's economic actors can lead or implement change.

6 Detailed information about BizCLIR can be found at www.bizclir.com.
 7 BizCLIR and AgCLIR both cover the following topics, albeit from different perspectives: Starting a Business, Dealing with Licenses, Employing Workers, Registering Property, Getting Credit, Protecting Investors, Paying Taxes, Trading Across Borders, and Enforcing Contracts, and Closing a Business.
 8 World Bank, *Doing Business 2010* (2009).
 9 World Bank, "World Bank Calls for New Emphasis on Agriculture for Development" (press release) (October 19, 2007) (citing 2008 World Bank Development Report: Agriculture).
 10 Ibid.

KOSOVO'S RANKINGS IN THE WORLD BANK DOING BUSINESS CATEGORIES

	2010	2009	Change
<i>Doing Business</i> Overall (183 countries surveyed)	113	107	-6
Starting a Business	164	156	-8
Dealing with Construction Permits	176	173	-3
Employing Workers	34	32	-2
Registering Property	68	60	-8
Getting Credit	43	41	-2
Protecting Investors	172	171	-1
Paying Taxes	50	49	-1
Trading Across Borders	132	129	-3
Enforcing Contracts	157	156	-1
Closing a Business	28	28	0

The fieldwork for this diagnostic took place over two weeks in November 2009. A team of international and local consultants conducted interviews throughout Kosovo across the agricultural sector, including with national and local officials, farmers and their associations, owners of agricultural enterprises, business associations, non-governmental organizations (NGOs), the financial services community, and many others. Over 150 people were consulted. The AgCLIR diagnostic culminated in a roundtable presentation and discussion on November 23, 2009, which was attended by more than 70 stakeholders in Kosovo's agricultural sector, including the private sector, Civil Society, government officials and donors. At the roundtable, team members introduced their preliminary observations, which were then subjected to feedback and elaboration from the participants. This input helped shape the final conclusions of the team, which are found in this report.

SUMMARY OF FINDINGS

Brief summaries of the findings and recommendations in the subject-matter areas examined in this diagnostic are set forth below.

REGISTERING PROPERTY

Despite a modern set of laws, the environment for property registration, so vital to agriculture for purposes of investment incentive and credit, suffers under the burdens of inefficient traditional practice, government inertia, a history of unfair practices and conflict, and a poor system of implementation and enforcement.

Land consolidation laws that help define use of land for agricultural purposes, as well as plans for privatization of traditionally agricultural land go largely unheeded. The Cadastral Agency, the Property Agency, and the Privatization Agency have the legal tools with which to work, but little capacity to implement them. Like the approach to real property, Kosovo's system for protecting intellectual and industrial property, such as seed varieties, remains very weak.

Significant improvement can result only from a long term and dedicated continuation of proper implementation of reforms that have already been begun; but, some shorter term solutions to problems clearly nagging the agriculture sector would go a long way in supporting growth. Among these are measures to encourage tenant investment in leased Socially Owned Enterprises, better enforcement of land consolidation principles, beginning with a pilot project, and an immediate commitment to the protection of intellectual property rights.

GETTING CREDIT

A number of problems have resulted in an agribusiness sector that is seriously underfinanced. These issues range from a traditional resistance to credit among Kosovo's farmers, to the absence of a use of creative collateral such as future crops and livestock, to banks that remain unmotivated to extend lending beyond the "safest" debtors. Agricultural loans, in fact, represent the lowest amount of lending in Kosovo.

Credit is expensive in Kosovo, with interest rates on short term lending typically more than 24% APR, and requiring two times or more the value of the loan in collateral coverage. Moreover, the types of collateral accepted are very limited, with credit usually only extended under guarantee of real property.

Seeds, fertilizer and other agricultural inputs are "lent" by processors and distributors to farmers in exchange for produce, but because of a lack of trust and a misunderstanding of how to most efficiently make this kind of credit work, the practice is limited. Capacity building in processor-farmer credit, and the contracting skills necessary to sustain the practice, will hugely benefit both levels of the value chain.

Successful expansion of commercial lending will likely require a holistic approach that begins with helping agribusiness understand that commercial debt can present far more benefits than drawbacks. Introduction of additional micro-lending products, that are well coordinated with

donor assistance programs will be an important next step, followed by assistance in establishing a viable credit information system, pledge registry, and crop insurance program.

Further work in expanding the types of accepted collateral is critical; these would include movable property, purchase orders, and collateralizing livestock and future crops.

PROTECTING INVESTORS

Kosovo's government, civil society, and private sector all clearly recognize the need for investment in agriculture. Despite low levels of investment into Kosovo agribusiness, there is significant opportunity for investment from Kosovo's diaspora communities, as well as from entrepreneurs living abroad who wish to capitalize on Kosovo's low labor costs and tariff-free access to regional and global markets. But potential investors must feel their risk is minimized, especially in a newly independent country with a weak economy, poor political reputation, and suspect institutions.

As with other areas discussed in this report, significant progress has been made at the legal and regulatory framework level, but the implementation of the laws is weak. This can begin at least with the immediate transparency achieved with consolidated online publication of relevant rules and regulations. As the first likely point of contact between an investor and Kosovo, the Business Registry must be strengthened and its processes simplified and streamlined. More attention must be paid to well-established principles of director liability and fiduciary duties.

To attract investment Kosovo needs to rely far less on providing incentives than on providing investors with information and reasonable assurances that the risks they are taking are not extraordinary.

TRADING ACROSS BORDERS

The imbalance between Kosovo's exports and imports has been widening with increasing speed over the past years, and has reached an

unsustainable point. The vast majority of the country's food needs are imported, and though farmers are learning more and more about efficient and safe modern production, exports, which are necessary for growth in a small country, remain weak. This is because of the political situation, the loss of old markets as they join the European Union, and, most of all, the lack of capacity within the government, civil society, and private sector to judiciously assert rights guaranteed by the Central European Free Trade Agreement (CEFTA).

Trade occurs, but often in spite of weak government policies, limited civil society engagement, and poor trade facilitation. Because goods are exported without full government collaboration, and sometimes illegally for want of simple paperwork, little value is added in Kosovo, and most of the potential profits are accrued in other countries.

Simple progressive steps include the establishment of a regional benchmark pricing information system that will help the GoK determine which countries are providing illegitimate export subsidies, encouragement of WTO-consistent behavior, even before the accession process begins, and the participation, with attendant capacity building programming, in UNCITRAL instruments.

ENFORCING CONTRACTS

Contracts, or more specifically in this case, commercial agreements between businesses, are the foundation upon which economic success is built. The more sophisticated the agreements that businesses use, the more protected they are from the vagaries of the market, natural disaster, and the unpredictability of business relations. And the more protected they are, the more willing they will be to invest more money and effort into their own growth.

Kosovo almost completely lacks this culture of contract. The courts are broken, the laws are not entirely up to date, the legal profession is weak, trust between farmers and processors

and distributors is absent, and no adequate systems for alternative dispute resolution have been established.

The key here is to focus on bottom-up development of new and better contracting systems as well as systems for enforcing agreements. Orders, cheaper credit and even investment could come flowing in to the farming community if they could develop a more sophisticated approach to negotiating the allocation of risk in their agreements. Likewise, the establishment of alternative dispute resolution should be concentrated at the lower levels of the value chain, to provide these new contracts with resolution and enforcement mechanisms.

CROSSCUTTING THEMES

Some issues burdening Kosovo's agricultural economy are so endemic that they are better described outside the context of the specific chapters. Those that are discussed below are not only considered broad enough to be called cross-cutting, but are of such importance that, despite their perennial popularity in donor and NGO reports, we would be remiss in excluding them.

These crosscutting themes are presented from the perspective of the agriculture private sector. Though it is likely that these themes would be just as relevant in any other sector, the manifestation, and perhaps the best ways to deal with them, are likely to be different for agribusiness.

CORRUPTION

Corruption comes in two varieties: the traditional bribery and graft, and the more insidious type, usually found in small, traditional populations in which nepotism and favors of friendship or family are almost a cultural necessity. The second variety may seem mild by comparison but is just as, if not more, crippling upon a close look. Kosovo suffers significantly from both types. The first variety produces an economy that discourages honesty, but the second type results additionally in systemic inefficiency.

Few really know the true impact of corruption in Kosovo, especially as it directly affects agribusiness, but a few facts are clear:

- The first type of corruption inhibits investment not only by foreigners with large amounts of capital that could drive the creation of commercial farms, but also by small holder farmers who grow reluctant to put savings into increased production or improvements to the land for fear of losing it to greedy officials.
- The second type of corruption, where friends and family are given positions of mid- and low-level authority instead of meritorious candidates, weakens government offices, capacity-building sources, and extension services, resulting in a private sector that, especially at the bottom of the value chain, can scarcely break free of the cycle of poverty.

Examples abound of attempted farm privatizations made nearly impossible because the SOE managers hold sway over the process and are able to effect a privatization that labels the land for a more valuable use but is against land use restrictions.

INFORMATION/DIALOGUE

Dialogue among and between various public and private sector actors, as well as systems for the distribution of information, needs to improve before meaningful economic growth can advance. There is a burdensome multi-level communication breakdown in Kosovo—within the public sector, between the public and private sectors, and within the private sector. More specifically, three areas of information/dialogue may be distinguished:

- **Public-public dialogue.** When businesses say they are “in every ministry,” they mean that for different aspects of their businesses, different ministries are relevant. The Ministry of Trade and Industry (MTI) is typically the most relevant, but the Ministry of Agriculture, Forests and Rural Development (MAFRD)

is often responsible for a large part of a business' value chain. Fruit juice is a good example. The MAFRD sets the policy from orchard to bottling, and then the MTI becomes responsible for setting the policy governing the rest of the value chain. In setting and implementing policy, the various ministries rarely communicate, so policies are often contradictory or inefficient, with substantial gaps left unfilled.

- **Private-private dialogue.** Private-sector firms with similar or related interests need to communicate in order to be efficient. In Kosovo, not only is there a lack of communication, there is also significant distrust and occasionally even reports of sabotage among these private-sector groups. Evidence exists, for example, that a firm with a large market share might form an association that includes all but perhaps one other large firm in order to effectively diminish its competitor's market share.
- **Public-private dialogue.** Demand-driven reform can only come through institutionalized, transparent dialogue between business and the government functionaries who create and implement the policy. Without communication feedback loops, policy is set from the top down only, without any bottom-up response from the groups of people meant to benefit from commercial policy. In Kosovo, virtually every attempt to create a platform for dialogue has died on the vine, in large part due to the failure of private-private dialogue. The Kosovo Chamber of Commerce (KCC), the Alliance of Kosovo Businesses (AKB), and the American Chamber of Commerce of Kosovo (AMCHAM) are all likely channels for communication, but so far little progress has been made.

Without these three types of dialogue, private-sector firms are like small islands in a fog. They cannot effectively advocate for the reforms that

will most help them compete, and they cannot take advantage of the natural synergies available through cooperation with related firms, both horizontally and vertically. Likewise, government is unable to create a united front in facilitating economic growth, and cannot be responsive to the needs of the private sector. Distrust seems to be one of the common threads in the failure of dialogue. The private sector distrusts a government that is new and still somewhat infirm, and government, whether one resulting from the declaration of independence or its predecessor, shows troubling signs of viewing the private sector as a burden to policy development. The assessment team heard government officials complain more than once that the private sector simply slows down the policy process. It is also clear that some in government misunderstand the role of trade-related agencies. It is common, for example, for Customs officials to see their roles only as enforcers of the law, and not customer-oriented facilitators of trade.

Much of this lack of dialogue is the natural offshoot of an infant government and economy and an associated lack of business sophistication. As business begins to realize the importance of playing a meaningful role in the development and reform of relevant policy, and as it begins to appreciate the benefit of working together, it will begin to focus not only on the daily management and production activities, but also on learning the country's framework of economics, law, and politics.

THE RACE TO EUROPE

With all the development of complex, new EU-compliant legal frameworks, capacity for implementing them remains low. Kosovo and interested donors have expended considerable effort and resources in adopting the new and revised legislation necessary to comply with the EU integration process. EU integration is especially complex, given the vast numbers of directives, regulations, and standards that must be met. The fruit juice industry alone requires the adoption of more than 10 directives regulating



everything from the way the fruit is processed to the way it is transported. But, attendant to the adoption of the rules, Kosovo needs to be able to implement and enforce them as well. This costs money, and requires the addition of trained individuals to government staff. Kosovo's difficulty retaining well-educated and well-trained citizens remains a large obstacle to effective implementation. The net effect is that business is now often bound by the new rules; however, with no facility for implementation, business cannot comply. In some cases this results in complete neglect of compliance procedures.. In others, it means that business

simply does not get done because in order to trade abroad, especially in the EU, companies need to be able to comply with the rules.

Proper implementation requires the addition and retention of qualified staff in both government and non-governmental institutions. Appropriate incentives must be put in place to make these positions attractive relative to alternatives both outside of Kosovo, as well as in the Kosovo private sector. In addition, significant additional and ongoing training must be provided to current employees in order to ensure that they understand and are qualified to carry out new directives.

An additional problem is that all the countries in the region are also racing to Europe. As other countries in southeastern Europe join the European Union, or achieve pre-accession privileges, before Kosovo, Kosovo loses traditional markets and is further burdened by subsidies and other support given by the EU to these countries.

GENERAL LEGAL RISK

Kosovo's institutions have been operating independently for less than two years. There was a long transition period before the summer of 2008, during which United Nations' government functions were shadowed by Kosovo ministries under the banner Provisional Institutions of Self-Government, but as democratic processes ensued the institutions and the people who staffed them changed rather quickly and sometimes dramatically. Roles that were in one ministry during the Interim Administration Mission in Kosovo (UNMIK) tenure were shuffled carelessly to others without consideration of impact.

Further, laws that were expeditiously promulgated because of the need to shed the system of discriminatory laws of the 1990s, and in anticipation of a more autonomous Kosovo, have been poorly implemented and drafted without critical gaps filled. Since independence, many additional laws have been promulgated that seem to have as their only objective additional responsibility

for enforcement by the ministry that initiated the process—a regulatory land grab.

All this results in a perception, sometimes imagined but typically well warranted, that doing business in Kosovo comes with substantial risk that the legal system—from regulations to dispute resolution to enforcement—will not adequately protect businesses of any sort. It is well known in the international legal community that businesses and their attorneys prefer well-established and time-tested law even to innovative “new legal ideas” because untested law is often unpredictable. Therefore, when business is required to comply with “new” Kosovo law, it is naturally wary.

DONOR DOGMA

One of the more difficult problems to address is that the donors themselves, the organizations seeking to help lead Kosovo into a vibrant new economic future, often get bogged down with doctrines that prevent pragmatic, cooperative approaches.

The vast array of donors and NGOs sometimes pursue inconsistent objectives, or the same objectives in inconsistent ways, leading to counterproductive activity. For example, one donor may pursue policy that builds revenue for the government through expanded import tariffs. This runs counter to activities done in the private sector that pursue the removal of tariffs in order to grow the economy. Donors also occasionally focus narrowly on the speedy accomplishment of an objective at the expense of executing it in a way long accepted in countries with a tradition of respecting the rule of law. The example that most harms the private sector is the donor practice of pushing through legislation without private-sector consultation because doing so would slow the process down—in spite of a well-established recognition that democracy demands private sector involvement in the law-making process.

A related problem occurs at the regional level. The various branches of individual donors

typically pursue programming that is highly focused at the national level at the expense of regional collaboration, traditional interdependence, and potential synergies. Ultimately, one donor may be recommending the pursuit of absolute advantages in the same product in all the countries in the region, clearly an approach that will result in potential discord.

HOW THIS REPORT IS STRUCTURED

Each chapter of this report is structured the same way. Following an introduction, each has four substantive sections, which are themselves followed by recommendations.

LEGAL FRAMEWORK

The chapters first examine Kosovo’s laws and regulations that serve as the structural basis for the country’s ability to achieve and sustain market-based development in the agricultural sector. They discuss the following questions: How accessible is the law, not only to elite, well-informed groups, but also to less-sophisticated actors, rural constituencies, or foreign investors? How clear are the laws, and how closely do they reflect emerging global standards? How well does law respond to commercial realities faced by stakeholders in the agricultural sector? What inconsistencies or gaps are present in the legal framework? This section examines key laws and regulations that apply throughout the economy, and additional laws and regulations underpinning the agricultural sector specifically.

IMPLEMENTING INSTITUTIONS

Next, the chapters examine those institutions that hold primary responsibility for implementation and enforcement of the legal framework. These institutions include government ministries, authorities, registries, and, in certain cases, private institutions such as banks and credit bureaus. In addition, courts are examined with respect to their effectiveness in addressing disputes that arise in the agricultural sector. Again, the indicators seek to uncover how these implementing institutions function not merely

with respect to mainstream business interests in the capital, but also in rural areas and agriculture-based communities.

SUPPORTING INSTITUTIONS

The chapters then look closely at those organizations, individuals, or activities without which the agricultural sector in Kosovo cannot be fully developed. Examples include farmer associations, rural banks, professional associations, agricultural and law faculties, the media, and donors. The relative awareness of law and practice on the part of each institution is examined, along with the specific ways in which institutions increase public and professional awareness, work to improve the economic performance, and otherwise serve their constituencies.

SOCIAL DYNAMICS

As the final point of analysis, the chapters discuss key issues that impact the environment for growth in the agricultural sector. Roadblocks to reform, in particular, are considered, including those entities that may be undermining change. This discussion also identifies significant opportunities for bolstering the environment for agricultural enterprise—such as champions of reform or regional initiatives—as well as matters of access to opportunity and formal institutions. Social dynamics also concern such important matters as gender, human capacity, and public health, each of which may have a significant bearing on how the business environment truly functions. Indeed, often a full understanding of legal and institutional issues cannot be achieved without a nuanced consideration of a country's social dynamics.

RECOMMENDATIONS

Following this four-part analysis, each chapter sets forth a set of recommendations. These are

drawn from the key findings in each chapter and reflect current reform capacities, opportunities, and evidence of will to reform. Some of the recommendations within the chapters may overlap—that is, some may be consolidated into a single reform initiative covering two or more topics—and all turn on the priorities and preferences as enunciated by the Kosovo government itself. The recommendations in this report are intended to serve, among other functions, as a threshold list for donor coordination of immediate initiatives and preparation of scopes of work.

AGCLIR SCORES

With respect to each area of inquiry, this diagnostic uses a process of reviewing and scoring **key indicators** to develop a thorough analysis. Once as much relevant information as possible is gathered—from written sources, meetings and interviews, and consultation among colleagues—each of the key indicators is scored, based on the assessor's best estimate of the issue at hand. To help an assessor determine a score, between 3 and 15 supporting questions accompany each key indicator. These questions themselves are not scored, but are intended to guide the assessor toward a consistent, fact-based judgment from which the key indicator score is then derived.

The scores are not intended to serve as a standalone, number-based pronouncement on the state of the agricultural sector in Kosovo. Rather, they should be read in conjunction with this report's narrative as a means of understanding the status of certain key indicators of a healthy legal and institutional environment for agricultural enterprise and identifying priorities for reform.

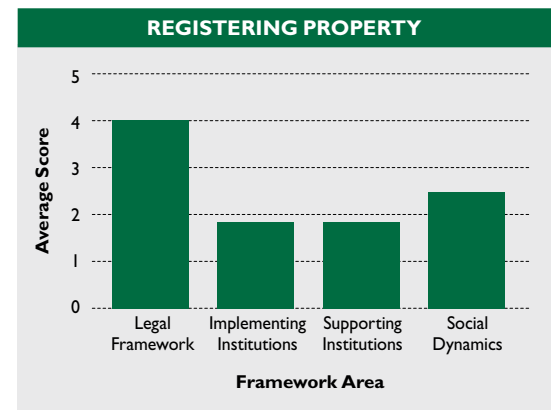


REGISTERING PROPERTY

In many respects, Kosovo’s laws pertaining to property ownership and transfer are solid reflections of contemporary legal theory and practice. Yet these laws do not by themselves simplify the maze of land issues resulting from a mix of archaic traditions, socialist governance, de facto separation of ethnic groups, armed conflict, and the confusion that invariably follows such conflict. Slow progress is being made in rectifying the situation, but in the meantime safe guarding the accuracy and sanctity of property rights in Kosovo continues to be a challenge. Continued donor funding in this area remains critical, and patience is warranted.

REGISTERING PROPERTY	
<i>Doing Business</i> Ranking 2010	68
<i>Doing Business</i> Ranking 2009	60
Procedures (number)	8
Duration (days)	88
Cost (% of property values)	1.0

Land in Kosovo has been in private hands for generations. Before World War II the people of Kosovo traded and inherited land, though registering such transactions was considered an unnecessary formality. During the Socialist years, the tradition of land as an asset continued despite the notion that under Yugoslav law people did not own land; they simply used it. This led to the creation of possession lists showing who was using what property. In the late 1980s the autonomy of Kosovo under Serbia changed, and ethnic Albanians found it increasingly difficult to register land holdings even when so inclined. During and following the conflict (1998–1999), many of the official records were destroyed or carted off to Serbia. After the conflict, land once again began (legally and illegally) changing hands, and ownership of tens of thousands of parcels was officially registered as disputed claims with the Kosovo Property Agency (KPA). To carry out its task of resolving disputed claims, the KPA had to deal with lost, destroyed, or inaccurate land records, and a cadastral system of maps, books, and possession listings that are inconsistent for a third to half of the country.¹¹



A little more than half of Kosovo’s 10,887 square kilometers is deemed agricultural (585,000 hectares (ha)), with another 41 percent (455,000 ha) considered forest land. Of the agricultural land, about half is cultivated in grains, with another 45 percent in pasture. Nearly 90 percent of farmland is privately “owned,” most of this on holdings of less than two hectares. The remainder of the agricultural land is controlled by socially owned enterprises (SOEs). While small in terms of total hectares, these SOEs constitute large individual holdings. By one account nearly 70,000 hectares are controlled by fewer than 25 SOEs.

LEGAL FRAMEWORK

Kosovo’s legal framework for land use and private property is a labyrinth of former Yugoslav laws prior to 1989, UNMIK regulations, and the laws promulgated by the Assembly of the

Republic of Kosovo. Until June 2009 private property was regulated through the Law on Basic Property of former Republic of Yugoslavia, enacted in 1980. The new law on Immovable and Other Real Properties was enacted in June 2009.

UNMIK regulations governing the registration of immovable and movable property are still in effect until new legislation and secondary legislation are enacted. However, the Kosovo government is undertaking positive efforts in streamlining legislation by consolidating new legislation and UNMIK regulations, making it easier for the legal professional and the public to navigate through the laws in effect.

The legal framework for property and property registration in Kosovo is solid and in line with best international practices, e.g., protecting private property, enabling owners to encumber it with mortgages and use it as a collateral to secure loans and financing. The challenge remains to develop effective mechanisms to implement the laws, and to successfully encourage the emergence of accountable and effective institutions free of corruption and abuse.

The highest legal act is the Constitution of the Republic of Kosovo, which came into effect in June 2008, after Kosovo's declaration of independence. The Constitution guarantees the right to private property to all legal and physical persons, be they citizens of Kosovo or foreigners. Recognizing the right of foreigners to own property in Kosovo, without any limitation or conditionality, is in line with international best practices and different from the practices in the region. For example, many countries that came out of former Yugoslavia allow foreign citizens to own property only under a condition of reciprocity.

The new law on property rights, the *Law on Immovable Property and Other Real Rights*, enacted in June 2009, includes both movable and immovable property rights. The law is a sound, modern piece of legislation, consolidating all private property right laws, including rights previously

KEY LAWS

- Constitution of the Republic of Kosovo
- Law on Basic Property Relations (1980)
- Law on Immovable Property and Other Real Rights (June 2009)
- Law on Cadastre
- Law on Establishment of an Immovable Property Rights Registry (2002)
- Law on Agricultural Land
- Law on Irrigation of Agricultural Land
- Law on Expropriation of Immovable Property
- Law on Kosovo Private Agency
- Regulation on allocation of land assets under the Kosovo Trust Agency to municipal administrations for public benefits purposes
- Law on Local Governance, 2008

found in the laws of former Yugoslavia, and UNMIK regulations. The relatively new property law is advanced and complies with international standards, streamlining many different pieces of legislation, thus creating a coherent legal framework on property issues in Kosovo. The law on pledge, mortgage, servitudes, and usufruct are now consolidated in the new law. It contains clear provisions enabling third parties, claimants, and the owner to protect their rights, and establishes who has a priority over a claim, extra judicial enforcement, etc.

The law requires that any change of ownership on real and other property, transfer, termination, or encumbrance be registered in the appropriate property rights register. The legislation regulating the registry of immovable property is UNMIK regulation 2002/5 and supplemental legislation from 2003/13. Even though the law foresees development of new legislation to regulate the immovable property registration, this has not yet been carried out; however, the law lays out basic principles and rights for registration of immovable property rights.

An innovation brought by the law is the requirement that registries are open to the public for at least five hours each business day, allowing

citizens full access to the records. The old bureaucratic and manual system made it very difficult and cumbersome for citizens to access and view property rights registries.

The immovable property rights registry is regulated by the Law on Establishment of an Immovable Property Rights Registry, promulgated in 2002. The main implementing agency is the Kosovo Cadastral Agency (KCA) and its operational units, the Municipal Cadastral Offices (MCO). The law puts forward a number of procedures and requirements for registering a property right. The different requirements were established in response to problems arising during the Kosovo conflict, which compromised the accuracy of the records—e.g., land transactions going unrecorded, land records removed to Serbia, the issuance of fake records either by the parallel registries in Serbia or elsewhere.

Thus while the procedures may seem to some people excessive, they reflect post-conflict measures in place to protect the rights of owners and potential investors. The law sets deadlines for registration of property, review of request for registration by a party, justification of a refusal, as well as legal remedies for refused requests. The laws also provide that Municipal and Kosovo Cadastral Offices should maintain manual and legal database of the immovable land registries.

AGRICULTURAL LAND

Other legislation regulating agricultural land and its consolidation are well written and generally consistent with international best practices. However, as noted, the main issue is the mechanisms in place within ministries and other government agencies to ensure proper implementation. The Law on Agricultural Land, for example, authorizes municipalities to monitor use of land with the express intent of protecting arable land by prohibiting change in use, except in rare cases. The mechanism to implement the law, however, is still inadequate and requires additional training and education.

The law also provides for consolidation of agricultural land, to create favorable conditions for maximum utilization of the land. Oversight responsibility for consolidation rests with the Ministry of Agriculture's Consolidation Committee. While the law is appropriate, the secondary legislation and mechanisms are not in place to ensure implementation.

WATER RIGHTS

The law relating to the irrigation of agricultural land would appear appropriate for maximizing the use of available water resources. The law provides for establishment of water companies to provide irrigation services to agricultural land users. However, the responsibility over water and other natural resources lies with Ministry of Environment and Spatial Planning, creating confusion among companies as to where to register. Moreover, the law provides for establishment of voluntary water user associations to provide irrigation services to their members and non-members. Members are privileged with easier and cheaper access to services. Associations can create federations, providing services to several associations. The law provides for creation of many layers of administration that will require time and significant efforts to establish.

SOCIALLY AND PUBLIC OWNED LAND

Public property as in other parts of the world is administered and managed by the municipality and the central government. The socially owned property is a relic of property rights existing in former Yugoslavia. The owner of socialist property is all citizens, or the so-called workers councils representing all society. Statistics on the size and the volume of socially owned property vary. There are no clear and accurate records over the public and socialist property in Kosovo, due to the removal of property records to Serbia in 1999 after the war and transfer of this property over the past 10 years.

While in the past the socially owned property was administered by local municipalities, after

the conflict in 1999 the property was under the authority of the UNMIK administration, the Kosovo Trust Agency (KTA). In 2000 with the creation of the Department for Trade and Industry (DTI) this authority was delegated to the DTI. During the last 10 years no coordinated legislative strategy has been developed to facilitate transition of the socially owned property and clarify the title holder.

The socially owned enterprises and assets that include immovable property (land) were leased for a period of 10 years through public tenders by the DTI. This process is known as commercialization versus privatization, whereby the users do not acquire any ownership right over the property. This initiative provided access to utilization of the property; however, the duration of the lease was insufficient to justify the investment and costs of the transaction. In many cases ownership over the socially owned properties still remains open. While in other parts of former Yugoslavia the socially owned immovable property has either been transferred into private property (Slovenia¹²) or into state property (Serbia,¹³ Macedonia, Croatia,¹⁴ Montenegro), the concept continues to exist in Kosovo due to the political sensitivity and the relationship with Serbia. Thus, existence of the socially owned immovable property is an outdated concept that does not match the reality and the civil and commercial development of the current day and age.

The Constitution of Kosovo authorizes the Kosovo Property Agency as the successor of the Kosovo Trust Agency to sell, transfer, and or liquidate socially owned property and enterprises. The agency is responsible for identifying the owners of assets and compensating them. However, an additional problem with socialist owned property is claims for restitution filed with the courts in Kosovo. While many other former Yugoslav countries have developed appropriate legislation to satisfy these claims, such legislation in Kosovo does not exist. After more than 20 years of misuse and

abuse of socially owned property it will require a Herculean effort to clarify who the entitled holder is.

IMPLEMENTING INSTITUTIONS

KOSOVO CADASTRAL AGENCY AND MUNICIPAL CADASTRAL OFFICES

The foundation on which investment in Kosovo's economic development and re-emergence will be built necessarily includes a functioning cadastral system. Kosovo Cadastral Agency (KCA), part of the Ministry of Public Services, is the key agency in this regard.

History and traditions have made the task of the KCA a difficult one. Over the decades, land—especially rural property—was traditionally handed down from one generation to the next through inheritance, primarily to the men of the family. As part of Yugoslavia, the country's cultural emphasis of private land ownership diminished with the rise of social ownership.

After the breakup of Yugoslavia and before the conflict, calculated acts of discrimination were eroding traditional rights in favor of a few. The conflict further complicated what was an already deteriorating land situation, with many records either destroyed or moved to Serbia.

Whatever the reasons, the cadastre situation in Kosovo was in catastrophic condition immediately following the conflict and is only slowly improving. Even now unregistered parcels continue to change hands and others have been subdivided among heirs, rendering already small plots smaller and further complicating the work of KCA.

There are two components to a good cadastre system. One part is the legal system: the laws that govern land. In Kosovo these have largely have been written or rewritten since 2000. The second part of the system is a geographic aspect: the maps and coordinates that demarcate parcels of land. In Kosovo, while the law is

12 Law on Privatization of Real Estate in Social Ownership.

13 Law on Construction Land.

14 Law on Transformation of Socially Owned Enterprises.

adequate, the various graphical records—cadastral maps, possession lists, aerial maps—do not match up.

History and tradition have contributed to a cadastre situation that is best summarized by the picture in Figure 1. The figure shows “vectorized” data (the red lines) from old cadastral maps overlaid on aerial photos from 2004. The difference is obvious. By one estimate, anywhere from a third to half of Kosovo cadastre information is in a similar state as that depicted in the figure—records do not match reality on the ground.

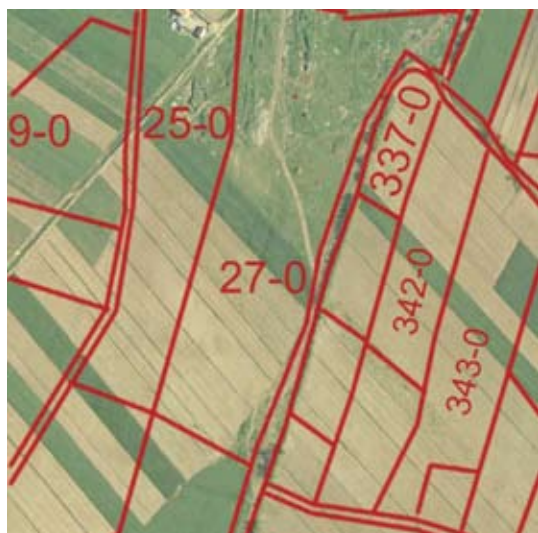


Figure 1: Historical cadastre information and actual aerial delineation.

The Municipal Cadastre Offices are charged with recording immovable property rights under the authority of the KCA. The KCA has the responsibility for overall administration of the official registry. None of the registries, municipal or the master KCA registry, are as yet accessible online. The development and full implementation of automated land registry would facilitate access to records for all interested parties, and streamline the registration and verification procedures.

KOSOVO PROPERTY AGENCY

The Kosovo Property Agency (KPA) was established in March 2006 to assist the courts in resolving property disputes resulting from the conflict between February 2, 1998, and June 20, 1999.

The KPA is charged with investigating ownership claims and property use rights with respect to agricultural and commercial private immovable property. From early April 2006 to early December 2007, claims were filed with the KPA. In total, more than 40,600 claims were filed, of which nearly 90 percent involved agricultural land. As of October 2009, more than 22,700 claims have been resolved.

The KPA and the Kosovo Cadastral Agency recently signed a memorandum of understanding (MOU) that will open the door to the KCA sharing information with the KPA with the intent of increasing efficiency of dispute resolution. With just more than half of the disputes resolved, this is a welcome exchange to increase efficiency of the KPA.

ENVIRONMENTAL PROTECTION AGENCY

Part of the Ministry of Environment and Spatial Planning, the Kosovo Environmental Protection Agency (KEPA) is charged with, among other duties, assessing spatial planning and adjustments, placing it squarely in the center of land classification. While the KEPA says it does not zone, its determinations regarding the basic use of land—agriculture or construction—broadly establishes the intrinsic opportunity value of land.

Within the KEPA, the Directorate for Planning, Urbanization and Construction is responsible for broadly defining the nature of land utilization, directly impacting on the availability of land for farming. For planning purposes land is categorized as either “agriculture” land (defined as “the land determined for cultivating of agricultural cultures”) or “construction” land (defined as “land on which buildings are constructed according to a spatial plan or . . . foreseen as land for the construction of buildings”).

One of the KEPA’s roles is to protect the status of agricultural land, that is, keep land designated as agriculture for this purpose and not redefined as construction land. In practice some agriculture SOEs are being chopped up into both

agriculture and construction, diminishing the benefits of scale for farming purposes. In turn, confronted with a *fait accompli*, courts often rule in favor of re-categorizing the land.

PRIVATIZATION AGENCY OF KOSOVO

Formerly the Kosovo Trust Agency, the Privatization Agency of Kosovo (PAK) works to privatize SOEs and publicly owned enterprises (utilities, airport, railways, etc.). SOEs, many of which are agricultural in nature, are to form new companies containing the assets but not the liabilities of the old SOEs, holding the new shares in trust. The KPA then sells the new shares to investors (domestic or foreign). In addition to price, the KPA can consider the activities, employment, and investment proposed by new investor/bidder in making its selection.

Until privatized, many SOEs are leased by would-be bidders and continue in operation, providing jobs and economic growth opportunity. However, current regulation suggests that leasehold improvements made by lessees in SOEs may not be recognized in their bids for SOEs.

This has the unintended consequence of stymieing investment in the facilities that could enhance competitiveness and create more employment. Among the companies interviewed for this assessment were two processing firms leasing SOE property. In one case the company acknowledged that it took a risk investing in improvements but felt confident it would win a privatization bid, and that win or lose its investment would be recognized. The other company's decision not to invest in leasehold improvements until the privatization process was final reflected a large number of opinions.

INDUSTRIAL PROPERTY OFFICE

The two-year-old Industrial Property Office (IPO) is charged with industrial property protection—patents, trademarks, and designs. The issue of copyrights is independent and, according to an EC working document, an office of intellectual property as distinct from industrial property has yet to be established.¹⁵ The office has

received in excess of 18,000 applications, most related to trademarks. The IPO does not register plant varieties, and Kosovo is not a signatory of the International Plant Protection Convention.

While it takes only minutes to complete an application registering an industrial property right (which provides protection immediately), the process has to be completed in person. There is no online application, and, of course, no online searchable database. In addition, the referenced EC report found that “administrative capacity to implement intellectual and industrial property rights insufficient,” enforcement weak, and the division of responsibilities among various enforcement bodies dealing not well defined.

SUPPORTING INSTITUTIONS

COURTS

While many of the laws in Kosovo generally reflect contemporary thinking (with many of them written or rewritten since 2000), the implementing judicial system is weak.

While the June 2009 Law on Immovable Property and Other Real Rights is a sound body of law, it is yet to be determined to what extent the new law is implemented by the relevant government agencies and the courts. In the past in Kosovo, despite the enactment of new laws, government agencies and courts continue to apply the old law either due to delayed distribution of laws and training on new legislation or due to delays in drafting secondary regulations necessary to implement the law.

Despite this, municipal courts are the first line of adjudication in land disputes. As cadastral information is inconsistent across possession lists, maps, and registries, ownership is determined based on the immovable property registry, which requires three pieces of information to validate a claim: a valid document from competent authority (administrative or judicial); a decision of a competent court; and evidence of

¹⁵ Commission of the European Communities, Commission Staff Working Document: Kosovo under UNSCR 1244/99 2009 Progress Report, Brussels, 14.10.2009.

a legal transaction. The system seems somewhat circular and certainly open to inducements.

A study carried out in March 2009 by the Organization for Security and Co-operation in Europe (OSCE) found major faults with the legal system's handling of property rights cases.¹⁶ The study noted that courts often recognize a transfer of ownership without a written contract, which is required by law. A second problem is the application of positive prescription, or when ownership is determined through possession over a given period of time, sometimes called adverse possession. This is overly applied as a means of circumventing the need for a written contract. However, in a post-conflict environment such as Kosovo, it is not uncommon for individuals to be absent for a long period, opening the door to abuse of positive prescription.

There also appears to be significant procedural law violations in decisions on property cases, suggesting at a minimum a need for training. Finally, courts appoint temporary representatives for absent owners without following procedures.

SURVEYORS

Both public and private surveyors operate in Kosovo. Private surveyors were licensed for the first time in 2009, and there are now about 50 licensed surveyors in Kosovo. The KCA is the agency charged with accrediting surveyors for the purpose of performing official cadastral surveys. The KCA is also responsible for licensing surveying companies as competent to perform cadastral surveys.

DONOR PROJECTS

The issue of land and property rights is one that has received a fair amount of attention from donors. The World Bank and the EU are among those that have assisted the KCA. Others include UNHabitat, the Swiss Agency for Development and Cooperation, the Swedish International Development Agency, and the Norwegian Ministry of Foreign Affairs.



However, despite these efforts there is after nine years a general lack of accelerated progress regarding immovable property issues. Forward movement around land rights is discernable (KPA has reduced disputed properties by half for example), but it seems glacial at times. Donors are committed to the effort but, whether from a lack of coordination or a lack of overarching strategy and pooled financing to address the cadastre disaster meaningfully, progress is slow.

SOCIAL DYNAMICS

RURAL ATTITUDES TOWARDS LAND

Traditionally, land was an asset handed down through the generations without need of registering title, while conveniently avoiding the time and expense of registration. As it passed from one head of household to the next, most often among the males of the family, land would become further fragmented and divided.

Many land transactions remain unrecorded. If Kosovo is to have a functioning land system, one in which titles are clean and can be mortgaged, the old ways will need to give way to formal and legal land registration, even if acquired through inheritance. Properly recorded land should increase in value due to clarity of ownership

¹⁶ Litigating Ownership of Immovable Property in Kosovo, Organization for Security and Co-operation in Europe Mission in Kosovo, March 2009.

(limited threat of ownership being disputed) and the ability to collateralize the land. Moreover, registering property properly should have a positive impact on women ownership.

FRAGMENTATION OF AGRICULTURAL LAND

Fragmentation of agricultural land further erodes opportunities for economies of scale. Already more than half of agriculture land is used to plant cereals that are inefficiently produced on small parcels. The breaking up of agricultural SOEs is especially unfortunate as these enterprises are of the scale to be efficient producers of more basic staples. When SOEs are subdivided, farm-based enterprise options are reduced.

GENDER AND LAND OWNERSHIP

Kosovo remains an agrarian society dominated by smallholders. More than 15 percent of households are headed by women. In a strongly patriarchal society, these women-headed households are at risk without clear property rights.

The current law begins to remedy the situation with respect to property acquired after marriage. The Kosovo Family Law is based on equality between spouses in which property acquired is regarded as common property. However, property that is brought to the marriage however acquired (inheritance, gift, purchase) is considered separate property.

RECOMMENDATIONS

Several land issues impact on the productive use of agricultural land, including land fragmentation, farm land being taken out of agriculture due to illegal construction or other misuse, poor cadastral information, misapplication of SOE privatization principles, application of procedural law, and lack of coordination among stakeholders around land law, management, and the reinstatement of a functioning cadastre system.

Following are a few focused, manageable recommendations that should contribute to improving on some of the issues mentioned. The recommendations are divided between near- and longer-term actions.

RECOMMENDATION: STAY THE COURSE WITH RESPECT TO FOCUS ON LAND ISSUES.

General: With respect to land issues, slow and steady will eventually win out. There is no silver bullet here. The untangling of the Gordian Knot of traditional practices, socialist governance, ethnic separation, armed conflict, and contemporary post-conflict property law will not be solved with one bold stroke but rather a steady and patient unraveling in a manner. In this regard, a catalogue of donor actions taken to date, results, and next steps would contribute to coordinated efforts and likely increased rate of progress.

Short Term

- Encourage investment in rented SOE premises by acknowledging the value of improvements made upon privatization and compensating the renting business accordingly. To do so requires a rather simple (by comparison to other actions) change in the law. A change that any landlord (in this case the GoK) should welcome as it encourages tenants to maintain the property, and could open new export markets as the result of investments in premises that upgrade facilities to comply with market standards.
- Enforce the letter and spirit of the existing law regarding maintaining agricultural land for agriculture, encouraging economies of scale that for some commodities require significant continuous tracts of land. A public awareness campaign is one approach, which would be more effective if the GoK appealed a few previous court decisions that allowed for the break-up of agricultural land.
- Establish a more efficient system for industrial and intellectual property protection. A recommendation that came out of a roundtable discussion of property rights reflects concern among private sector regarding safety of such rights. One first important step would be making the systems online and real time.

Long Term

- Remain focused on land issues as a foundational necessity to investment in Kosovo. From cadastral system to dispute resolution to application of the law to securing the return of missing property registries, donors would do well to support what appears to be this fundamental initiative in a coordinated manner. An important step to coordinating efforts then would be the cataloguing of previous and current efforts by any government or donor program from writing or rewriting laws to equipping government services to training public and private implementers.
- Provide training for judges in the proper application of law in regards to adjudication of land disputes. If such training has been carried out (see above regarding need for catalogue of immovable property actions), repeat new training. As what gets measured gets accomplished, develop a system for scoring performance of judges in the proper application of the law. Those falling below a certain level would receive additional training, or be let go.
- Change existing attitude towards women ownership of land. This action could start with a study to quantify and qualify the issues and opportunities to improving women's access to land title.
- Invariably, increasing women ownership also requires changing attitudes. This might start with promoting the benefits of spousal ownership of immovable property and application of law in this regard. Also consider changing the law to favor the wife with regards to the status of pre-marriage assets. This could be remedied simply by requiring that the husband must take action to separate by law any assets brought to the marriage rather than the passive acceptance in the current law that such assets are separate.



GETTING CREDIT

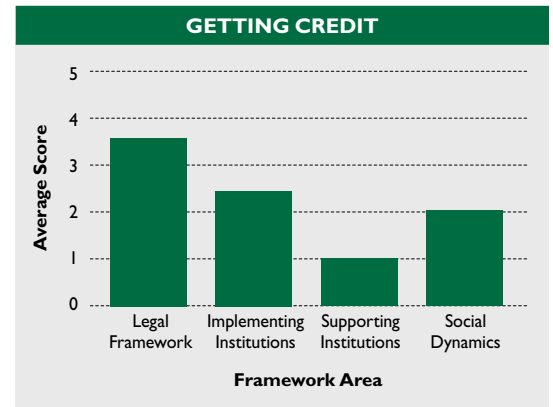
Whether from a lack of collateral, a limited understanding of agribusiness (leading to higher perceptions of risk), a predominantly small-farmer agricultural sector, a nascent financial sector still growing into the market, or a lack of business savvy on the part of many agribusiness operators, or most likely a combination of all these factors, Kosovo's agricultural sector is underfinanced. Some exciting services are emerging that may open the doors to increased financing options for agriculture, but in the near to medium term, agriculture is likely to remain underserved in an economy dominated by the trading sector where loans are secured by developed urban immovable collateral.

GETTING CREDIT	
Doing Business Ranking 2010	43
Doing Business Ranking 2009	41
Strength of legal rights index (0–10)	8
Depth of credit information (0–6)	3
Public registry coverage (% of adults)	18.9
Private bureau coverage (% of adults)	0.0

As in other emerging economies the lack of affordable credit is often singled out as “the” most pressing concern for agriculture-based businesses, whether farming, processing, or trading. This concern is followed by a wringing of hands over the financial industry’s failure to understand agriculture’s “unique” needs. Kosovo is no different.

On the other hand, agribusinesses often focus on the “agri” side while minimizing the “business” side of agribusiness. While 14 percent interest, as found in many commercial banks, is steep for many businesses, there are sound opportunities that can support this rate of interest (which for preferred customers can be under 10 percent).

For small farmers, production credit and longer-term credit, say, for the purchase of machinery and implements or irrigation equipment, is limited to a few microfinance institutions and more adventurous commercial banks. These excep-



tions lend weight to the general rule, though, that agriculture is woefully underfinanced.

In 2008, banking assets represented 80 percent of total financial sector assets of €2.3 billion. Pension funds represented 11.4 percent, microfinance institutions (MFIs) 5 percent, and insurance companies 3.4 percent. While loans to agriculture increased nearly 30 percent in 2008 over 2007, they still accounted for only about 4 percent of total loans made, against a contribution to GDP of 20 percent.¹⁷

Within the banking community, more than 75 percent of loans went to enterprises and most of the remaining 25 percent to households. Nearly half of all loans went to trading activities, followed by, in decreasing order, other services, construction, industry, mining, and finally agriculture.

¹⁷ 2008 Central Bank of Kosovo Annual Report, June 2009.

Kosovo is quite dependent on the international community and diaspora. It is estimated that together these two constituent groups account for 30 percent of GDP, roughly 15 percent each. In 2008 official remittances reached nearly €540 million, more than 2.5 times the value of exports.¹⁸

Kosovo weathered the financial crises better than some countries in 2008. However, remittances increased at a significantly lower rate in 2008 than 2007, 2.7 percent vs. 11.7 percent, respectively, given the impact of the crisis in countries of remittance origin.¹⁹ A similar slowdown in growth is likely in 2009. This is relevant to the extent that many households and (agri-) businesses seem to depend on remittances for financing living and working capital needs.

It seems that there is liquidity in the system, with, for example, one bank reporting well over €200 million in what it termed excess liquidity. Rates hovering around 14 percent are considered high by borrowers in Kosovo when they compare them to rates in other European countries. Needless to say, interest rates are based on a number of factors that are difficult to compare across regions (inflation;²⁰ operating costs—marketing, operations, taxes/licenses; cost of funds; risk—borrower, sector, country; and, of course, profit). In light of a deflationary environment as suggested by IMF figures (reference below), the current rate of 14 percent (9 percent for some preferred corporate clients) does suggest that the perception of sector risks and inefficiencies in operation are keeping rates higher for Kosovo where much of the borrowing market is comprised of small and medium (even micro-) enterprises.

In the current environment the challenges to agri-lending are numerous but addressable. Part of the problem is that companies and farmers do not fully understand their own costs and fixate on products that are not competitive. Transactions tend to be costly, especially for small farmers. On the other side of the coin, it is difficult for lenders to mitigate

risks other than through collateral (e.g., there is no credit bureau, the existing pledge registry lacks efficiency, crop insurance is non-existent, and contract enforcement is considered by many to be non-existent).

LEGAL FRAMEWORK

The legal framework for regulation of financial institutions in Kosovo is new, developed after 1999. Unlike some of its neighbors that had to reform existing outdated laws and regulations, often times a more painful and laborious process, Kosovo had the advantage of starting from scratch. As a result, the legal framework regulating financial institutions is limited, coherent, and in line with international best practices. The financial legal framework consists of the Law on Central Bank of the Republic of Kosovo, which contains chapters on bank rules, non-financial institutions, microfinance institutions, insurance companies, and the Credit Registry Authority, and a body of secondary legislation in the form of rules and administrative directions governing the above-mentioned areas to facilitate implementation.

According to the EC progress report, the legal system for the financial sector in Kosovo reflects contemporary thinking in line with international best practices. Enforcement of contracts, however, remains one of the main obstacles to accessing credit and, concomitantly, to business growth. High interest rates for loans and ineffective enforcement of creditor's rights

KEY LAWS

- Central Bank of Kosovo Law
- UNMIK Regulation 1999/21 on Bank Licensing, Supervision and Regulation
- UNMIK Regulation 2004/2 On the Deterrence of Money Laundering and Related Criminal Offences
- Banking rules
- Rules on Licensing and Supervision of Micro Finance institutions
- Law on Immovable Property and other Real Rights

¹⁸ Ibid.

¹⁹ Havolu, Sokol, CBK Working Paper No.3, Determinants of Remittances: The Case of Kosovo, 2009.

²⁰ The World Bank 2009 Country Brief notes that inflation in 2008 was 0.5%, with deflation January 2009 of -0.5% and May 2009 of -1.2%. The IMF has forecasted an average annual deflation of -2.1% for 2009.

and of contracts result in high costs and risks for financial institutions.

The range, scale, and scope of the existing financial sources and products available to commercial and agribusinesses are relatively limited and not appropriate for normal operational activities. Foreign investments in the banking sector are likely to increase competition and improve conditions for private-sector businesses but high interest rates are still problematic and obstacles for many small businesses and individual borrowers. In terms of support for agriculture, the EC progress report highlights that agriculture loans account only for 4 percent from the overall value of the loan distributed in 2009.²¹

CENTRAL BANK OF KOSOVO LAW

The law on the Central Bank of the Republic of Kosovo (CBK) promulgated in June 2008, transforming the former interim administration Banking and Payment Authority of Kosovo to the Central Bank of Kosovo, establishes the CBK as a central authority in Kosovo to license, supervise, and regulate all financial institutions in the territory of Kosovo. Financial institutions under supervision of the CBK include commercial banks, non-financial institutions, insurance companies, microfinance institutions, and pension funds. In addition the CBK has established a Central Credit Registry.

As an independent agency, the CBK has the power to issue and revoke licenses; monitor, audit, and regulate domestic and foreign banks and financial and non-financial institutions; issue rules, orders, and guidelines to regulate their operations; and audit the financial institutions to ensure their affairs are in compliance with the law. The number and variety of financial institutions are growing in Kosovo, with 8 registered commercial banks, 10 savings and credit associations, 15 microfinance institutions, 8 non-banking financial institutions, and 10 insurance companies. The principal role of the CBK is to develop a sound and efficient, functioning and stable financial market with safe financial instruments, as well as support general economic

policies in Kosovo by advising the government in the above areas. The capital of the CBK is set at 30 million Euros.

The CBK legal framework regulates banks, non-bank financial institutions, investment companies, and microfinance institutions. The banking rules establish minimum requirements for bank capital, which comprises Tier I and Tier 2 capital. Tier I includes common equity, preferred shares, but not distributed earnings. Tier 2 capital includes reserves for loan losses up to a maximum of 1.25 percent of its risk, ordinary preferred shares, and term preferred shares. The law requires that Tier 2 capital will be reduced by 20 percent of their original amounts at the beginning of each of the last five years of the instrument's life. The CBK has introduced reasonable policies to limit credit risk exposures of the banks to individuals and aggregated groups of individuals, limiting the total value of the loan up to 10 percent of the Tier I capital. In addition, except with permission from the CBK, the law prohibits banks from acquiring or maintaining land or other fixed assets (e.g., land, building, leasehold, fixture, furniture), the aggregate value of which at any time exceeds 50 percent of the bank's Tier I capital.

In April 2006 the Kosovo government promulgated a law on foreign investment, whereby all foreign investors are to be governed by the principle of national treatment. This means that foreign investors will be treated equally with the domestic enterprises, including foreign-owned banks. As such, the bank rules foresee reasonable requirements for licensing foreign banks in Kosovo and verifying their capital levels, asset quality, and liquidity ratios. General rules on bank governance apply equally to domestic and foreign banks.

As a response to last year's world financial crises, the CBK introduced new measures to monitor bank liquidity and credit risk exposures: the CBK developed higher standards to review policies and procedures used by the banks in monitoring credit risk exposure and requiring

²¹ Commission of the European Communities, Commission Staff Working Document: Kosovo under UNSCR 1244/99 2009 Progress Report, Brussels, 14.10.2009.

a minimum of quarterly review and reporting. This effort was acknowledged as a positive step in the EC progress report for Kosovo for 2009.

The CBK has adopted rules to prevent money-laundering activities. For example, all credit-granting institutions are prohibited from disbursing loans in cash greater than 10,000 Euros, or to structure loans in such a way to avoid this rule.

The CBK requires that all credit-granting institutions maintain full transparency towards their customers in disclosing information on interest rates, products, and service fees to allow borrowers to compare interest rates and other charges among different banks on loans and deposits. However, the rules do not contain any penalty if the credit institution fails to do so.

The CBK has established a central credit registry system. All credit-granting agencies, banks, and microfinance and non-bank institutions are required to provide accurate data on borrowers. The purpose is to make credit reporting mandatory for all credit providers in accordance with the CBK. In return, the credit providers will have access to credit reports on borrowers: credit worthiness, credit standing, credit capacity, and character or general reputation. Information connected to a credit transaction can be obtained by paying a nominal fee. According to the World Bank *Doing Business* 2010 report for Kosovo, the credit registry covers 18.9 percent of the adult population.

Commercial banks and microfinance institutions have different capital requirements, and can be engaged in different types of activities. Banks are authorized to engage in the following activities: receive deposits, give loans, buy and sell securities, foreign exchange, financial leasing, and other activities as determined by law. Microfinance institutions (MFIs) are authorized to give small loans in value of 5,000 to 15,000 Euros to low-income households and individuals, and 15,000 to 75,000 Euros to small enterprises. The law on the Central Bank of Kosovo differentiates between registered and licensed MFIs.

Registered MFIs can give loans, obtain funds by grants, place funds in the market, and provide technical assistance to borrowers. In addition, licensed MFIs can accept deposit savings, buy and sell foreign exchange, and extend credit facilities such as letters of credit, bonds, and guarantors. While banks give loans to larger businesses, the MFIs are set up to provide credits to low-income households and small and medium enterprises. Minimum capital requirements for MFIs are 2,500,000 Euros and/or common equity shares, statutory and general reserves, donations, and capital equivalency deposit.

REAL PROPERTY AND MORTGAGES

Real and immovable property are the dominant forms of security in Kosovo. Most financial institutions distribute loans using immovable property as the main source of collateral. The legal framework for mortgages is solid, and is in compliance with EU legislation and international best standards, providing sufficient legal remedies and protection for both the debtor and the creditor. It provides judicial and extra-judicial protection to secure creditors' claims, and provides sufficient legal remedies and protection for both the debtor and the creditor.

However, implementation of a "best practices" mortgage law remains a crippling problem. The biggest challenge for creditors is identifying the property title holder, due to inaccuracies in immovable property registries. Many of the property registries were transferred to Serbia after the conflict in 1999, with many properties changing hands since then, thus complicating a proper updating of the cadastre system and calling in question the integrity of the registries. Existence of parallel registries enables multiple sales of the same property, gives rise to corruption, and creates chaos in land registry and administration in Kosovo. This confusion pushes banks to increase interest rates and apply high-risk premiums for loans. Another problem faced by the financial institutions in securing their claims is contract enforcement through the local courts.

Pledges are also used to secure creditors' claims for debt repayment. Provisions on pledges in the legal framework state that any movable property right that can be transferred to another owner can be used to secure a claim, if specified in the agreement, including future products. The provisions do not contain further clarification as to whether the future products can be used as collateral; however, legal provisions are vague enough to allow parties to a contract to determine what movable possession or rights can be used as collateral.

IMPLEMENTING INSTITUTIONS

CENTRAL BANK OF KOSOVO

The Central Bank of the Republic of Kosovo (CBK) is generally well respected and considered to be well managed. One of its important objectives is the development and modernization of the financial sector. As it has matured, it has moved from rules-based to risk-based supervision, following Basel Core Principles and Pillar 2 of Basel II.²² The CBK is responsible for providing most central bank functions except lending or providing temporary liquidity, as it is not an issuing bank.

The CBK operates a credit registry. Regulations require all banks, MFIs, and non-bank financial institutions (NBFIs) to enter loan data into the registry within 24 hours of extending a loan. The registry is available online for registered lenders. The information collected includes disbursement date, amount, term, collateral, loan rating (A, B, C, or D), and whether there are any late payments or delinquencies. By all accounts, the system works well, and is timely and easy enough to use.

COMMERCIAL BANKS

On paper, the economy of Kosovo is fairly well served by eight commercial banks, which together have nearly 300 branches and sub-branches combined.²³ Of the eight commercial banks recognized by the CBK, six have

AVAILABLE BANKING SERVICES/PRODUCTS

- Individual guarantee
- Bank guarantees
- Import letters of credit
- Cheque clearing
- Pre-export financing
- Salary accounts
- Export letter of credit
- Internet banking
- Corporate guarantee
- ATMs
- Bridge loans
- Leasing
- Term loans
- Bid bonds
- Letter of counter guarantee
- Advance payment guarantees
- Cash services
- Performance bond
- Deposits
- Facility guarantee
- Purchase order finance
- Remittances
- Overdraft facilities

significant or majority foreign ownership. While somewhat diverse, commercial bank lending is heavily concentrated in just two banks—Raiffeisen and ProCredit—accounting for approximately 80 percent of total loans. The maturity of term loans varies, with nearly a third for two years. However, over time, as confidence returned, loan maturity has lengthened. In 2005 less than 45 percent of loans had a maturity of more than two years. In 2008, 68 percent did.²⁴

As confidence grows, commercial banks tend to increase the services offered. In Kosovo, many of the most basic banking services/products are available.

While services and products are expanding, agriculture remains underserved by commercial banks. The factors for this are varied and include the following:

- Systemic risk such as weather, plant disease, etc.

²² Basel I primarily focused on credit risk. Assets of banks were classified and grouped in five categories according to credit risk. The purpose of Basel II is to create an international standard that banking regulators can use when determining how much capital banks should put aside to guard against the types of financial and operational risks banks face.

²³ See <http://www.bqk-kos.org/>.

²⁴ 2008 Central Bank of Kosovo Annual Report, June 2009.

- Seasonal and cyclical market risks
- Credit risk
- Small-farmer agriculture inefficiencies
- Limited collateral-appropriate assets
- Slow returns on investment
- Poor infrastructure
- Threat of political interference
- Regulatory risks
- Low technical awareness on farm and business acumen, and lack of capacity among sector support bodies (associations, producer groups, chambers, etc.)

To cope with the risks of agriculture, banks generally have tended to shy away from agricultural lending, use short maturities, provide no grace period, and apply rates of interest commensurate with the perceived risks. Commercial banks also apply two coping strategies that work against agriculture and agribusiness lending in Kosovo: reliance on collateral and emphasis on historical performance.

COLLATERAL IS KING

Commercial banks in Kosovo tend to rely significantly on (developed) real estate as collateral. This largely limits valued collateral to urban areas and excludes much of the rural population. In addition, there is a tendency to undervalue the real estate and over collateralize a loan. By some accounts, collateralization tends to be one and half to even three times the value of the loan.

Commercial banks, no matter where they are located, are not the highest-order risk takers. They lend confidently based on what they know or understand. In the case of Kosovo, like many emerging economies, commercial banks do not understand agriculture/agribusiness as well as other industries, especially the industry of simple trading. In agriculture, information is spotty and, in banks' eyes, possibly unreliable. Risk is hard to determine and often nearly impossible to offset (i.e., insurance, hedges). In such an environment the fall back is to collateralize significantly based on what is better understood—urban or peri-urban developed real estate.

SHARING THE RISK

To familiarize commercial banks with agriculture and to mitigate the need for collateral, the USAID introduced a Development Credit Authority (DCA) guarantee scheme to eligible banks. Eventually Raiffeisen Bank signed up. The program extended a partial loan portfolio guarantee for agribusinesses, a sector previously underserved by the bank.

USAID/Kosovo linked the DCA to technical assistance to borrowers and supply contracts—distributors to farmers to processors/traders. Backed by the partial guarantee, the technical assistance, and the contracts, Raiffeisen lent with greater confidence to a segment of the economy it previously would not have considered—small agribusinesses and farmers.

The facility has now run its course, with the full \$10 million ceiling lent. This exposure to a previously lightly regarded segment of the loan market and the linking of borrowers to buyers provides an important precedent to come back to (see recommendations).

Many agribusinesses are bereft of sufficient real estate collateral to adequately finance growth. In Kosovo (and elsewhere) houses and other personal assets are tied up as collateral to cover a mix of financial needs—working capital, equipment, buildings, transport. Not all of these needs are long term in nature, yet long-term assets are pledged as collateral against short-term needs. This puts many agribusinesses on a treadmill to nowhere. They may be able to maintain but can not grow.

THE REARVIEW MIRROR

Historical financial performance is an important element of any loan consideration. Dependence on the rearview mirror, though, means commercial banks miss opportunities to lend. In fairness, many agribusinesses do not help themselves in this regard as their financial records are often poorly presented. However, banks could

do more cashflow-based lending. This requires greater confidence in the borrower's record keeping and ability to manage the business (whether farming, processing, or trading), as well as a better understanding of the markets. It also requires that a borrower demonstrate a higher level of business acumen and that commercial banks employ a greater capacity for financial analytics and understanding of the business.

Two recent services seek to tackle both of these obstacles—a credit guarantee program and purchase order financing. See the text boxes *Sharing the Risk and Banking on Cash Flow*.

MICROFINANCE INSTITUTIONS

Microfinance has significant representation in Kosovo, with 15 microfinance institutions (MFIs) listed in the CBK's 2008 annual report. MFIs play an important role in reaching a part of the economy that commercial banks find difficult to service—small and micro-businesses, farm households, and agribusiness, as well as disenfranchised or underserved borrowers such as women and minorities.

The Association of Microfinance Institutions of Kosovo (AMIK) has nine members (highlighted in the box below) that had approximately €94.8 million outstanding to nearly 54,000 borrowers in September 2009 (about €1,800/borrower).

Competition among MFIs in urban and peri-urban settings is fairly strong. There is less choice the farther the borrower is from a city or town. In this regard, even the CBK has remarked that it would like to see MFIs extend their coverage to include more rural households.

There is a wide range of services offered by MFIs—agricultural loans, group loans, small medium-sized enterprise loans, loans for housing, trading, and starting a business among others. MFI services generally are priced on a monthly declining basis, with annual rates, while varying among MFIs, running around 24 percent and up. Terms range widely from a few months to 60 months, depending on the type of loan. Collateral requirements also vary depending on

KEY MICROFINANCE INSTITUTIONS

- Agency for Finance in Kosovo (AFK)
- Atlantic Capital Partners (ACP)
- Balcanactie
- Beselidhja
- Qelim Kosove
- Cordaid
- FINCA
- KEP Trust
- Kosovo Grameen Mission Acrobaleno
- KosInvest (World Vision)
- Kosovo Aid and Development
- Kreditimi Rural i Kosoves (KRK)
- Meshtekna
- Perspektiva 4
- Start

loan and methodology of the MFI. Some lend based on references from a village lending committee, others lend based on group guarantee, and still others lending hinges on the guarantee of a single person or multiple individuals. In some cases movable and immovable property and salary pledges are required. The philosophy and lending practices of MFIs in Kosovo are as varied as the number of MFIs.

By law MFIs, which are considered NGOs, **cannot** accept deposits. This will soon change, when, by early 2010, MFIs will be able to transition to deposit-taking entities. Those MFIs highlighted in blue (above) are among those that may make the transition. The general impact of transitioning to a deposit-taking entity will be to reduce the cost of capital. Depending on how many transition, there may be competitive pressure upwards on saving rates at well, which earn around 4–4.5 percent currently.

NON-BANK FINANCIAL INSTITUTIONS (NBFIS)

NBFIs include leasing companies, lending firms, payment facilitators, and financial advisors. Those recognized by the CBK are listed below. The intriguing NBFIs, from an agricultural–financial services perspective, are those that introduce new lending products/services. Two “new”

services are of interest—leasing and purchase order financing.

The **leasing** law is modern and appropriate, but little leasing is done outside vehicles. Leasing is a nascent financial service in Kosovo and as such what leasing that occurs gravitates to the known such as vehicle leases.

Building on the success of the DCA credit guarantee, leasing could be a good fit for a similar guarantee program that encourages leasing firms, and there are but two in Kosovo—Raiffeisen Leasing and Factor Leasing—to extend their services to agribusiness.²⁵

The agricultural market would seem to be significant for leasing. For example, the 2007 agricultural household survey shows that there are nearly 27,000 tractors (>40HP) and more than 50,000 tractors (<40HP) used by small farmers.

Many of these tractors may have been given away since the conflict to help restart agricultural production. That means much of this equipment is seven to nine years old, and perhaps ready for replacement. Moreover, farmers generally have been exposed to the advantages of mechanization and use of proper equipment, which makes them a realistic market for leasing.

Based on interviews, there does seem to be a somewhat negative attitude towards leasing by the less informed. The feeling is, why lease and pay interest if at the end of the day the equipment is not mine. Of course leasing is not appropriate in every situation but it does minimize the need for collateral, as the equipment remains in the name of the lessor. There are tax implications as lease payments are deductible as operating costs, and at the end of the lease the asset being leased can often be purchased at a nominal cost.

Among the NBFIs, Crimson Finance Fund (CFF), a relatively new and interesting institution, is a mix of private and donor capital (Norse Aid and USAID), and I relatively small (\$1.5M) and cutting edge in Kosovo). The CFF is offering financing based on purchase orders.

BANKING ON CASH FLOW

As explained by the CFF, purchase order financing (POF) is a transaction-based form of working capital financing. When a business receives an order from a buyer, the CFF advances a loan for the company to cover all the steps necessary (production, purchasing, processing, packaging, etc.) to ship the order. What POF covers is important as many existing services such as LCs cover only a short period of time, usually shipping. LCs largely assume that the product to ship is available or that the seller can finance the costs necessary to fill an order. POF allows for a longer horizon that includes production of the commodity to be shipped. In POF, the purchase order (the contract between the seller and buyer) becomes the collateral for the loan. The accounts receivable is transferred to the lending institution and becomes the source of loan repayment. The financial institution collects payment for the loan plus interest and fees from the buyer once the product has been delivered.

Purchase order financing allows for a longer lending window than typical letters of credit (LC) (see text box).

The CFF's relatively small initial capital is now fully lent, and new loans are revolving from repayments on existing loans. The opportunity for POF to work for agribusinesses would seem to be significant, especially as the collateral is the contract to purchase. POF also addresses the historical performance issue as it recognizes that future performance requires new purchase contracts and that these contracts serve to mitigate the risk of a loan, despite historical performance.

SUPPORTING INSTITUTIONS

CREDIT BUREAU

No credit bureau or other credit-rating agency exists in Kosovo, and there is a need. A properly functioning credit bureau service should

²⁵ CFF will move into equipment leasing for businesses and specifically equipment leasing for agriculture and food processing in 2010.



- 1) Prove the utility of information collected
- 2) Refine the business case/offering, including pricing of services
- 3) Prove demand

PLEDGE REGISTRY

The Pledge Registry, which is embedded in the Ministry of Trade and Industry, receives mixed reviews by users. A pledge can be registered in person or remotely, but not online. To register remotely, the user must sign an MOU with the registrar. With the MOU the user receives a database file that allows the user to upload information regarding the pledge, which is then e-mailed to the registrar. Upon receipt, the registrar exports the information into its database. Once a week, users deliver hard copies of the pledges sent to the registrar by e-mail. While perhaps marginally tolerable for those in Pristina, interviewees reported that it is a definitely onerous system for those outside Pristina.

During interviews with the pledge registry it was mentioned that the World Bank had agreed to finance upgrades to the registry to, among other things, make it online and real time. Regrettably, for whatever reasons, the money has not been forthcoming.²⁶ Interviewees strongly suggested that the registry can be an invaluable tool, but to date its potential has been woefully unrealized.

result in lower interest for creditworthy individuals/businesses.

If there was agreement, the current well-functioning credit registry maintained by the CBK could serve as a transitional credit bureau by collecting a few additional pieces of data on such things as tax payments (individual and company), VAT payments, utility payments, and credit card payments.

While providing a credit bureau service is not usually the job of the central bank, in a country the size of Kosovo involving the CBK in a transitional way could prove beneficial to the eventual establishment of private, public, or private-public credit bureau. The CBK's role could help in several ways:

INSURANCE

At the end of 2008 there were 10 insurance companies in Kosovo, 7 of which were foreign owned, managing more than 70 percent of the assets in the insurance sector. Vehicle insurance is the dominant activity of the industry, with both policy and claims growing in 2008 over 2007. As life insurance was just introduced in 2008, it is no surprise that there is no crop insurance available as yet in Kosovo.

LEGAL/NOTARIES

There are approximately 550 licensed lawyers in Kosovo or 1 lawyer for approximately every 4,100 (compared to 1 lawyer for roughly every 600 Germans and 1 for every 265 Americans). While some countries may have a plethora of

²⁶ Follow up with the World Bank for confirmation and status update was not possible.

lawyers, Kosovo appears to be quite underserved by the legal profession. Many of these do not practice commercial law, and nearly half reportedly work in the environs of Pristina. With bar exams organized sporadically, it is not likely that a great many commercial lawyers will suddenly enter the market.

Notary services are limited in Kosovo. There is a project underway through the Swiss Cooperation Office to train and certify notaries. Out of about 200 trainees, approximately 50 will be certified and of these, it is estimated that 20 or so will be in and around Pristina.

ACCOUNTANTS/BOOKKEEPERS

Kosovo has adopted a simplified version of the International Accounting Standards. The Kosovo Association of Accountants offers training and certification for accountants. Generally those who value the work of accountants and auditors find the profession in Kosovo to be well served, especially in Pristina. As might be expected, in more rural areas, one finds far fewer qualified accountants/auditors and more bookkeepers, trained to varying degrees.

The challenge lies not in the qualifications of accountants and auditors but in the ability of agribusinesses (whether processing, trading, or commercial farming) to access the services. In addition, there is a decided lack of interest by many agribusinesses in the professional services of accountants and auditors. Mistaken or not, cost is perceived as high, access is seen as difficult, and rationale for the expense is not well understood.

ASSOCIATIONS/EXTENSION SERVICES

Severe budget constraints limit the Ministry of Agriculture, Forestry and Rural Development's (MAFRD) effectiveness as a provider of extension services. The ministry received assistance in 2003 to establish its Advisory Service Section, which assists farmers to adopt best practices; however, among the many interviewed, not one talked of receiving assistance from the ministry.²⁷

The private sector (processors/traders who seek the commodity and input dealers who seek to sell inputs) plays an important role in extension. The quality of this private extension is not clear and likely varies. One barometer of the lack of proper extension is yields, which for many of the commodities produced in Kosovo significantly lag average yields across Europe.

Associations and agricultural-related groupings generally lack sound organization management. There are exceptions, but they tend to prove the overall need for better group management. Few such organizations are assertive in advocating improved financial services for agriculture. Fewer still educate members on matters related to improved financial management and other activities that would enhance their bankability.

SOCIAL DYNAMICS

MISTRUST

With the passage of time since the major political and social disruptions of the 1990s, bank use is increasing. Average deposit size per person increased from roughly €200/person in 2001 to €690 in 2008, and loans increased 130 percent between 2005 and 2008, €514M to €1,183M, respectively. Interviewees suggested that with agribusinesses there is a lingering mistrust of banks and a reluctance to seek out loans. The preference is to rely significantly on extended family or own revenue for financing.

While reliance on personal funds to start up a business is not uncommon, reliance on them to grow a business is less desirable. One 2008 study found that more than 80 percent of small and medium enterprises (of which most agribusinesses would be a subset) financed investments from own financial resources.

Is it a preference for personal funds? Unlikely. Rather it is probably a combination of things: a lingering preference to stay liquid in case of emergency (read insecurity), the need for cash to operate in the gray economy, and the low

²⁷ While in Kosovo for this assessment, the ministry announced an input subsidy program for small farmers.

opportunity cost of holding on to cash (savings pay little more than 4 percent), a poor understanding of financial leverage, and a belief that lending rates are simply too high. It may also reflect simple reality that many agribusinesses are not bankable under current lending practices given the poor state of their financial records and lack of acceptable collateral. Whatever the reasons, unwillingness to establish relationships with lenders retards the growth of some promising agribusinesses.

LIMITED BUSINESS ACUMEN

Lack of business management skills in agribusiness sectors affects how well a business is run and, by extension, the ease with which an agribusiness can get credit, as well as the rate of interest. Poor understanding of leverage was frequently made clear and is a critical factor in the low financial services penetration.

Banks, with reason, tend to place a good deal of emphasis on historical performance. Unfortunately, very little attention is paid to future cashflow projections. Lack of business acumen means agribusinesses are not always putting the best foot forward. The case for those seeking financing is further eroded by the limited availability of quality accounting/bookkeeping services, especially in rural areas, which means that financial statements are poorly presented.

PREFERENCE FOR OWNERSHIP

Leasing should be a useful financial service in Kosovo and the market would appear to be significant for farm implements. However, there is generally an attitude that it is better to own than to lease. This suggests a need to educate the farming marketplace as to the advantages of leasing versus owning.

This education program (otherwise known as marketing) should really be undertaken by the private leasing companies. To give them a push may be appropriate. Such a push could be through market research that is shared broadly with the financial services industry, perhaps carried out under the auspices of the Kosovo Bankers Association (KBA) and AMIK and funded by any number of public groups.

ACCESS TO CREDIT FOR ALL

Given the difficulty women have traditionally experienced in accessing property rights, it stands to reason that reliance on real estate as collateral in lending is necessarily biased against women borrowers. Moreover, there are few women-led businesses in Kosovo that have sufficient business assets to collateralize. Even at the micro-enterprise level one MFI noted that it had to insist certain business loans be made only to women, as men were applying for loans for businesses that tend to be operated by women—arts and crafts, household gardening, and poultry.

RECOMMENDATIONS

There is an emerging interest in agriculture by banks and MFIs alike. However, limited understanding of agriculture and the associated risks sharpens the perception that agriculture is riskier than it really is. The following recommendations revolve generally around the theme of reducing risks.

RECOMMENDATION: LOWER THE PERCEPTION OF AGRICULTURE AS RISKY BUSINESS

General: Improve ability of agribusiness and creditors to talk with each other, while introducing risk-mitigation measures.

Short Term

- Reduce perception of risk. There is an emerging interest in agriculture by banks and MFIs alike. However, limited understanding of agriculture and the risks sharpens the perception of risk in agriculture being higher than what it might truly be.

Lowering the perception of risk can happen in several ways: train lenders in agricultural lending, improve how agribusinesses (whether farming or processing) are managed, and introduce risk management tools (e.g., credit bureau, crop insurance, leasing). The first can happen through the KBA, which already regularly organizes on a for-fee basis training for member banks.

- Use business opportunity plans. For those subsectors that look particularly competitive for small-farmer-based production consider developing “canned” business plans. This off-the-shelf approach has worked well in other countries for targeted investment opportunities (e.g., flower production in Uganda or coffee-washing stations in Rwanda). Professionally done, the plans provide a clear road map for investors (small farmers, processors, traders) to follow and for banks to clearly judge the risks.
- Expand cash flow lending by leveraging success of purchase order financing. The success to date of the CFF and its use of POF strongly suggests that others should be educated and introduced to this lending technique. Many of the businesses interviewed for this assessment operate at less than 50 percent capacity. In such circumstances, working capital is the constraint to growth, not long-term investment capital—the very need that POF addresses.

If there is adequate liquidity in the system as suggested by a few banks, then there should not be a need to actually fund POF lenders but rather entice them into this lending segment. In this regard then, it may be beneficial to undertake a proper assessment of POF market size through the KBA and/or AMIK, with results to be shared broadly with members of both associations.

Long Term

- Strengthen agricultural-related associations’ ability to improve members’ business acumen. The MAFRD extension service in principle is to train farmers in the commercial operation of their small farms. This is not happening. Associations and producer groups are another way to reach farmers with training in farming as a business.

- Use the credit registry to transition to a credit bureau. A credit bureau is needed if banks are to have increased confidence in borrowers. With increased confidence will come lower collateral requirements.

The first steps to establishing a credit bureau are building a public and private consensus on the need for such and building a system that collects both negative and positive information on borrowers. Consensus largely exists already.

The underpinning of a system is also significantly in place. The success of the CBK’s credit registry provides the foundation to establish a credit bureau. This can be accomplished by adding information, e.g., individual and company tax payments, VAT and utility payments, credit card payments, to that which is already collected by the CBK’s credit registry. With more extensive information, CBK can house a separate credit bureau as a transitional step to an independent operation.

- Consider establishing a crop insurance scheme based on the rehabilitation of irrigation infrastructure.

In the 1980s irrigation potential was estimated at around 200,000 ha, roughly 18 percent of Kosovo’s area. Maximum developed irrigation infrastructure reached at one point slightly more than 70,000 ha, with about three-quarters of this (52,000 ha) actually farmed under irrigation. A post-war assessment of infrastructure estimated that under 20,000 ha of irrigation was operational, and in 2003 only 10,700 ha were actually farmed under irrigation due to cracked and leaking canals, silted pipes, and destroyed pump stations. By 2007 the Agriculture Household Survey reported more than 39,000 ha of irrigated land, or just more than half of developed irrigated infrastructure and one-fifth of total potential irrigated land.

Short Term (cont'd)

- Encourage growth of leasing. Leasing in the agricultural arena seems to hold promise. The 2007 Agricultural Household Survey suggests significant market possibilities for agricultural equipment and implements, including irrigation equipment. One possibility to opening up this market is to carry out a rigorous market survey that covers scale and attitude. The survey performed jointly with banks, MFIs, and NBFIs would be shared broadly.
- Consider another DCA facility. The Raiffeisen DCA facility appears to have been successful. Based on this, and assuming that there are other qualified institutions in Kosovo, extending another DCA for the purposes of agribusiness lending should meet with equal success.

An alternative to agribusiness lending would be to use a DCA facility to encourage leasing companies to expand their services to include agricultural equipment and implements.

Long Term (cont'd)

Weather is the one uncontrollable risk in considering crop insurance. Diseases and other such factors of crop loss, while requiring proper crop husbandry and access to inputs, are manageable and controllable. The (re)development of irrigation would provide a critical risk mitigation factor for the establishment of crop insurance. In turn, crop insurance mitigates the lenders' risk and should increase the flow of funds for basic production.

- Establish small-farmer lending programs that bring together MFIs, processors, and small farmers by building on what each does well. MFIs know how to lend, farmers how to produce, and processors how to add value to a commodity. Allow each to do what they do well through a targeted lending program.

For example, a processor guarantees to purchase from a select group of farmers. The MFI, following all of its lending principles and with the guarantee of market from the processor, lends to participating small farmers for the purchase of inputs. At harvest, the farmers sell to the processor who pays the MFI, which deducts loan principal and interest, paying the remainder to the small farmer.

There are variations of this scheme as well that have the MFI lending to the processor who provides inputs to farmers. Another variant could be created around rehabilitating irrigation infrastructure. As before, the processor/trader guarantees a market to the participating farmers and MFI. The MFI lends to farmers to rehabilitate irrigation, which also reduces crop failure risks, and the farmers sell to the processor/trader the harvest, with proceeds paid to the small farmer through the MFI after deducting loan and interest repayment.

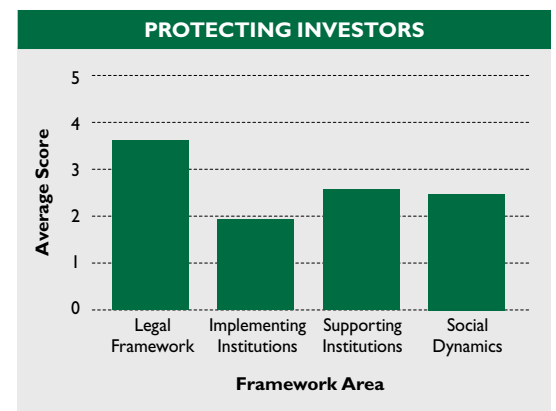


PROTECTING INVESTORS

Agricultural enterprises have a number of options for raising capital to pay for their inputs, equipment, and other costs of growing a business, most of which are appropriate instead of—or in addition to—seeking a loan from a bank or other lender. Of course, each option carries not only the promise of economic gain, but also the risk of loss. The more investors feel that they are protected against loss—particularly that which can be prevented through better information, more thorough scrutiny of an enterprise’s financial history, and faster access to prompt and fair dispute resolution—the greater the possibility that they will invest. AgCLIR Protecting Investors looks at the tension an economy experiences between investment protection and investment promotion. This chapter discusses some of the most relevant risks and opportunities to agricultural investment in Kosovo, and recommends a road to reform that encourages investment across large and small agribusinesses alike.

PROTECTING INVESTORS	
<i>Doing Business</i> Ranking 2010	172
<i>Doing Business</i> Ranking 2009	171
Extent of disclosure index (0–10)	3
Ease of shareholder suits index (0–10)	3
Strength of investor protection index (0–10)	2.7

Most agribusinesses in Kosovo are unsophisticated family operations, selling their small surplus products from family production to the market. However, not all agribusinesses fit this characterization: over the last 10 years, a number of Kosovo entrepreneurs have grown their businesses to meet wide market demand. Over the course of the two-week assessment, the team found a small number of firms, large and small, that are dependent on external investment to finance their business needs. While most firms in Kosovo’s agricultural sector are too small to attract foreign direct investment, other classes of investment, including family, friends and suppliers, are all realistic options for typical agribusiness in the economy. There are also a small but growing number of firms able to absorb investments large enough to attract international interest.



The government of Kosovo has made substantial progress in building institutions and stabilizing the macroeconomic environment since the end of the conflict. These are the precursors to future investment-led economic growth in the country—and their continued presence is imperative for future growth. There are numerous concerns, however. The low level of government expenditures dedicated to the sector, the high level of agricultural imports as a percentage of overall agricultural economy, and the slow rate of reform all contribute substantially to the slow pace of turnaround across the sector. Moreover, the rate of recovery is considered

THE DOING BUSINESS RANKING

With a *Doing Business* ranking of 172 out of 183 countries for Protecting Investors, Kosovo undoubtedly has room for improvement. However, the *Doing Business* ranking does not necessarily reflect the true situation in Kosovo's agricultural sector relative to global comparators. The World Bank's indicators place heavy emphasis on the accountability of directors and the ability of shareholders to bring suits, something important to institutions supporting Kosovo's agribusiness sector (e.g., banks, utility companies) but much less so to most agribusiness in their current forms. At this stage in Kosovo's agricultural development, the importance of improving the *Doing Business* score is as much about branding Kosovo as a good place to do business as it is improving the environment for investment in Kosovo's agricultural sector. It is important either way.

too lethargic to meet the needs of the population. Numerous interviewees suggested this failure to meet expectations, and continued lack of economic development despite the partial resolution to the greater political question of Kosovo, is likely to have a continued negative effect on the country's political stability and could further dampen economic growth. Declining foreign assistance and private remittances make it difficult to achieve this target. The resources internal to the population of Kosovo are insufficient to finance the required investment for reconstruction and growth due to low levels of domestic savings. A transparent, predictable, and business-friendly policy environment matched by strong institutional support is the fundamental precursor to investment necessary for development.

Investment in agriculture has the potential to transform Kosovo's economy. One local economist estimates that more than 150,000 jobs could be created through agriculture in Kosovo²⁸—representing nearly half of the country's unemployed population. Regarding the

factors for attracting and retaining investment, Kosovo has a mixed record.

LEGAL FRAMEWORK

The legal framework for the protection of investors in Kosovo is still a work in progress, but one that has made great strides over a relatively short period of time. To attract foreign and local investment, the legal framework needs to guarantee the protection of investors' rights. To attract foreign investment in particular, foreign and local investors should be treated equally. But most important, legislation needs to be transparent, predictable, clearly defined, and stable—investors abhor unpredictable, hard to interpret, or constantly changing legal regimes.

While the legal framework for investor protection is generally sound and in line with international standards, with a modern and internationally acceptable company law, investment statute, and modern legal mechanisms for dispute resolution, supporting regulatory uncertainty is considered a foundational problem for Kosovo. Stakeholders knowledgeable about the legal and regulatory regime supporting the agricultural sector cited uncertainty regarding the procedures and mandate across Government ministries for drafting new laws, and the ability of ministries to draft effective regulation. Despite the modern legal framework, Kosovo is rated 172 out of 183 countries in the World Bank index of protecting investors, indicating clear problems in investors' protection.

ACCESS TO LAWS

Access to laws and regulations relevant to investors or potential investors in Kosovo is generally adequate. Improvements still need to be made to clarify the maze of Yugoslav and

POLITICAL RISK

Perception of political risk was the most frequent response to a recent Economic Initiative for Kosovo (EIKS) survey of potential investors in Kosovo regarding the weaknesses in Kosovo's investment climate.

28 This statistic could not be confirmed independently, but was considered "reasonable" by other economists knowledgeable about the sector.

KEY LAWS

- Law on Business Organizations, 02/L-123
- Investment Law- 02/L-33
- Law on Economic Zones 03/L-129
- Law on Cooperatives

post-Yugoslav laws and regulations. All the laws, as well as a substantial portion of the regulations, are accessible online, either through the Kosovo Assembly website,²⁹ respective Ministries, official gazette website, and older legislation is available on the UNMIK website. Determining the most recent law or regulation can be somewhat more difficult. All laws and regulations are supposed to be available in Albanian, Serbian, and English in order to make them accessible to both domestic and foreign investors. Examples of laws that are not readily available either online or in the above-mentioned languages include the Cooperative Law and the Seed Law, respectively.

INVESTMENT LAW

Kosovo's investment law and laws concerning movement of capital are liberal and provide a good foundation for future investment growth in the agricultural sector. The Kosovo Assembly enacted the Law on Foreign Investment in 2005. The law on foreign investment is generally sound, covering the important areas of investment. The main objective of this law is to guarantee investment security and assure domestic and international investors the protections offered against any changes in the legal framework taking place after their investment was made. The law has a number of key features:

- It spells out a number of cases when foreign investors are entitled to compensation from the government for damages and lost profit, if the damage is caused because of inaction or any action done by the government, in case of war or civil unrest.
- It prohibits nationalization of foreign investors' property without remedy. Expropriation is allowed only in certain circumstances, obligating the government

to compensate such an investor for the property based on its fair market value. The government is then required to make prompt payment and pay interest fee for any delay in completion of payment.

- Investors can own immovable and movable property, are allowed to transfer the profit out of the country in the currency of choice without any interference by the government, and employ and repatriate foreign citizens without interference from the government.
- The foreign investor can choose the appropriate mechanism and jurisdiction for dispute resolution. While Kosovo is not a member of the International Centre for Investment Disputes (ICSID), it can express consent to be a party to a case. The case can be either resolved by rules promulgated by ICSID, the United Nations Commission on International Trade Law (UNCITRAL), or the International Chamber of Commerce (ICC) rules of procedure.
- The law establishes a structure to govern and monitor the implementation of the foreign investment law. A new agency under the auspices of the Ministry of Trade and Industry called the Foreign Investment Institution (FII) was established with the purpose of assisting foreign investors as well as advising the Kosovo government in developing foreign investment policies. Further, the agency is guided by the Investment Promotion Advisory Board (IPAB), whereby members of the board are ministers. The law also established the Foreign Investment Council (FIC) at the level of the Prime Minister's Office.

The Law on Foreign Investment seeks to guarantee a degree of consistency for foreign investors. For instance, according to the existing law, if any changes to the law occur after an investor invests in Kosovo, and are less favorable to that investor, the changed law cannot affect their interests. In cases where the law is amended

²⁹ See <http://www.assembly-kosova.org/?cid=2,1>.

Subject	Albania	Serbia	Montenegro	Macedonia	Kosovo
Tax Holidays	10 years, if promoted activity (5y no CIT +5y only 50% of CIT)	10 years if €7 Mill invested, 100 jobs created	N/A	3 years (in free zones 10 years)	No
Employment Incentives	N/A	100% of gross salaries; €2-10,000 for each job created, dependent on sector	N/A	N/A	No
Undeveloped Regions	For tourism development	5 years tax free	3 years tax free	50% of tax base = value invested	No
Customs	Tourism 100% VAT credit for machinery and equipment	N/A	New equipment 0%, raw materials -50%	Equipment, spare parts, if 20% of company belongs to a foreign investor	Agriculture machinery and inputs
Concessions	N/A	5 years tax-free if concession-related investment	N/A	N/A	No
Carrying Forward Losses	N/A	10 years	N/A	3 years	5 years
Double Taxation	Yes	N/A	Yes	N/A	Yes
Special Allowances	Yes	Yes	Yes	Yes	Yes

and is less favorable to the investors, they are entitled to compensation from the government. However, in practice this is not the case. Stories abound that after foreign investors made investments in Kosovo, the government adopted less-favorable rules and enforced them against investors. Examples include increased license fees for businesses and increased excise duties. In principle, this is in violation of the law. Interviewees reported frequent and similar inconsistencies in the law. This will not promote foreign investment in the agribusiness sector in Kosovo, or other sectors for that matter.

INVESTMENT INCENTIVES

Investment incentives are used to achieve a variety of policy objectives. However, many regional economies and all of the EU economies are de-emphasizing investment incentives in favor of

an overall attractive tax regime. They are commonly used by governments to promote foreign firms' entry into new markets in an effort to generate employment and economic growth. They may also take various forms, from government concessions or contracts to tax advantages or availability of infrastructure. In Kosovo, investment incentives are Spartan compared to regional economies. Table XXX below compares Kosovo's investment incentive regime with that of its neighbors. Areas for future consideration include tax holidays, employment incentives, and concessions. To compete with regional economies, many interviewees suggested the importance of a more robust investment incentive regime. The empirical literature is mixed on investment incentives' net effect to economies. One thing is clear: such incentives are only as good as the investors who take

advantage of them. Publicity is an essential piece of the investment incentive system that is currently lacking—a responsibility that falls to IPAK and potentially other ministries in contact with foreign investors.

LAW ON ECONOMIC ZONES

The purpose of the law is to encourage foreign investment in Kosovo by developing adequate and necessary infrastructure for businesses including agribusiness. Foreign investors enjoy equal treatment and rights in developing business activities within the free economic zones. Property issues must be clarified, approval needs to be obtained from the Ministry of Trade and Industry, and a business plan needs to be submitted for an economic zone to be established. Once permission has been received, the developer is required to complete building and development of the economic zone within two years, or permission may be revoked.

The initiative for establishment of the free economic zone can be undertaken by any ministry, municipality, business, or public-private partnership. They can be created on private or public property. When zones are developed on public property, eminent domain is not permitted and the property will be given on lease for 99 years. Overall responsibility for development and monitoring of the free economic zone lies with the MTI, through the Department for Economic Zones.

While the law provides the framework for establishment of economic zones and this is a good start to attract investment, the law does not clarify the responsibility to provide the basic infrastructure in Kosovo. Similarly it fails to clarify responsibility for ensuring proper functioning and maintenance of the economic zones. This is a critical issue, given Kosovo's unreliable basic resources such as water and power, both crucial for agribusiness.

The most significant challenge to investor protection in Kosovo is not the legal framework, but the implementation and enforcement of

OPENNESS TO INVESTMENT

Kosovo is open for investment. The GOK and the Ministry of Trade and Industry actively promote foreign investment in Kosovo, albeit ineffectually, according to most interviewees in the AgCLIR assessment. The Foreign Investment Law stipulates investors select from one of multiple, well regarded dispute resolution conventions for investment dispute arbitration. To encourage investment, businesses importing capital goods and are granted a six-month VAT payment deferment. Agricultural inputs are imported duty free and VAT is not meant to be paid on these inputs. However, a few interviewees noted that they do pay VAT on agricultural inputs to avoid the “hassle” of declaring exemptions

the laws or lack thereof. Institutional effectiveness and deterrence of corruption will not be attained by increasing bureaucratic layers but through better governance.

LAW ON BUSINESS ORGANIZATIONS

The purpose of company law such as the Law on Business Organizations is to set forth basic principles of corporate governance—that is, the rules that outline the division of roles and responsibilities between company management, boards of directors and supervisory boards, investors or shareholders, employees, and outside stakeholders. Corporate governance entails disclosure and transparency requirements regarding the type of information that companies must report to their investors, and, in many cases, to the public. Corporate governance practices provide proper incentives for company boards and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.³⁰ The *Doing Business* Report measures “Protecting Investors” by rating corporate governance. While most agribusinesses in Kosovo are far from the point of worrying about corporate governance, many

³⁰ Definition at www.bizclir.com.

firms that support agribusinesses do need to worry about aspects of corporate governance such as shareholder rights and director liability, including financial service providers, energy companies, and transportation companies. In this regard, Kosovo needs substantial reform, as noted by the low score in the *Doing Business* ranking—disclosure and liability rules are weak, and the strength of shareholders' rights within a court setting to resolve corporate grievances are particularly weak compared to regional and global benchmarks.

Until 2007, business organizations and companies were regulated by UNMIK Regulation 2001/6. In 2007, the Kosovo Assembly enacted the new Law on Organization of Businesses. In 2007, the BizCLIR assessment team, under the auspices of USAID, evaluated the law and found it to be adequate for conditions at that time. It was clearly drafted and included the essential elements of a good company law, e.g., a statement of duties of care and loyalty of company directors, guaranteed basic shareholders rights (meetings, shareholder information), and distinct competencies between the shareholders and the board of directors. The new law lays out a foundation allowing both foreign and domestic agribusinesses to commence activities relatively quickly. It does not contain limitations on activities in which foreign businesses can be engaged. Presentation of an original certificate of incorporation to Kosovo authorities may be a challenge for foreign investors; however, a notarized certificate of incorporation should suffice for this purpose. The Law on Business Organizations sets forth types of business organization in Kosovo and the structure, rights, and obligations of the owners, managers, directors, legal representatives, and third parties. The law allows for a wide range of business structures, including personal enterprise, general and limited partnership, a limited liability company, and a joint stock company. The new law on business organization was initially drafted by domestic legal experts, and reviewed and commented upon by European and international experts.

Similar to the BizCLIR team's findings in 2007, this team found the law to be generally adequate for the attraction of investment in agribusinesses, given the economic conditions and the level of business organizations in Kosovo.

There are amendments to the Law on Organization of Businesses under discussion within the MTI. The view of international experts and stakeholders interviewed for this activity noted that the changes in question are unnecessary and do not improve the legal framework for investor or shareholder protection. The risk is that by making certain changes, the provisions will further weaken protection of shareholders, increase bureaucratic processes for businesses, and discourage foreign investors. The MTI would be well served by considering the *Doing Business* report prior to making any changes or reviews of the Law on Organization of Businesses. Brand Kosovo is at stake.

IMPLEMENTING INSTITUTIONS

Kosovo's institutions are relatively young and exhibit unevenness in implementation. Ministries including the Ministry of Agriculture, Forestry and Rural Development (MAFRD), the Ministry of Trade and Industry, the Ministry of Justice, and the courts together implement the country's legal framework. The MAFRD has the preeminent role in agricultural development. Responsibility for investment lies within the Ministry of Trade and Industry's Investment Promotion Agency. The government of Kosovo's expenditures toward agriculture are limited,

KEY IMPLEMENTING INSTITUTIONS

- Investment Promotion Agency of Kosovo (Ministry of Trade and Industry)
- Ministry of Agriculture, Forestry and Rural Development
- Courts
- Food and Veterinary Agency (within Prime Minister's Office)
- Anti-Corruption Agency Office of the Prime Minister

FDI INQUIRIES BY SECTOR



equaling less than 3 percent of the total national budget of €7 million in 2008. Investment promotion expenditures are much smaller still.

INVESTMENT PROMOTION AGENCY OF KOSOVO

The Investment Promotion Agency of Kosovo (IPAK) is situated within the Ministry of Trade and Industry (MTI). The IPAK has a €250,000 annual budget and 13 employees. Investment promotion services are rated as poor by users interviewed for this report. The IPAK's strategy is considered insufficient and not focused at all on agribusiness. The agency is cash strapped and unable to help foreign investors. Foreign languages are not widely spoken at the agency. Private sector representatives interviewed for this report noted the "disorganized" and "unsophisticated" nature of the IPAK. Many of those interviewed said that the human and financial resources within the IPAK are simply ill suited for the job of investment promotion and investment "capture." Particular issues noted by interviewees included production of materials not useful for an audience of potential international investors (e.g., lack of editing and absence of any real strategy), lack of standardized data collection or dissemination for investment purposes, and a near total absence of communication with other key ministries, including the Ministry of Agriculture. There is no one with agricultural expertise to assist potential agricultural investors in the IPAK.

The IPAK has yet to make a substantial contribution to investment in Kosovo, especially to agribusiness investment. Some analysts note that perhaps agriculture should not be emphasized as

an economic development strategy; this report takes the view that the enabling environment for agriculture has to be sufficient to jump start rural growth and revive what was traditionally a large portion of Kosovo's economy. In 2010 the IPAK will develop its first Foreign Direct Investment strategy, a move that should be lauded. Despite this strategy, there is still very little clarity on how it will integrate with the government's larger policy to promote key sectors of the economy. And, unfortunately, the constraints to the sound implementation of such a strategy remain high. The unit is not adequately funded to meet its objectives and its physical facilities are located in an inconspicuous and hard-to-find location within the Ministry of Trade and Industry. There are no obvious places to meet with potential investors. The IPAK does not go through any known performance review processes, and there are no known uses of objective monitoring indicators. Likewise, the IPAK collects very limited investment data such as registration, levels of investment, employment, liquidation, or other statistics of interest to policy makers and the private sector. That the total number of potential foreign investors showing interest in agriculture in 2009 was only five speaks volumes about the challenges faced by the IPAK.

MINISTRY OF AGRICULTURE, FORESTRY AND RURAL DEVELOPMENT (MAFRD)

The stated policy purpose of the MAFRD is to "boost agricultural farm incomes through increased productivity of farming." The ministry also has a role in formulating policy for rural

SOURCES OF FOREIGN DIRECT INVESTMENT INQUIRY



development outside of the agricultural sphere. But more important, the government needs to reconsider its focus on productivity in light of the larger systemic-enabling environment issues raised in this report. The MAFRD is a relatively large and top-heavy public agency with 35 senior managers and 487 non-managers, the vast majority of whom work for the forestry agency. Interviewees familiar with the MAFRD noted a low level of morale within the ministry, based at least in part on the poor remuneration, a system that does not recognize seniority in pay scale, and a total lack of career development opportunities. There is also a sense of increased politicization with the MAFRD since the Prime Minister's office took over the Kosovo Food and Veterinary Agency. Organizationally, the MAFRD mixes regulatory roles with service delivery functions (e.g., extension services with regulation of service providers). This has the potential to create conflicts of interest by being both the "player and referee," and generally distracts the government from its core *achievable* function of providing public goods—in this case sound regulation, market data, analysis, coordination, grant administration—and other functions generally reserved for the government or most likely provided by it.

The MAFRD is characterized by a top-down or supply-driven approach to policy making. In line with its policy priority of increased productivity, focusing on what, when, and how to produce various agricultural products, the ministry would be well served to instill a more market-oriented approach, starting with information about consumer markets and moving backward

to transfer knowledge and information to agribusinesses. Information such as market prices, demand, regulation, and opportunities are all roles well suited to a ministry, and tend to concentrate the ministry's resources so that it has a fighting chance of achieving successful outcomes. Data collection needs to start with an agricultural census, something that has not been carried out for over 20 years.

The MAFRD, like other ministries, affects investment through at least two channels. First, the ministry's regulatory function provides the "rules of the game," which, if followed, produce a predictable and transparent system—the essential building blocks for encouraging increased investment. Such a role would be conducive to a system whereby the MAFRD no longer feels one of its key functions is the need to "advocate for lower interest rates on loans," instead opting to address the root cause of high interest rates: high risk and high transaction costs. By focusing on the reduction of transaction costs and risk in agricultural value chains, the MAFRD may actually be able to cause lower interest rates. Second, the ministry is in a unique position to collect and provide useful data on the sector. Data necessary for analysis is difficult to obtain or not available at all. The current state of agriculture-related data in Kosovo could be greatly improved with a streamlined focus on essential data including commodity market reports, agricultural trade statistics, and local and regional crop prices.

The widespread and deep weaknesses in the statistical systems do not allow for meaningful

KEY IMPEDIMENTS TO INVESTING IN THE AGRICULTURAL SECTOR

Value Chain Risk. The low level of cooperation, communication, collaboration, and overall knowledge across most local value chains present substantial risk to agricultural investments. Moreover, investments along most agricultural value chains in Kosovo face risks associated with the following challenges:

Environmental

- Lack of wastewater treatment and waste disposal issues leaving many rivers near urban centers unsuitable for irrigation

Market Infrastructure

- *Wholesale markets and collection centers:* Little effort going into proper storage, handling, sorting, grading, or merchandising of product to distinguish one seller from another
- *Storage facilities:* Both dry and cold storage facilities are rare and often in too poor of a condition to serve their purpose
- *Packaging:* A lack of packaging options, substantial risk specific to particular value chains exist

or trustworthy assessments of the current economic situation in Kosovo by potential investors or public policy makers. Private agribusinesses repeatedly noted their disbelief of official statistics. For instance, the data on national investment figures tends to be old and fragmented, and very time-consuming to collect. The principal source for data is the Statistical Office of Kosovo (SOK). Large discrepancies in official data are reported, and tend to result from the utilization of different data sources and the consistent recirculation of outdated information. The only known source of agricultural data is the annual Household Survey managed by the SOK, which covers a limited range of topics.

A good example of how agriculture ministries can offer real value to the agricultural sector is the Federal-State Market News Service (FSMNS) of the U.S. Department of Agricultural Marketing Service. On a daily basis, this service gathers price data pertaining to 300 different fresh fruit and vegetable commodities in 31 markets in North America and Europe, from 181 different shipping points. This data is then compiled at each of the 15 FSMNS offices across the country, aggregated at the Washington, DC, headquarters, and published online. Access to the information is free of charge. The budget for this service is \$7 million annually. A similar system in Kosovo, with Kosovo labor rates and a

far more limited range of commodities, markets, and shipping points, would cost only a fraction of the FSMNS annual budget. The Agricultural Marketing Service is generally quite generous with its proprietary technology and would likely be favorably disposed to work with Kosovo in the development of such a system there.

COURTS

The courts are widely considered to be an impediment to doing business in Kosovo and no less so for agribusiness. They are poorly organized for the types of cases most often handled in agribusiness, and endowed with insufficient resources to fulfill their mandate. They are widely seen as inefficient and lacking sufficient information technology to handle larger volumes, and more important, to ensure that case distribution is done randomly. This is of serious concern to both the private sector and the legal profession. The commercial court has too many cases on its docket that fall outside of its mandate, and many others that relate to small dollar-value electricity cases. There is no prioritization based on value of the case. Interviewees knowledgeable about the subject noted that the Commercial Court is generally viewed as more efficient and with more specialized knowledge of commercial matters than other courts, and is still the preferred location. Despite this,



and without significant change since the 2005 BizCLIR report update, “the courts remain under-funded and under-staffed, while judges and court officials are often under-trained and under-paid. Given this, it is not surprising that courts do not have the public’s confidence and are not viewed as institutions capable of defending contract rights. Parties see no reason to defend their rights because of the extended time commitment and unpredictable outcome. This, coupled with the lack of a tradition of using written contract documents, means that Kosovo has a ways to go before contract law takes its rightful place at the core of commercial relationships,³¹ including agribusiness relationships.

The competent court for any dispute arising as a result of breach of fiduciary duty or director liability is the municipal court, where cases are adjudicated by judges with very limited experience in deciding complex cases arising from the company law. The best solution, according to international legal experts working in Kosovo, is to create special arbitrage courts that will handle complex disputes involving foreign and local investors. Even though the arbitration law was passed last year, very little progress has been

made in its implementation. The law requires that arbitration decisions be validated by the court. However, if a decision made by an independent arbitrator needs to be confirmed by the court, there is the potential to jeopardize the neutrality of the arbitration process and the need to have an impartial arbitration.

SUPPORTING INSTITUTIONS

The health of an investment environment can be gauged to a significant degree by the availability and quality of information and professional services in a given community. Among the key supporting actors that increase investment potential and reduce risk to investors are the institutions discussed below.

UNIVERSITIES

In 1999, the Serbian faculty of the University of Pristina took up new premises in Mitrovica. The ethnic Albanian faculty stayed on the premises in Pristina, and remain there still. Both institutions maintain agricultural programs.

The faculty in Mitrovica considers itself part of the Serbian educational system, follows Serbian curriculum, and receives funds from the Serbian authorities for all educational costs. Both campuses offer courses in basic agricultural studies, but only the University of Pristina offers a course on agribusiness. The faculty in Mitrovica does not offer classes in agribusiness because of a lack of resources. Neither university offers extension services. The University of Pristina has expressed interest in offering such services but cannot because the law prohibits it from doing so. Similar to the University of Pristina’s responsibility for training in-country seed and plant-health inspectors, the university could offer a valuable option to the government as a provider of extension services. This is similar to successful models elsewhere in the world, including the United States.

Both agricultural faculties need substantial attention before they are able to contribute

31 BizCLIR 2005. www.bizclir.com.

fully to Kosovo's agricultural sector. First, both faculties' total attention to on-farm activity comes at the expense of perhaps the single most important impediment to agricultural growth in Kosovo—robust agricultural marketing to consumer markets. Second, both universities are reported to have weak linkages with players in the agricultural sector, including trade associations, cooperatives, model firms, and donors. Third, members of the research community noted the poor research and scientific infrastructure, including labs, buildings, and other equipment within both universities. Fourth, and certainly a key element of the above-mentioned issues, both faculties report financial positions scarcely able to support broader academic initiatives.

FARMER-BASED ORGANIZATIONS

Farmers in Kosovo tend to be too small to supply major buyers. This creates a strong demand for pooling of resources in cooperative-like arrangements. Agro-combines, or industrial cooperatives, were part and parcel of Kosovo's agricultural sector until 1991, when they collapsed along with much of the state apparatus. The collapse left a vacuum that the small and fragmented agricultural sector has yet to fill—no longer able to rely on agro-combine production centers, market information, or supply of agriculture inputs. The sector currently is characterized by small farms, fragmented input supply chains and market access issues due to a lack of market organization and economies of scale. The government, donors, and private sector need to understand that without more effective organization, the competitiveness gap with regional competitors will only grow wider.

Few companies in the agricultural sector of Kosovo are yet at the scale necessary to attract investment. The most likely route to such scale is through the cooperative or association model, at each level of the value chain from farm gate to marketing of the product. This model holds enormous potential for domestic agricultural enterprises, but needs to go through

a full-scale transformation in Kosovo before it contributes substantially to the country's development. Specific roadblocks to growth of cooperatives and associations include the history of treating cooperatives like cash cows, insufficient levels of trust among members of such organizations, poor management capacity, and inconsistent treatment of agricultural contracts between members and non-members. That is, small agribusinesses that are members of cooperatives or associations are not well protected from the vagaries of agriculture that such entities were meant to reduce, thus representing a risk to personal investments.

MARKET INFORMATION SYSTEMS

There is very little formality in the sharing of agricultural-related prices in Kosovo. Most private sector actors we spoke with described their reliance on mobile phones and personal networks to receive their price information. LIT-M, a small NGO, formerly part of an EU project, is now the only formal provider of market information for agricultural products aside from weekly price updates in local newspapers. A glaring hole in each of these sources is the lack of analysis about what, where, and when to market agricultural products. Simply put, price reporting is not sufficient information to be useful to the market. There needs to be a system for analysis of the domestic and regional markets. In addition, prices change too quickly for weekly price reporting. There also tends to be little to no information available relating to farm-gate prices, only retail.

THE LEGAL PROFESSION

A vibrant legal profession is essential to the growth of any sector of the economy, and agriculture is no exception. The culture of contracts is weak in Kosovo, especially in rural areas and among and between agribusinesses. This increases the risk to any given transaction and substantially limits financing options for agribusiness. According to interviewees during this assessment, and to the BizCLIR 2004/2005/2007 reports, the legal profession has contributed

very little to the reform of the business environment. Lawyers, businesspeople, and government officials reported that few lawyers have been sufficiently trained to provide usable services, including legal drafting, to create a functional system of contracting. BizCLIR 2004 reported, and confirmed through interviews with members of the legal profession, that:

Judges, through incompetence or corruption, prevent the courts from being viewed as an institution that protects contract rights and thus encouraging the greater use of contracts. Both lawyers and judges suffer from a lack of legal research resources and training in contract law.³²

As BizCLIR 2004 reported, and as a number of meetings with private agribusinesses over the course of this assessment made clear, there is an increasing demand for these services from foreign investors and businesspeople who want to invest or trade in Kosovo, but there are simply not enough qualified lawyers to meet this demand. To date, the law schools do not offer courses in rural property, water rights, or agricultural contracts that would prepare lawyers to specialize in agricultural law. In general, reliable and knowledgeable legal assistance for agricultural actors is rare or non-existent across all levels and types of value chains in Kosovo.

DONORS

Donor involvement in Kosovo is substantial. Donors, including USAID, GTZ, World Bank, Mercy Corps, the EU, and Swiss Intercooperation, are all actively involved in the agricultural sector and independently working to increase investment along numerous value chains. It is estimated that these donors collectively provide €15–18M/year to the agricultural sector in Kosovo. However, donor coordination in the agricultural sector was reported by almost all stakeholders as poor or non-existent. A couple of donors noted that recent, somewhat ad hoc gatherings of donors were quite useful in terms of information sharing regarding

breadth of planned programs. Various interviewees gave examples of donor duplication, donors working at cross-purpose, and donors working towards the same end across each country in the Balkans—a prospect that could mean disaster for producers of any particular commodity supported by those donors. There is little justification for this. It is an imperative, supported by the Paris Declaration of 2005, that donors coordinate to avoid duplication and to maximize value for resources spent.

In 2005, the BizCLIR team recommended the adoption of a model used in Serbia and elsewhere, where there is a monthly donors' meeting with a rotating chair which is open only to donors working in a given thematic area. The purpose of such meetings is to share programmatic information, experiences, best practices, and how to avoid redundancies. Meetings tend to run two to four hours, depending on the objective. The meetings increase efficiency and lead to greater familiarity between donors, something that tends to result in more synergistic programs and fewer redundancies.

THE PRIVATE SECTOR

Agriculture often starts with the farm, and in Kosovo the farm is most often comprised of the family unit. These mostly family farmers consider farming a way of life more than a business. So much of the agricultural community is still quite rural and set apart. Other levels of agricultural value chain, including traders, transporters, and processors, also tend to be quite poorly organized and unaware of existing, supporting initiatives, be they government or donor. For instance, of the agribusinesses this team met with during the assessment, few were aware of the investment incentives available to them. Similarly, the agribusiness and agricultural-related trade associations reported a general sense of exclusion from the policy-making process and seemed to be infrequently consulted for either policy proposals or the design of donor interventions. To date, much of the donor involvement in the country is said

³² BizCLIR 2004, www.bizCLIR.com.

to focus on government-to-government interaction. There is a strong need to continue to invigorate private-sector voices and to assist the private sector in its engagement and awareness of government.

Meanwhile, there is a dearth of trade or industry associations that can effectively represent the private sector in public debate over updates and changes in the commercial law. Often the government exacerbates this issue by consulting with one or limited sector representatives at a time. Recent effects of narrow rather than economy-wide (or even sector-wide) consultations helped one group (dairy farmers) while harming another (grain farmers). The weakness in such institutions stretches to what interviewees reported as a lack of meaningful opportunities in the agricultural sector for networking, training, and sharing of best practices. One donor saw an opportunity to help organize a high-priority value chain by inviting them to all sit around a table and coordinate—the result was reportedly an all-out blame game between actors in that particular chain. In addition, the events that do occur are often Pristina-centric, largely ignoring northern Kosovo’s minority Serbian population. As one academic in the north told us, “Your team is the first to visit or include our institution.”

There seems to be no knowledge of agribusiness by those groups working to improve the company law, corporate governance, or other legal framework for protecting investors in Kosovo. However, agribusinesses and cooperatives tend to know or care little about these same legal frameworks. While trade and industry associations (including the chambers of commerce and niche trade groups) are accustomed to advising their membership on matters of relevant law and corporate governance, there is little consensus on how the private sector can make a meaningful impact over time.

Specific to the issues of the investment incentives, company law, corporate governance, and investment law considered in this chapter, few

Rank	Obstacle	Intensity (I 100)
1	Power Supply	82.8
2	Informal Economy	75.9
3	Public Services	74.0
4	Roads and Telecommunication	72.1
5	Corruption	70.6

government officials that we met with seemed concerned with the outcome of any ongoing efforts to reform the sector through legal revision. Most important, few outlets exist for formal review of the investment incentives, or for other similar policy issues affecting investment in Kosovo. The government is open and welcoming to private-sector participation, but as yet has limited fora for their timely engagement.

SOCIAL DYNAMICS

More than 80 percent of Kosovo’s food needs are supplied via imports. This is symptomatic of the many challenges facing Kosovo’s agricultural sector. Typically small farmers, informal markets, and processors are not equipped to meet the demands of a highly competitive and evolving retail sector, with high barriers to entry. Moreover, the so-called fresh window in Kosovo is short on account of the scarcity of greenhouses and proper cooling facilities. Restaurants in Pristina, Prizren, and other major centers in Kosovo rely upon imported processed dairy products, meats, and vegetable items because of these issues and the generally superior reliability, quality, quantity, and lower transaction costs due to more developed value chains, compared to domestically produced products. Buyers in regional markets must face the same calculus. Substantial investment in the agricultural sector, both across and within value chains, is necessary to grow Kosovo’s agricultural sector to its full potential, creating jobs and reducing poverty in the process.

Kosovo’s social, political, and cultural diversity is still delicate following armed conflict. Travel between northern and southern Kosovo

remains a special affair, requiring the removal or changing of license plates. Serbian speakers report not being fully comfortable in their native tongue in Albanian-dominated areas. Residents of northern areas of Kosovo interviewed for this report articulated a clear allegiance to the Serbian government and noted their connection via government revenue and use of government services. In a recent survey of the region, the *Balkan Monitor* reported that only 17 percent of Kosovo Serbs said it would be possible to live peacefully with Kosovo Albanians; of the latter, 70 percent felt peaceful coexistence was viable.³³ Clearly, there is a long way to go before Kosovo will be able to catalyze large investments or stand the test of mobile citizenry and the free flow of goods and services. While risk of expropriation is no longer a concern for most agribusinesses, concerns of how to return individuals previously engaged as farmers to their farms is seen as a serious challenge. Serbian minorities reported major security concerns around returning to Albanian-dominated areas to resume agricultural operations. This problem is compounded by a general dearth of information within enclaves about where to sell products (e.g., in which markets and when).

DEMAND FOR REFORM

There is a private-sector sense of urgency about the conditions related to reforming the legal, regulatory, and institutional environment for doing business in the agricultural sector. The majority of interviewees for this report focused on few issues when queried about the “biggest challenge to Kosovo’s agriculture sector.” The majority of interviewees reported that the biggest challenge to agriculture in Kosovo is foreign subsidies. This overlooks the substantial, and more fundamental, constraints to start-up and growth in the agribusiness sector. Local and international experts on agribusiness report that more fundamental constraints to growth of Kosovo’s agricultural sector include:

- Lack of knowledge of consumer markets and absent state support in this regard

- Lack of basic business skills including financial management, strategy, and marketing conducive to the attraction of investment or other suitable external financing
- Poor organization of agribusinesses within and across value chains

The media play an essential part of informing, creating, and moderating the demand for reform in any country. In Kosovo, the media have had a “take off” since the end of the conflict. Donors and private media operators have financed print, radio, and television outlets, each freely reporting on the content of their own choice. The development of this sector is still in its early stages, however, with substantial content sourced from press releases and news conferences. The result of this type of “reporting” is that the news tends to be dominated by politicians—with a general lack of reporting relating to issues or trends of interests to agribusiness. As one interviewee noted, there is plenty of information reported, “but using it for [his] business makes no sense.” Investigative reporting is rare if not altogether non-existent, which is a serious weakness to combating the corruption in courts or elsewhere in the economy.

SUPPLY OF REFORM

Government officials interviewed in the course of this assessment showed a mixed level of interest in agriculture. Some spoke of agriculture as a thing of the past, as a poor way for Kosovo to progress. Others mentioned agriculture as the country’s greatest economic challenge, but seemed daunted by the challenges necessary to transform the sector. Only recently has the highest-level political involvement become noticeable, sometimes attributed to the food crisis. Most crucial to the government’s “supply” of reforms is its willingness to include the private sector while formulating reforms and in drafting laws germane to the agricultural sector. On this level, the government receives a mixed review. The recent example of the dairy industry lobbying for a change in VAT policy is a good example. Despite

³³ See 2008 Summary of Findings at www.balkan-monitor.eu.

evidence showing that dairy products were being unfairly taxed (e.g., raw milk was taxed when used as an “input,” contrary to existing legislation), the government reform process was slow to respond, first at the bureaucratic level, then at the legislative level.

CORRUPTION

The legal framework for rooting out corruption and instilling confidence in an international class of investors is still insufficient. There is no law on the financing of political parties, control of assets, or conflict of interests. The problem is pernicious and pervasive—companies that were

interviewed as part of this assessment consistently told the same story about corrupt procurement practices, tax collection, and access to government-related services. *Quid pro quo* is the name of the game. Before Kosovo can fully claim the confidence of investors big or small, the nascent institutions need to establish a clear track record of credible investigations (as opposed to political), prosecutions, and convictions. While nearly a quarter of Kosovo’s GDP comes from public procurement,³⁴ the constancy of cancelled tenders due to non-compliance is anathema to building investor confidence in the country.

34 Kosovo Under UNSCR 1244/99 2009 Progress Report, Commission Staff Working Document, October, 2009.

RECOMMENDATIONS

RECOMMENDATION: INCREASE THE ATTRACTIVENESS OF INVESTING IN KOSOVO'S AGRICULTURAL SECTOR TO BOTH DOMESTIC AND FOREIGN INVESTORS

General: Increase national investment in agricultural systems, including institutions, infrastructure, and incentives.

Short Term

- Create a single, online repository of commercial laws and relevant implementing regulations. Work to ensure that there is one authoritative source of law online, updated at least monthly. This should be lead by the Ministry of Justice, with likely donor support.
- Engage in a high-level forum, including the government, private sector, donors, and other stakeholders, as a first step in determining the level of investment incentive that the government can afford and the most efficient method of achieving policy goals within this budgetary framework. The output of such a forum should be an action plan taken up by a newly created inter-ministerial working group focused on this topic.
- Clarify the Law on Economic Zones to make clear responsibility of respective parties in terms of building/operating basic infrastructure.
- Assist the MAFRD to become more market oriented, clarifying and narrowing its mission while rationalizing any internal conflicts of interest relating to regulator-service provider functions.
- Invest in the agriculture faculties at the Universities of Prishtina and Priština to enhance their capacities to educate the next generation of agribusiness men and women, paying particular attention to post-farm gate activities, particularly marketing.
- Use the substantial donor presence in agriculture as an example for the larger donor community by forming a thematic working group with monthly meetings to share information and address any potential duplication of efforts.

Long Term

- Strengthen the IPAK through (a) implementing a robust and achievable strategy, agreed to at the highest levels of government, (b) increasing its budget allocation to reflect the importance of the agency's work, (c) reconsidering its physical location, and (d) paying substantial attention attracting dedicated talent.
- Support public awareness and training on good business practices and basic corporate governance through organizations and programs directed at small businesses and farmer-based organizations (FBOs). Create education and training programs on basic business management, with a special emphasis on training rural entrepreneurs.
- Invigorate the extension services through (a) revision in the legal framework to allow for university-based extension services with (b) commensurate investment to support a robust and self-sustaining extension system.

RECOMMENDATION: ENHANCE THE LEGAL FRAMEWORK FOR INVESTMENT IN KOSOVO.

General: Focus on improving both investor protections and investment promotion to attract and retain international and domestic investment in the agricultural sector.

Short Term

- Simplify the business registration process, including filing charter amendments with the business registry and clarifying the time when amendments enter into force to correspond with the businesses practices in the region. For example the current law on business organizations requires that foreign investors provide an original certificate of incorporation to the Business Registry, whereas in most countries presentation of the notarized registration certificate is sufficient.
- Take advantage of the fact that the law on business organizations is under legislative review. Use this opportunity to amend the law to conform with modern corporate practices. Specific focus should be paid to greater flexibility over the management structure of the JSC and LLC, by recognizing that companies can choose between a one- and two- tier management system. The current law allows for one-tier management structure only. Add clarification in the law to include sanctions for directors who have breached the duty of loyalty, the duty of care, and requirement to disclose a conflict of interest. While the law enables shareholders to file a complaint with the relevant court, it does not require directors or members of the board who have breached these duties to compensate the damages caused to the company or assign proceeds from such transaction to the company. Neither does it allow for the board of directors to file a claim with the court.
- Amend the Law on Cooperatives to clarify the nomination and election process of the members of the board, including their roles and responsibilities.

Long Term

- Provide assistance to relevant government entities when drafting regulations to promote and uphold the principles laid out in primary legislation to avoid development of complicated, cumbersome, and bureaucratic procedures.
- In cooperation with the government and other donors, advocate for the promulgation of the Law on Courts. The new Law on Courts modifies the jurisdiction of the regular courts, authorizing yjr Commercial Court to adjudicate all commercial cases, and ensuring that cases are heard from qualified and experienced judges on commercial law.
- Improve incentives in the legal framework, e.g., law on business organizations, foreign investment, corporate income tax, to attract foreign investment in Kosovo, including the development of tax holidays, incentives for job creation, etc.
- Promote the development of mechanisms that will focus on the enforcement and implementation of all enacted laws, including development of sound regulation and mechanisms to facilitate implementation by, for example, strengthening of monitoring mechanisms.



TRADING ACROSS BORDERS

No country can thrive as an economically self-sustainable island. Though the Government of Kosovo (GoK) and most donors support some self-sustainability through import substitution as a high-priority near-term goal, few doubt that cross-border trade is key to Kosovo's medium- and long-term prosperity. Nonetheless, in 2008, Kosovo's exports constituted approximately 9 percent of its total cross-border trade, and amounted to less than €200 million.³⁵ This translates to about €100 per capita in exports, compared to more than €960 per capita in imports. Aside from émigré remittances, international assistance, and foreign direct investment, exports of goods and services can provide the only source of currency income. In other words, Kosovo needs to dramatically develop its ability to export in order to pay for increased imports and to create savings and growth in GDP.



The 2010 Doing Business report Trade Across Borders Section ranks Kosovo 129 out of 183 countries, in the bottom third. Kosovo ranked poorly in both time to export and import, and especially in cost to export, with costs nearly 50 percent higher than the OECD average, mainly due to inefficient practices and barriers of political origin.

Trade comes in two varieties: trade in goods, a familiar concept for most, and trade in services, which is a less-understood and, at the international level, far more complex concept. Kosovo is in the early, precarious stages of cross-border trade in goods, and international trade in

services is almost non-existent. In agribusiness, the most relevant type of trade is, of course, goods. Kosovo is an importer of agricultural services, such as growing conditions analysis and training, but is too far away from an ability to export such services for it to be relevant to this report.

Regarding food imports, the trade balance is similarly import heavy, and the trade deficit is far worse than the overall figures. The 2008 Ministry of Trade and Industry (MTI) trade report indicates approximately 151 million Euros in food imports, and only 6.5 million in exports. This translates into approximately 4.4 percent export cover of imports.

A significant portion of Kosovo's trade in goods is regional (especially Macedonia, Albania, and Serbia), and is, as with other trading partners, heavily import-dependent. The majority of Kosovo's needs for food, consumer goods, and construction materials are satisfied by imports, often under unfavorable conditions artificially set by trading partners who may be more experienced, hail from more sophisticated (and, usually, much more predictable) regulatory environments, and may therefore

³⁵ Government of Kosovo statistics, available at <http://www.mti-ks.org>.

possess greater bargaining power. Kosovo lacks a coherent policy and framework for leveling the playing field and for facilitating its own role in international commerce, which severely deepens the problem.

The logic is simple: no state can thrive without international trade, and no state can effectively facilitate and support trade without integrating itself into the global trading community. As a small country near the end of the queue for EU entry, Kosovo cannot make demands backed up by threats embargo, and high import barriers. Kosovo must instead become the most knowledgeable and activist trader in the region. Kosovo must be able to deftly apply CEFTA and other principles of trade that, if carefully and knowledgeably applied, benefit not only Kosovo, but also the whole region. Further, until Kosovo moves beyond policy that focuses on self-sustainability of energy supply and import substitution to the exclusion of a comprehensive trade policy, any efforts by the business community and investors (especially foreign investors) to engage in cross-border entrepreneurship will experience much higher risk than necessary.

LEGAL FRAMEWORK

Even though Kosovo can boast, on paper, an economy equally open to imports and exports, it remains an economy that is defacto based on imported consumer goods paid for mostly by remittances. Imports have been increasing steadily in recent years, reaching 1.9 billion Euros by the end of 2008.³⁶ Due to its geographical proximity, Kosovo's main export countries are CEFTA members, followed by the EU countries. Even though local production is increasing relatively steadily, Kosovo is still forced to import goods and raw materials that are not produced by the local market. The main imports of commodity goods range from prepared foodstuff, beverages and tobacco, and minerals to machinery and articles of stone. Exports in 2008 reached 195.9 million,³⁷ with an increasing export to its main trade partners and CEFTA members.

KEY TRADE AND LAW POLICIES

- WTO agreements
- CEFTA
- Law on Foreign Investment No.2002/L-33
- Law on Business Organization (Law No. 2007/02-L-123)
- Law on Foreign Trade No. 02/6
- UNMIK Regulation No. 2002/17 regulates Value Added Tax
- Law 2003/03 L-109 on Customs and Excise Code

Because of a GoK recognition of this trade reality, as well as Kosovo's recent history as a ward of the multinational community, the country's policy reflects the rather dramatic liberalization of trade effected in the past ten years. There is a flat 10% import duty, and almost no obstacles to entry into the market, or the territory for that matter, by foreign traders.

CEFTA 2006 AND REGIONAL TRADE

The Central European Free Trade Agreement (CEFTA) was established shortly after the economic and political upheavals in Eastern Europe in the early 1990s as a path to freer trade in newly independent countries. While the agreement began in Hungary, Poland, and Slovakia, it expanded to other countries quickly. As the original members joined the European Union, they withdrew from the agreement (as required by the rules of accession) and were replaced by new economies. By 2006, it became necessary to reestablish the agreement and draft a new preamble. So, though the membership looks nothing like the original, and there is technically a new agreement, the content of CEFTA remains virtually the same as it did.

Kosovo is a member of CEFTA, though it became so through the UN Interim Administration (UNMIK) before it declared independence. The concern is whether Kosovo remains a member through the doctrine of succession despite the non-recognition by some of the CEFTA membership. Serbia, in particular, which holds the chair of the organization

³⁶ Ministry of Trade and Industry Trade Report

³⁷ Ministry of Trade and Industry Trade Report.

in 2010, objects to Kosovo membership without UNMIK taking the lead role. Kosovo, in turn, objects to Serbia's objection, and regularly walks away from working group meetings on grounds of principle. Even beyond the political issues, however, CEFTA is plagued in the region by non-compliance in a setting in which few members take the agreement seriously.

WTO COMPLIANCE

Though Kosovo is not presently in the process of accession to the World Trade Organization (WTO), it is at the very early stages of exploring this possibility.

Membership in the WTO, or even the meaningful involvement of a country as an observer nation making significant headway in compliance with WTO principles and practices, gives a country a number of trading advantages:

- It is a basic indication of an economy's regulatory readiness to "do business";
- WTO provides, for members, a mechanism for lodging complaints about the unfair trading practices of others; and,
- The accession process is a catalyst for the kinds of general regulatory, policy, and implementation change that is good for trade and growth independent of the benefits membership itself provides.

Kosovo is not far along the path of compliance with WTO requirements. The Ministry of Trade and Industry has drafted a trade policy that states Kosovo's ambitions as a trading nation, but inadequately comprehends the critical need to prepare for that role as a small, landlocked, financially weak nation.

Beyond the trade policy, Kosovo is poorly prepared for WTO accession. Kosovo has no road map outlining the considerable long-term efforts required to come into compliance. Until substantial headway is made in implementing regulatory frameworks in everything from intellectual property protection to sanitary and phytosanitary rules, Kosovo will remain far behind

schedule in its goal to be part of the global trading community.

Interestingly, in spite of the absence of a number of rules that could facilitate trade and contribute to growth, Kosovo often continues to focus on issues that, while important in the long term, should not necessarily be immediate priorities. For example, Kosovo's Parliament is expected to adopt a law on protecting the domestic market with the aim of protecting local producers through "safeguard measures" such as anti-dumping; however, there are already issues with the execution of the draft law. Also there is the problem of knowing the nature of these safeguard measures or legal remedies applied against unfair trade practices abroad. Under the WTO Agreement, "grey area" measures are prohibited and any sort of measure must have a time limit (sunset clause). It is still not clear how WTO compliant these measures really are, and compliance will depend largely on how they are implemented.

CUSTOMS REGIME

Kosovo is an independent customs entity with a liberal trade regime. Custom duties and border taxes are regulated across two layers: Under Law 2003/03 L-109 on Customs and Excise Code, a 10 percent flat rate is imposed on imports and 0 percent on exports. The typical exceptions exist for imports of raw materials. Second, under Law 2003/03 L-109 there is an excise tax of between 10 percent and 50 percent of the value of goods. The excise taxes are charged on products, such as mineral water and soda, whether they are imported or produced domestically. The Customs Code is based on the EU Customs Code and is fully compliant with World Customs Organization (WCO) rules on customs procedures and the Harmonized Commodity Description and Codifying System.

LAW ON FOREIGN ACTIVITIES (2002/6)

This law aims to promote the development of a healthy market economy in Kosovo, while

securing adherence to regulations that affect trade between Kosovo and regions outside of Kosovo to develop and be implemented with the best European and International standards. This law is very similar to the Law on Foreign Investments above.

THE LAW ON BUSINESS ORGANIZATIONS

Similar to common practices in EU countries, only certain types of business can be registered in Kosovo. According to this law (Law Nr. 2007/02-L-123) these types are a single person enterprise, a general partnership, a limited liability company, a limited partnership, and a joint stock company.

In accordance with the clauses of the Foreign Investment Law, foreign companies are permitted to engage in any business activity open to domestic business. In addition, there is no restriction regarding the share of capital that foreign entities are allowed to hold. Therefore, foreign entities may establish subsidiary enterprises and branches in the same manner and to the same extent as similar domestic business organizations. This is welcome news for trade with foreign investors.

Kosovo's institutions are aware that resolving its wide trade imbalance requires a comprehensive economic and political approach in order to change the operational environment in Kosovo, for the purposes of improving the competitiveness position of Kosovo in the world market. Such a commitment has been stated in the Medium Term Expenditure Framework (MTEF), a basic governmental document guiding the economy of Kosovo in 2009–2011. It is easy to point the finger at ineffective laws; however, the topic of trade leads to a spider's web of governmental entities, such as the ministry of Foreign Affairs, the President's Office, the prime Minister's Office, and MAFRD, as well as scores of indirectly related laws and regulations. Legal and institutional change, therefore, is required both at MTI and across the other entities with

the ultimate goal of general compliance with international and WTO best policy practices.

SPS ISSUES RELATED TO TRADE OF AGRICULTURAL PRODUCTS

The term “sanitary and phytosanitary,” usually abbreviated to SPS, refers to countries' rights to restrict import of agricultural products that do not meet scientifically established minimum standards. While all countries limit imports based on SPS standards, the WTO and other organizations encouraging free—or *freer*—trade implore countries not to use SPS measures as hidden unnecessary technical barriers to trade. The legitimate use is a complex, but valid, way to protect people from harmful imports.

While a carefully crafted and implemented SPS regime is imperative, it is also important for any country involved in the export of agricultural products to develop a system for compliance with its trading partners' SPS rules. This requires an internal system for information collection and analysis, but it also requires a broad commitment among public sector bodies to adapt quickly and reasonably to changing rules and circumstances.

Kosovo is not yet recognized as a State by the United Nations and is, therefore, not yet a member of UN-related international organizations such as the WTO and the Food and Agriculture Organization (FAO), the Codex Alimentarius body for FAO food standards, and the World Organization for Animal Health (OIE). A formal request has been sent for re-evaluation to the OIE by the National Veterinary Services in Kosovo but has been refused pending resolution of diplomatic issues. Until Kosovo is eligible for membership in the WTO and SPS bodies (IPPC, OIE, FAO Codex, Cartagena Protocol, Kyoto Protocol, etc.), it will continue to experience an uphill battle in convincing the international community that its standards are EU compliant. Despite this, all import and export documentations are similar to WTO members.

MINISTRIES RESPONSIBLE FOR FOOD CONTROL

- MAFRD
- Kosovo Veterinary and Food Agency (KVFA)
- Department of Plant Protection and Production (PPD)
- Agriculture Border Control
- Livestock Department

At the municipality level food control is the responsibility of: (a) sanitary inspectorate; (b) veterinary inspectorate; (c) agricultural inspection.

CERTIFICATION REQUIREMENTS FOR FOOD IMPORTS

All consignments entering Kosovo need to be accompanied by a health certificate issued by the relevant authorities of the exporting country and an import license issued by the relevant authority of the country for which the export is intended. The health certificate describes minimum health conditions to be fulfilled by the consignment whereas the testing requirement depends on the country of origin. Occasionally, authorities in Serbia will refuse to supply the necessary documentation for consignments intended for Kosovo because, according to the authorities, their trade with Kosovo is still considered as internal. The same scenario applies to Bosnia.

While some traders continue to complain about problems with exporting agricultural products to some neighboring countries, no one has filed a case with the relevant Kosovo authorities. As a result, MAFRD statistics do not show cases of rejections or detention of food exported from Kosovo. MAFRD reports a number of instances in which documents are submitted incomplete by traders, and the goods subject to the temporary detention until the missing documentation is provided.

SEPARATE INSPECTION SYSTEMS FOR EXPORTED GOODS

Another issue faced by this sector is the lack of separate inspection systems for exported food. Both food of animal origin, live animals and

plants, and food of plant origin are inspected by the KVFA. The systems of food inspection for exported foods consist of a health certification (veterinary/ phytosanitary); a certificate of origin; and, a bill of lading. Whenever required by the importing country, a laboratory analysis of the goods intended for export is performed. Some regional countries do not accept SPS certificates issued by Kosovo authorities on the grounds that Kosovo does not have an accredited laboratory authorized to certify that goods for export are safe.

KOSOVO VETERINARY AND FOOD AGENCY (KVFA)

The Veterinary Law, adopted by the Assembly in July 2004, transforms the former Veterinary Services into an executive agency under the MAFRD, the KVFA. Now, with the adoption of the new Food Law, the KVFA falls directly under the authority of the Prime Minister's office. The law regulates the combat and prevention of infectious animal diseases, veterinary medical practice, the circulation of products of animal origin, veterinary control of the import, export and transit of live animals and products of animal origin, and the rights and obligations of public and local government institutions, as well as of individual persons, in this field.

PHYTOSANITARY INSPECTION

There are 28 phytosanitary inspectors (Agriculture Officers) employed in the Kosovo municipalities. All are graduated agricultural engineers but, as with the sanitary inspectors, there is no information about the organization for which they work, the Crop Protection Department (CPD). The role of these inspectors with regard to food control seems unclear. They do a certain amount of "checking", which apparently includes checking expiry dates of products and visually examining fruit and vegetables, although they do not take samples because of alleged jurisdictional issues between them and the Institute of Public Health (IPH).

The new laws on seeds, fertilizers, and pesticides to some extent formalize the relationship between the MAFRD inspectors and the municipality inspectors. In addition, there is significant cooperation between the two levels with periodic joint visits.

CONSTRAINTS IN EXPORTING TO SOME NEIGHBORING COUNTRIES

A number of exporters based in Peja and Prizren claimed that it is becoming increasingly difficult to export fresh produce into both Montenegro and Albania. In particular they are having problems with satisfying the phytosanitary requirements with the inspectors on the Montenegrin border who allegedly ignore the phytosanitary certificates produced by the Kosovo authorities and demand their own inspections, which has to be done in Podgorica, the capital city. There is similar anecdotal evidence of refusals at the Albanian border. This non-acceptance of Kosovo certificates seriously impedes exports because the border inspector is only on duty for two hours each day, and only five days per week. If no inspector is available, the exporter must personally take a sample to Podgorica, leaving the truck at the border. The exporter is given a certificate to take back to the border and the vehicle is then released. The sampling and testing of produce in Podgorica has reportedly never resulted in a rejection. However, this procedure leads to obvious delays in border processing, which in turn can lead to significant reductions in product quality and losses in revenue.

Technical barriers, such as the accreditation of laboratories should be resolved without much trouble. However, political problems involving Kosovo's status with respect to the non-recognition of SPS documentation is beyond the control of Kosovo's authorities and the surrounding competent bodies.

CEFTA COMPLIANCE

Regional trade rules, procedures, and guarantees established by CEFTA are critical. There

have been numerous ongoing trainings for government officials as well as local lawyers to update their understanding of regional trade and the importance of CEFTA. However, there has been a risk of CEFTA paralysis due to disagreements over the Kosovo status issue, which is already preventing the adoption of the Protocol on Agricultural Trade Liberalization. Protectionist measures, such as removal of excise tax on domestic products only, leaving what amounts to an import duty on the same products produced abroad, will slightly advantage local producers, but it is unlikely to have any major impact. Further, other neighboring countries will retaliate when their advantage is lost. Such action from Kosovo will mean non-compliance with CEFTA provisions (i.e., Article 8 (1) CEFTA 2006) and a strong reaction from other CEFTA members and the EU.

ADOPTION AND USE OF TRADE-RELATED CONVENTIONS AND MODEL LAWS

Developing capacity in the legal profession and entrepreneurial private sector sets the stage for accelerated growth. Adoption of the commercial laws that have been developed through the consensus of the people actually doing global business gives Kosovo businesses the tools to knowledgably enter agreements abroad and to allocate their risks as they desire.

Kosovo should, at a minimum, embrace the following two conventions and one model law:

- The UN Convention on Contracts for the International Sale of Goods (CISG). Kosovo has technically adopted the CISG, under UNMIK, but has yet to fully embrace it
- The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention)
- The UNCITRAL Model Law on International Commercial Arbitration.

There are at least an additional 20 recommended laws/conventions, but these 3 would provide an excellent foundation for growth.

THE UN CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG)

The CISG was adopted unilaterally by UNMIK, but Kosovo's status as a member state was lost when it declared independence without full recognition of UN bodies, such as UNCITRAL. The use of contracts to define the parameters of a business transaction is a nearly universal phenomenon, and represents an exercise in minimization and allocation of risk by the parties. It also represents the exercise of autonomy of the parties; by establishing certain conditions, the parties are agreeing to the rules—law—that will govern their relationship. Virtually every step in the trade value chain can be envisioned in a contract of sale. The CISG, which is now the default law for international sales of goods in 70 countries, is considered among the essential international trade treaties because it is a simple mechanism for creating the foundational rules underlying, and complementing, the agreements made by the parties. It also acts as a set of default rules even where the parties have not agreed to specific terms. It provides a uniform and fair regime that introduces an element of certainty in commercial exchanges, thus decreasing transaction costs and making the processes of drafting agreements and settling disputes more consistent.

More specifically, the advantages accruing with use and promotion of the CISG are the following:

RELIABILITY

Contrary to what might seem natural, foreign businesses will prefer to trade with sophisticated and knowledgeable Kosovo partners. The CISG introduces a broad new source of easily understood legal resources that are designed with the international community in mind, not just one labyrinthine and perhaps archaic legal tradition. Businesspeople who know and understand their contracts of sale tend to abide by contract provisions more than those who rely on their partners to draft the terms of an agreement.

Put bluntly, people who do not know and understand the terms of an agreement have a strong tendency to breach contracts.

SIMPLE DEFAULT RULES

The simplicity of the CISG is that if a transaction meets a very small set of minimum of requirements, the transaction will, by default, constitute a contract. This is not always readily apparent, or even true, in the case of the use of a country's national law.

REDUCED TRANSACTION COSTS

The efficiencies established by the use of a simple, neutral set of rules typically result in lower transaction costs and, ultimately, lower prices for the final consumer.

CONSISTENCY

The CISG prevents the application of national domestic law rules by an adjudicatory body (court or arbitral panel) absent a contrary agreement made in advance of a dispute. This means that international parties always know in advance what law will be used in a dispute. Otherwise, the law used will depend on where a suit is brought. As a practical matter, suit can always be brought wherever there is a nexus to the contract and where the defendant has assets.

MODERNIZATION

Adoption of the CISG has a positive general effect on a country's regulatory framework, similar to that motivated by WTO accession. It is widely agreed, for example, that China's adoption of the CISG, and the wave of commercial reform that followed, helped pave its way to WTO membership and its impressive economic development.

IMPLEMENTING INSTITUTIONS

While the legal framework provides a reasonably solid foundation for trade facilitation and, in theory, a very liberal trade policy, the institutions charged with implementing the policy and law are, with the partial exception of the

KEY IMPLEMENTING INSTITUTIONS:

- Ministry of Trade and Industry
- Ministry of Economy and Finance
- Customs Authority
- Ministry of Foreign Affairs, Office of Bilateral and Multilateral Agreements
- Ministry of Agriculture CEFTA Office

Customs Authority, very weak, overburdened with unnecessary tasks, poorly funded, and often corrupt.

Trade policy begins in Kosovo with the Ministry of Trade and Industry (MTI). The MTI, as the ministry with primary responsibility over trade promotion, setting policy for internal trade, and designing systems for better facilitation of trade for Kosovo importers and exporters, has taken the lead in developing a trade policy and sponsoring laws and regulations related to international trade. Kosovo is not unusual in placing the responsibility for international trade with the MTI; nonetheless, this method presents some significant disadvantages.

SUPPORTING INSTITUTIONS

Transition countries often focus far more on monitoring and restricting trade across borders to gain the most economic benefit, through tariffs and VAT, than on liberalizing and facilitating it to maximize its jobs and revenue growth potential. This behavior can inhibit countries' ability to take advantage of export industries and industry that is led by raw materials imports. Because of this short-sighted emphasis on what amounts to burdensome dependence on trade, there is a concomitant absence of attention paid to the kinds of institutions that support and facilitate trade as a long term growth prospect. Such is the case in Kosovo.

At least two types of supporting institutions should exist in a country that wants to build its trading capacity:

- Implementing Institutions as Supporters—Implementing institutions such as customs and ministries of trade and industry that otherwise exist to collect tariffs and other similar revenue, as well as to protect the public from harmful products, but also take on the function of support and facilitation. In fact, the most progressive countries and regions in this regard describe Customs' role as primarily trade facilitative rather than protective,³⁸ and,
- Civil Society and private sector institutions that ease the restrictions and barriers to trade, both imports and exports, goods as well as services. These would include private sector international trade associations as well as membership in multinational organizations, such as the UN Commission on International Trade Law (UNCITRAL), and The International Trade Centre (ITC). They also include private sector services such as freight forwarders, testing labs, customs brokers, and lawyers, accountants and logistics professionals with trade experience.

While Kosovo has can boast a few freight forwarders and testing labs, they deeply lack capacity, and virtually none of the other institutions exist, partly because of a lack of motivation on the part of the GoK to liberalize trade (because so much revenue is generated from tariffs and VAT, and because controlling trade is an adequate way to protect personal business interests) and partly because of the uncertainty of Kosovo's status.

It is worth noting that though there are three cross-sector chambers of commerce—The Kosovo Chamber of Commerce, the American Chamber of Commerce of Kosovo, and the Alliance of Kosovo Business—they all suffer from low capacity and/or a misunderstanding of their role regarding trade. The American Chamber has, in the past, taken on the role of champion on trade issues, but has recently lost some of its enthusiasm in reaching out on

³⁸ See, for example, the rules encouraging trade facilitative behavior in the Central American Free Trade Association, available at <http://www.seic.gov.do/baseConocimiento/TLCEEUU%20DRCAFTA/Texto%20del%20Tratado%20en%20Ingl%C3%A9s/Chapter%2005.%20Customs%20Administration%20and%20Trade%20Facilitation/TLC-EUUU%20DR-CAFTA%20Customs%20Administration%20and%20Trade%20Facilitation.pdf>

these issues. The other two chambers also lack the funding and international experience necessary to become a force in trade, but they also tend to take a stance against trade that appears overly protectionist of Kosovo businesses.

SOCIAL DYNAMICS

THE NEED FOR A COHERENT TRADE POLICY AND COMPREHENSIVE REFORM ROAD MAP

Kosovo is import friendly, but decidedly export unfriendly. All industries are suffering from the lack of a trade policy, the immaturity of the trade-related regulatory framework, and the maladministration and non-enforcement of the few components of trade-related framework that do exist. But, most of all, Kosovo suffers from a lack of a pragmatic approach to trade. What little trade exists is severely burdened by the dominance of the politics surrounding Kosovo's position in the region and the world, and the absence of the realization that in order to trade effectively Kosovo, as a small poor country, cannot leverage others into fair trade with punitive measures. Kosovo must instead trade "smarter" than its neighbors.

The following are examples of how domestic industry is adversely affected by the lack of a trade policy and regulatory/institutional framework:

- Domestic grains and dairy production cannot compete against agricultural imports that are subsidized by Macedonia, Serbia, and the rest of the southeastern Europe (SEE) region.
- Domestic crops, such as peppers, meant to be protected to some degree by a customs duty charged at the border on imported goods, even when they are from other CEFTA countries, cannot compete when goods from abroad flow freely through open or poorly enforced border crossings.
- Entire crops run the risk of destruction because imported seeds can carry disease that should be intercepted through enforcement of simple sanitary-phytosanitary rules.

When looking at economic development through the lens of international trade, however, the problems are significantly more complicated, and will require a sea change in the way the GoK and donors look at the legal/regulatory framework.

First, the GoK needs to develop a coherent policy on its economic relationship with the region and the rest of the world. Though some principles—e.g., the need for a liberal tariff and foreign direct investment structure—have been vaguely articulated in the Medium Term Expenditure Framework (MTEF) and elsewhere, there is no single document that outlines Kosovo's trade philosophy and objectives. Questions concerning policies on protective treatment of particular industries, state trading issues, treatment of regional partners as compared with others, whether the GoK desires a free trade in services, goals concerning protection of intellectual property, and a host others need to be answered concurrently with the development of domestic growth and expenditure policies, not afterwards.

Second, the GoK must draft and implement a legislative and institutional reform agenda, or road map, that declares specific goals and a realistic timeline for compliance with established international norms for trade. These norms are embodied in the WTO agreements. They are embodied in these agreements because they are norms rather than because they favor one group of trading nations over another. The norms facilitate trade for all; therefore, whether Kosovo is assisted in its bid to join the WTO or not, assistance in achieving the norms is critical.

Third, the GoK should make every effort to unilaterally (if UN recognition is not imminent) adopt a number of standard international trade/commercial conventions and model laws that have been instrumental in simplifying cross-border transactions and dispute resolution, and promote greater control by transacting parties over the allocation of their risk.

Finally, as described in greater detail elsewhere in this report, the development of capacity in the legal profession and entrepreneurial private sector is critical. Though some of the benefits of the above recommendations can accrue by default, most will accrue only if the business and legal communities take advantage of them.

WTO COMPLIANCE

Compliance with the principles and basic rules of the WTO acts as a catalyst for economic reform through policy change, good economic governance, and the establishment of a solid regulatory foundation. Most important, it results in economic development through cross-border trade. The WTO begins with the simple maxim that all countries are in a position to create wealth by identifying and taking advantage of their resources and to create productive advantages by cultivating international markets. All countries have production advantages, either in absolute terms or in comparative terms. But since countries' natural tendencies are towards inefficiencies associated with the protection of all industry, the principle only works if the global playing field is level, transparent, and predictable.

Though WTO membership for Kosovo is the ideal objective, adoption of WTO principles and compliance with the basic regulatory framework accomplishes two important steps: First, it affords Kosovo an expedient accession process when membership becomes possible; and,

second, it establishes a climate conducive to substantial growth in trade. Participation typically promotes the right mix of top-down policy development and bottom-up community practicality resulting in a solid foundation for comprehensive legal reform and trade development.

The benefits of WTO membership (or engagement) are the gradual but determined establishment of a transparent, predictable, and fair economic legal and institutional regime; fair access to markets for foreign investors; fair access to foreign markets for domestic investors; and the growth of domestic industry through competitiveness rather than protection.

Donor involvement in, and guidance of, Kosovo's integration/accession process is critical, and achieving these objectives will require a substantial commitment on the part of the GoK and investment into a team of local and international experts that answers directly to one minister, but cooperates fully across all ministries, civil society, and the private sector.

An international trade team/office would analyze the regulatory and institutional framework through the lens of international trade, and would be responsible for gathering the information necessary for the GoK to make appropriate decisions. To effectively develop its trade regime, a country must make all legal, regulatory, and institutional decisions in lockstep with its trade policy and road map.

RECOMMENDATIONS

RECOMMENDATION: BUILD CAPACITY TO TRADE AS A MEANINGFUL PARTNER IN THE REGION AND BEYOND

General: Use trade as a lens through which to look at the entire national framework of laws, regulations and implementation mechanisms, and establish strengths in global and regional trade best practices.

Short Term

- Develop a regional benchmark price information system so the GoK and the Kosovo private sector can better determine whether countries are providing prohibited export subsidies. This will also afford more measured responses to unfair trade practices.
- Encourage a more pragmatic approach by the GoK to trade issues that begins to disconnect trade policy from the politics of recognition.
- Establish concentrated programming in trade- capacity building for the GoK, civil society, and private sector.
- Encourage observer-status participation in the WTO at a minimum, perhaps accession application as a Customs Territory.
- Support the drafting of a comprehensive WTO accession road map that carefully outlines all of Kosovo's responsibilities over the entire accession process.
- Support the enthusiastic participation in UNCITRAL instruments, including the development of legal and commercial technical assistance programs to build awareness of international best practices at the private sector level.

Medium- and Long-term

- Establish an inter-ministerial or extra-ministerial export council to explore trade policy and trade facilitation issues. This should also include a Rapid Response Team comprising 4 or 5 key representatives from the GoK, plus one representative from the private sector, who will commit to being available whenever important trade issues emerge.
- Develop a better system for marshalling the resources of the donors in the region in a coordinated way.

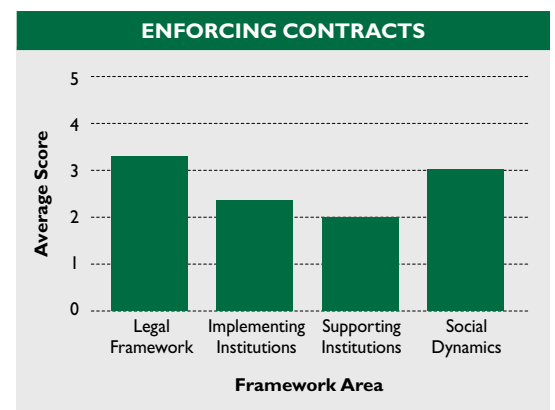


ENFORCING CONTRACTS

The concept of contracts and their enforcement is considered differently in various contexts. The World Bank *Doing Business* rankings view contracts from their most literal, prosaic perspective—the enforcement perspective—or the ability to force a business partner to adhere to the terms and spirit of an agreement. This typically requires a deep look at the courts and alternative dispute resolution systems, as well as the systems for enforcement of judgments. The assumption inherent in this view is that if contracts can be enforced efficiently, businesspeople will naturally use them and will be more comfortable participating in more sophisticated business relationships—and, this is true to a degree, but principally for the already more sophisticated levels of commerce.

ENFORCING CONTRACTS	
<i>Doing Business</i> Ranking 2010	157
<i>Doing Business</i> Ranking 2009	156
Procedure (number)	53
Time (days)	420
Cost (% of claim)	3

AgCLIR, and its parent, BizCLIR, look at contract enforcement from a more comprehensive perspective. In the AgCLIR methodology, contracts are the core feature of any business transaction, and a look at enforcement is incomplete without an adequate understanding of the entire contracting climate, especially in the lower levels of the value chain where even farmers cultivating less than a hectare may benefit from using relatively sophisticated arm's-length contracting. AgCLIR asks fundamental questions about the relationships businesspeople maintain. Do businesspeople even enter into contracts? How sophisticated are they? Is there societal or economic motivation for adhering to agreements? How are contracts and negotiations used? These are some of the questions, in addition to dispute resolution and enforcement, for which AgCLIR wants answers. A good look at the whole contracting environment provides an excellent window into the general level of business sophistication in an economy.



Kosovo's very poor score in the Enforcing Contracts category of the *Doing Business* report (157 out of 183) tells only part, perhaps the happiest part, of the story. While, compared to other countries in the region, it does not take an unusually long time to enforce a claim, it does cost an extraordinary 61.2 percent of the value of the claim, putting Kosovo between Niger and Bangladesh. It is no wonder then, with a costly and drawn-out process for gaining justice, that Kosovo businesspeople rarely enter into written contracts in the first place. It is not surprising that when they do enter contracts, they rarely bring a claim for breach in the courts, nor is it surprising that investors and foreign traders stay away.

But the story goes much deeper than this. A contract is defined as an offer for the exchange of something (potatoes) for something else (money) that is accepted by the other party. Therefore, according to this definition, where there is business happening, and at least some is happening in Kosovo, there are contracts. In Kosovo, however, for reasons discussed below, the culture of contracting is very weak. Parties are not using contracts to create certainty of supply and distribution through allocation and minimization of risk. Lack of trust remains a serious issue. Agricultural processors and exporters are not providing adequate extension services to farmers because the farmers do not capitulate with in-kind adherence to contracts. Farmers, on the other hand, feel the processors, with their perceived unequal bargaining power, will necessarily take advantage of them. At the other end of the value chain the processors and exporters are not typically careful about entering into contracts with their foreign trading partners.

Contracts have been discussed as part of the numerous CLIR analyses in Kosovo since 2004, when the first commercial and legal institutional reform assessment was done.³⁹ Even a superficial look at that document paints a bleak picture of the intervening five years. Little has changed. The system is still broken. The discussion below outlines the problems through the lens of agriculture, and offers some unique and simple solutions.

LEGAL FRAMEWORK

The regulation, formation, operation, and conclusion of commercial relationships, and the associated need to allocate or minimize commercial risk, are vital to any commercial party. Businesses are reluctant to enter into agreements that could ultimately become meaningless, or even counterproductive, upon the development of a dispute.

The legal framework is the most basic element in the infrastructure and mentality of the

KEY LAWS

- Law on Obligations—SFRY 29/78 with latest amendments applied in Kosovo, Official Gazette SFRY 29/78
- Law on Contracts for the Sale of Goods—UNMIK Regulation 2000/68 on Contracts for the Sale of Goods
- Law on Public Procurement in Kosovo, Law No. 2003/17, promulgated by SRSG in UNMIK Regulation No. 2004/3 dated 9 February 2004, amended by UNMIK Regulation No. 2004/3 Addendum dated 28 July 2004 (intended to complement the law on obligations and to raise the standard of contracting in Kosovo)
- Law on Arbitration (02/L-75), 2007
- Law on Foreign Investment—No. 02/L-33
- Law On Chamber of Commerce No. 2004
- Law on Execution Procedure

contractual environment. The absence of a solid contracts legal framework makes contracting awkward and fraught with risk for the businessperson. Moreover, because the businessperson relies heavily on the contracts law in order to predict the outcome of unlikely, but potential, events, and to determine how much detail to include in a contract, the more well established and tested a legal framework is the more reassuring it is to those relying on it. Kosovo suffers on two counts: First, as a new economy, its laws, and more important, how those laws are interpreted by courts, are brand new and largely untested; and, second, there have been some fundamental missteps in the development of the legislation.

Kosovo's most basic legal framework for contract law is embodied in the Law on Obligations and the UNMIK Regulation on Contracts for the Sale of Goods (Regulation 2000/68).

THE LAW ON OBLIGATIONS

The 1978 law, which is a fairly typical civil-style law that governs all obligations, both contractual and tortious, is thought to function reasonably well by most in the legal community. A comprehensive replacement Law on Obligations,

³⁹ See http://bizclir.com/cs/bizclir_assessment_kosovo.

drafted and passed by the Kosovo Assembly in 2004, was pending approval of the UNMIK Legal Office when legal authority transferred. The disposition of the law remains uncertain, though demands for an updated law are growing stronger. The aim of the new draft law was to do away with references to the old socialist socio-economic system and conform Kosovo contract law to EU directives on private law as well as to update it to clearly include modern business realities such as electronic signatures. The Yugoslav law is more than 30 years old and not adequate for a modern commercial environment that requires more comprehensive commercial contracts legislation. This law, as well as the passage of a new Law on Public Procurement, should have gone a long way towards raising the standards of contracting and developing good contract practices. However, the legal community has complained of macro structural problems with the draft Law on Obligations, so regardless of the fact that the law was adopted by the Kosovo Assembly (Law 2004/25, Kosovo Law on Obligations, passed through the Kosovo Assembly on July 28, 2004), it is still under active consideration. The draft law aims to introduce new and modern contracts such as timesharing, franchising, and leasing contracts. Legal commentators worry that such extensive revision might lead to unfamiliarity and that the new legal language in the Albanian version might cause misunderstanding.

Though the draft Law on Obligations, under consideration for more than five years, would provide a significant benefit to contracting in general, a few important flaws should be addressed:

- The law would benefit from a section on terminology. There is, for example, no definition of “reasonableness,” a term that is typically defined differently among jurisdictions, and is considered a primary issue under the standard *Principles of European Contract Law*.
- The law does not define valid notice, the extent of knowledge and intent imputed to a contracting party from someone

acting on his behalf, the validity of a written merger clause stating that the contract is the entire agreement, and what constitutes “fundamental” non-performance.

- The law should clarify how terms are to be interpreted. Preferably, terms should be interpreted in light of the entirety of the contract in which they appear.
- The law fails to state the basic objective of damages—to put the aggrieved party in the position he would have been in had the contract been performed, and is unclear on a preference for specific performance or monetary damages.
- The right to specific performance is not provided for, merely inferred in Art. 512. If provided, it should encompass the usual limitations on specific performance (i.e., performance is not awarded if it causes unreasonable effort).
- Article 152 of the law states that “contracting parties may provide that a third party shall interpret the contract in case of a disagreement concerning the meaning and scope of terms in the contract.” This is far too vague to interpret that parties may resort to **ADR** resolution of the entire dispute, both facts and law. Linked to this, it is not clear whether foreign arbitral awards or court judgments are binding in Kosovo. Moreover, whether or not the New York Convention binds Kosovo with respect to foreign jurisdiction is not stated.
- Because the **Law on Execution Procedure 1978** is thought of as weak regarding the execution of judgments for monetary awards, the law should address the issue of collection of monetary judgments specifically.

Although the new draft is not free of criticism and requires tweaking, it is still thought of as suitable for a commercial environment and in line with EU directives. The Ministry of Justice has set up a working group spearheading review of the draft and expects to adopt a final version for approval by early 2010.

THE LAW ON PUBLIC PROCUREMENT

The Law on Public Procurement has added to the creation of a new contract environment in Kosovo. As part of its central role in improving public procurement, it will pressure lawyers and the business community to face up to the current atmosphere of informal, oral contracting and move towards the use of written contract documents based on a code of contract law, at least for concession contracts with the government. Just like the Law on Obligations in the commercial arena, the Law on Public Procurement sets out a specific set of rules for contract formation, negotiations, operation, interpretation, fulfillment, and termination. It is another mechanism in implementing this commercial contract mentality, further adding value to the Law on Obligations and helping stakeholders in the agricultural sector better face up to the commercial realities of a contracting environment.

Unfortunately, the procurement law has come under some heavy criticism for being perhaps too comprehensive. In an effort to stave off possible corrupt behavior in procurement activities, the law has taken an approach ostensibly closing off all possible avenues for unethical or non-transparent practices. This approach has resulted in a law that some find to be overly complex and unwieldy, and has, ironically, increased the potential for misuse.

Alternative Dispute Resolution in Contract Enforcement. The Law on Arbitration (02/L-75) came into force in January 26, 2007. However, the number of cases solved by arbitration is extremely low, with only around 30 cases having been heard by the Kosovo Chamber of Commerce until now.

There is a widespread perception that legal agreements cannot be enforced due to the current political situation in Kosovo. Also, the immaturity of institutions limits, to a certain extent, the ability to enforce most contracts. Nonetheless, the law provides ways for parties thinking ahead to nearly guarantee enforcement. For example, a duly signed contract that

KOSOVO'S LAW ON ARBITRATION

The new arbitration law is in line with many facets of modern international practice and provides, among other things:

- Any business dispute may be submitted to arbitration.
- A court will not take a case that has previously been submitted to arbitration.
- The parties can choose the arbitrators or the procedure for choosing the arbitrators.
- The arbitrators can issue preliminary orders enforceable by a court.
- The parties can agree on procedural rules or agree to have the arbitrators do this.
- Basic rules for evidence, witnesses, use of experts, etc., are specific, but the parties can agree to vary these.
- The parties can choose which law applies (Kosovo law or that of another jurisdiction).
- The award must be written with stated reasons;
- The parties can settle the case at any point before a final decision; and
- The award can be enforced by a court.

includes clauses giving an entity like the **Kosovo Chamber of Commerce (Law No. 2004 / 7)** the authority to act as a forum for arbitration is a more solid and formal agreement.

Given the unfamiliarity of Kosovo lawyers, judges, and businesses with arbitration, it cannot be predicted how extensively the new law will be used in the short term. However, it is a significant step forward to have a modern arbitration law and to have expert training on the subject. Furthermore, with continuous training for arbitrators and mediators, it is hoped these methods of dispute resolution can be better implemented.

LAW ON CONTRACTS FOR THE SALE OF GOODS

One legal peculiarity is the use of a slightly altered version of the United Nations Convention on Contracts for the International

Sale of Goods for use as a general sale of goods law in Kosovo. The alteration was accomplished simply by removing references to “international” and by removing a provision that made it applicable only to sales between merchants. Its use for domestic consumer sales is odd since the treaty was designed specifically and exclusively for international commercial transactions between businesses. Though it is officially applicable and is the default law for sales of goods, it is apparently rarely, if ever, applied by the courts. The rationale for its existence is inexplicable, and is a good example of some of the legislative experimentation under which Kosovo has suffered.

LAW ON FOREIGN INVESTMENT

The Law on Foreign Investment promotes foreign investment in Kosovo by providing foreign investors with certain fundamental and enforceable legal rights and guarantees ensuring that foreign investors and their investments will be protected and treated with fairness and respect in strict accordance with the rule of law and widely accepted international standards and practice.

Two issues relevant to contracts are raised in the investment law. First, the rules regarding the circumstances under which the government may expropriate property of foreign investors are made clear, protecting the investor’s contractual rights. And, second, the preference of arbitration of disputes where designated beforehand makes for a clear preference for carefully written contracts.

LAW ON EXECUTION PROCEDURE

The Law on Execution Procedure is archaic, allowing too many objections and appeals in civil cases, thus extending the period before enforcement sometimes to absurd lengths.

IMPLEMENTING INSTITUTIONS

Tremendous resources have been spent on the judicial system in Kosovo, most of them expended on, understandably, building a solid criminal and administrative system founded on the rule of law.



Some effort has gone into building the capacity of the Commercial Court, but largely without success. The civil system for implementing the enforcement of contracts is, for all intents and purposes, non-functional. Arbitration, and the efficient public or private enforcement of awards, should provide a good backup to the courts, but, for reasons outlined below.

COURTS

In the first CLIR assessment in Kosovo, in 2004,⁴⁰ some enthusiasm could be seen for the Commercial Court. The assessment recognized the relative efficiency and knowledge of the judges in the court. CLIR updates in 2005, 2006, and 2007 recognized that the Commercial Court was not progressing as hoped but continued to view it as the more well informed judicial option. Five years after the original CLIR, the view, however, is depressing. A visit to the Commercial Court revealed stagnation; there was virtually no activity and painfully little energy or enthusiasm. Still, the handful of cases the court hears can drag on for years without resolution.

A major problem with the civil judicial system is that the Commercial Court lacks jurisdiction over the vast majority of farmers. Unlike many countries, including the United States, Kosovo does not treat as default businesses those who

⁴⁰ Ibid.

KEY IMPLEMENTING INSTITUTIONS

- Commercial Court—for legal entities
- Municipal courts—for non-legal entities
- District courts—for non-legal entities
- Kosovo Chamber of Commerce Arbitration Center

are undertaking commercial activity, and therefore acting as businesses, but who have not registered their businesses with the Ministry of Trade and Industry and the appropriate municipality. The law strips these individuals of their rights as businesses, including the right to access the Commercial Court, and instead imposes heavy fines. In the United States, for example, the default business entity is a sole proprietorship and requires no act, other than carrying out business, to be treated as such. All obligations, including the payment of taxes and compliance with business-related regulations, must be complied with, but at the same time, all privileges accruing to a registered business are also available to the unregistered sole proprietor. In Kosovo, the neglect of a default-style business entity virtually cuts small agribusiness out of the commercial sphere. Small farmers are the commercial equivalent of untouchables. As such, they must bring claims as individuals in district or municipal courts, where they are treated with disdain because they are unregistered, and are put into a docket queue that stretches months or years.

Another reason for the paucity of contracts cases is simply the cost in time and money of bringing a claim. Cases are likely to go on for years, with multiple appeals and objections. A business with money tied up waiting for a claim to be resolved will likely suffer irreparable damage. So many businesses, rather than take risks on the courts, will not enter into contracts at all. This report discusses the disuse of traditional contracts in more detail below.

Finally, even if a judgment is rendered, enforcement can be difficult. Enforcement of judgments is the responsibility of enforcement judges,

rotated into the positions from the general judicial pool. These judges have little practical experience with enforcement and have few usable tools—bailiffs, dedicated police units—at their disposal. Kosovo would benefit greatly from the establishment of a group of executors dedicated to enforcement work.

Beyond these specific issues, the courts remain riddled with apathetic, often corrupt, judges; poor infrastructure; underpaid and under-trained staff; rarely used technology such as cameras and other recording/stenography devices; and dockets in the district and municipal courts bursting with unpaid utility bills and other cases that should be resolved by other means. In sum, growth of a predictable, efficient culture of adjudication of contracts cases is unlikely in the short and medium term.

KCC ARBITRATION CENTER

The only available alternative to the courts, outside of agreeing to adjudicate or submit to arbitration abroad (which is typically the demand made by foreign trade partners), is the Kosovo Chamber of Commerce (KCC) which, by Article 26 of the Law on the Kosovo Chamber of Commerce, has the authority to arbitrate cases. The KCC has set up an arbitration unit, but the number of cases entertained thus far is unclear. The poor capacity of the KCC to arbitrate cases is, however, clear: The legal department, which is responsible for arbitrations, the legal matters of the chamber, as well as advice and representation in legal matters for the membership of the KCC, consists of only two lawyers; there is no training or support program offered to arbitrators; and, there is no supply of legal/procedural resources. When the legal department was asked what arbitration rules they use, the lawyer in charge referred to the Kosovo Arbitration Law, which indeed provides some rules (e.g., number of arbitrators, contested judgments) but does not relieve the necessity for the adoption of a widely accepted and well-understood set of arbitration rules.

It is well established that a business climate is made more effective, productive, and efficient if commercial alternative dispute resolution (ADR), especially arbitration, is promoted, facilitated, and made available to businesspeople. There are a number of reasons for this, some of them perhaps a bit surprising unless commercial ADR is thought of as a *structure* that underlies the entire *process* of business, from negotiating a deal, to drafting an agreement, to the performance of the obligations, to the resolution of disputes if necessary, and to the long-term, multi-agreement relationship between the parties. Through the provision, promotion, and facilitation of a system of arbitration, a culture of contract and the allocation of risk—in other words, *educated contracting*—can be developed. This concept of ADR as a structure, or underlayment, is also why it is considered in this context as a crosscutting theme.

The notion of ADR as an after-the-breach method for referring disputes to an organization outside an inefficient judicial system is only the tip of the iceberg. The true value of an ADR system is in its ability, if it is structured properly, to provoke the careful preparation of agreements so disputes are never suffered, and if they are, the burden is minimal. ADR systems promote the development of doing business with *dispute prevention* at the fore.

SUPPORTING INSTITUTIONS

The widespread use and enforcement of contracts are unlikely to gain momentum unless institutions that understand the needs of the business community, from the large vegetable processor fueled by foreign direct investment (FDI) to the smallest contract farmer, are trusted by their constituency and support more sophisticated business practices. The implementing institutions are often perceived to act as a “stick” to incentivize compliance with contracts through punitive measures for breach. Supporting Institutions, on the other hand, are widely considered to exist expressly

CONTRACTS AND COMMERCIAL LAW CURRICULUM

- Basic Commercial Practice
- Risk Allocation Contracting
- Basic Contractual Terms and Conditions
- Legal Drafting and Reasoning for Contracts
- Letters of Credit and Price-Delivery Terms
- Incorporation and Other Business Entities
- International Business Transactions
- Breach of Contract Litigation
- Enforcement of Contract Terms
- ADR Clauses

for their value as a positive business incentive. Generally speaking, Kosovo’s supporting institutions regarding contracts are weak but improving. Part of this may be a natural effort to build in the private sector protections and capacity that can bypass the wretched implementing institutions. Another part is surely the recent recognition given by the donor community to building the organizations that support and facilitate business.

Though agricultural associations are relatively weak in Kosovo, they are providing the broadest support in building contractual relationships simply by bringing farmers and processors/exporters together. These meetings can be tense, with farmers complaining that until the processors pay a fair price they will not have an incentive to adhere to contracts. The processors find that they really do not need to adhere to contracts since courts do not enforce them. They are happy to sign a contract, but doing so has no particular ramification upon their businesses. This sentiment echoes the lack of sophistication and mistrust that the farmers bring to the meetings. The concept that there must be some professional (rather than punitive) incentive to use and adhere to contracts has clearly not been introduced to much of Kosovo’s business community, especially at the lower levels, where farmers and small processors have the most to gain from the certainty of supply and market that good-faith contracting promotes.

LEGAL EDUCATION AND PROFESSIONAL DEVELOPMENT

An economy that boasts high levels of educational and professional capacity is one that enjoys self-determination and efficiency. Where top-down policy makers (Kosovo has been a thoroughly top-down system for nearly 20 years) are not balanced by bottom-up private-sector demands based on first-hand knowledge of industry, labor needs, and markets, business tends to be restricted rather than facilitated. Well-educated lawyers, accountants, MBAs, and engineers infuse industry, as well as civil society, with the tools and enthusiasm needed to become voices in setting policy and law.

Kosovo's legal and judicial community lacks commercial legal professional development. Emphasis over the past 10 years, with influence from the international community, has been on public law and policy areas such as justice sector restructuring and human rights. The educational system has been slow to evolve from the old socialist system of education that does little more than instill a collection of rules, without teaching students that their role is to facilitate business by supporting dispute prevention and smoothing the road to dispute resolution when business relationships break down. There is little practical or clinical training in commercial law at the law faculty, and the Kosovo Chamber of Advocates (KCA), the bar association, has no commercial law committee or section.

Legal education remains troubled. Only one institution trains lawyers (the University of Pristina) and it remains mired in politics and apparent corruption, and is burdened with a huge student body, most of which chooses legal education because it is traditionally the easiest to complete. This analysis is reasonable since few students profess a desire to practice law, and there is indeed a very small demand for lawyers in the community generally.

The demand issue is complicated, but relatively easily resolved in the medium term. As in many other places, Kosovo students keep demand for

professional education disproportionately high compared to the demand for vocational education because of the associated prestige. But in Kosovo where both professional and blue-collar jobs have been slow to develop, students have tended to choose the programs that are easiest to pass—one of them being legal education. By making the programs easy, politically connected university administrators have increased demand and turned education into a low-quality service provider that produces enough income to keep faculty in jobs but does little to prepare professionals for the rigors of doing business at home and, especially, abroad. So education remains cheap but popular and poor. The law faculty still maintains an enrollment of approximately 7,000 for a national population of two million.

Factors that have generally benefited education include the introduction of competition in the form of private universities, though not yet in legal studies;⁴¹ the hiring of young faculty educated abroad; investment of resources by the donors; and, efforts to improve curricula. Nonetheless, some of the problems identified in the original CLIR and its updates still plague the system: public demand for improvements in quality has been slow to develop; for financial reasons young faculty are not able to devote all of their efforts to teaching; and entrenched, tenured faculty are resistant both to change and to the competition brought by young faculty.

While some progress has been made in training law students in public and criminal law and human rights areas, more attention must be paid to commercial law training. Unfortunately, donor funding for commercial legal training, either at the university level or in the practicing community, is not as popular as training in human rights and other public policy. Some funding, for commercial moot competitions, for example, has been available, but continuing the funding from year to year is difficult, and sustainability of the programming—and, therefore,

41 Educational competition has been a double-edged sword. Though some facilities, such as RIINVEST and AUK, have raised the bar, the lack of oversight and meaningful regulation has led to occasional quality issues with some of the less-discerning private institutions.

use of future programming as an incentive to study commercial law—has not occurred.

THE LEGAL PROFESSION

Many of Kosovo's core problems lie within the sphere of professional capacity. At its simplest, it is abundantly clear that if education and professional capacity achieve a level that inspires individual professional growth and the strengthening of professional associations, economic growth will follow. The establishment of a well-rounded and effective educational system and a vibrant, activist community of skilled labor and professionals is a long way off; but significant near-term progress can multiply the effects of other activities by supporting even minor changes in the way people learn and function professionally.

Practicing lawyers are nearly as unaccustomed to commercial best practices as their clients. A handful of lawyers do maintain commercial practices but because they are so few, they are focused on foreign clients who pay higher rates. Of 12 licensed lawyers conducting commercial work recently identified by ABA-CEELI⁴² and USAID-KPEP,⁴³ none had local companies as transactional clients.⁴⁴ Because there is little demand in the business community for commercial lawyers, and because human rights and public law practice in a post-conflict society is more popular, few lawyers see an incentive to develop commercial practice. Though some programming designed to assist the development of a commercial bar has recently been established,⁴⁵ it is too new to have achieved success.

If economic growth cannot survive without many of the accepted components of the rule of law, and the rule of law cannot exist without lawyers, then logic dictates that economic growth demands lawyers. Though Kosovo's high law faculty enrollment would suggest saturation of the market, because demand remains artificially low and very few graduates pursue careers in law, the number of lawyers entering the market remains low—and those who do enter the market are not in any way equipped to provide adequate counsel.

The concept that education does not end with graduation from a university, and should continue in professional life, is beginning to gain some credence in Kosovo, particularly noticeable in the legal profession. A number of lawyers—most, but not all, educated abroad—are treating law much more like a business than ever before. These lawyers recognize the need for proper management, continuing legal education, professional responsibility, client development, and, most of all, a change in professional thinking from the notion of lawyers as problem solvers to the notion that lawyers can keep problems from arising in the first place, and can therefore reduce transaction costs for business and can even contribute to economic growth.

The government, civil society, and the donors could do significantly more to help create the necessary market demand for lawyers. There is still a strong tendency in Kosovo, as is common in formerly socialist countries, to think of the legal profession as one that exists only to serve others, rather than one that exists in part to make money and facilitate business. Therefore, the existing regulations make it difficult to efficiently operate a law practice. Firms are still technically not permitted; lawyers may be partners but cannot be hired; advertising—even informational websites—is not permitted; and client development is frowned upon, if not prohibited.

Few programs have focused, even indirectly, on contracting or contract negotiation. The American Bar Association (ABA) has long worked on capacity building and training of the legal community but without a specific focus on commercial law. The ABA's work with the KCA and the University of Pristina Faculty of Law (UPFL) has nonetheless established a good foundation for further development of a commercial section at the KCA and of UPFL legal clinics and courses. Twelve licensed lawyers with interest in commercial work have been identified and have attended a law practice management training co-sponsored by the ABA and the KPEP.

42 American Bar Association Central European and Eurasian Law Initiative.

43 USAID Kosovo Private Enterprise Program.

44 Transactional clients are those with whom the lawyer is engaged in negotiating and drafting contracts. Transactional work is preventive in nature.

45 SEAD, BearingPoint, KPEP, EC Commercial Law Fellowships.

The USAID Economic Management for Stability and Growth Project developed and delivered training for judges and the magistrate schools on a series of commercial law topics, including arbitration, company law, bankruptcy, and intellectual property. More training is planned in the fall but a more focused and practice-oriented approach is warranted.

NOTARIES

A Law on Notaries (2008/03-L-010) was recently passed, and requires real property contracts to be drafted by notaries. This is a fairly typical requirement in civil law systems, and in this case the law was adapted, with few changes, from the Swiss law. Because of the newness of the notary system and the Chamber of Notaries (the body that licenses notaries), and because the law makes no provision for competition among notaries (all the people of a particular zone must rely on the services of one notary), there have been a number of complaints and accusations of nepotism during the system's short existence.

PROCESSORS, EXPORTERS, AND DISTRIBUTORS' ROLES AS SUPPORTING INSTITUTIONS

The level at which basic raw fruits, vegetables, and herbs undergo the basic next value-added steps such as processing, sorting and distribution, or packaging and export seem to have the most incentive and capacity for growth as an institution that supports the farmer and collector. Many of these organizations are associations, but most are companies (many are privatized SOEs) that extend credit and know-how to the farmers in exchange for promises of supply. Until many of the contractual relationship problems outlined above and discussed in more detail below, are solved, however, and farmers are more willing adhere to reasonable contracts, the processors' role as supporter will be limited. The processors need to take more active and pragmatic steps to build trust among their partners, and to create a support foundation based more on long-term potential.

SOCIAL DYNAMICS

BUILDING A CULTURE OF CONTRACT

A culture of contract exists when businesspeople rely more heavily on negotiated agreements to reduce risk rather than the distance between themselves. Reducing distance can effectively minimize risk, but it tends to increase transaction costs, sometimes dramatically, for example, when an importer of agricultural equipment asks for the delivery of goods on spec from a distant location on the theory that seeing the goods before buying reduces his or her risk of receiving non-conforming goods.⁴⁶ In fact, the institution of contracting developed out of traders' need to seek supply and markets ever farther from home. Competition and the discovery of desirable commodities in distant lands meant that traders could no longer rely on the old trust and character-based methods for reducing risk. No longer could business be done simply on a handshake between people who had known each other for years. The new risks were significant, though. Differences in language, custom, standards, currency, as well as the risks inherent in shipping goods across vast distances and the related issue of separating payment from delivery in time required the development of legal standards that could be agreed upon by both parties in advance and form the basis for resolving disputes. Traders found it not only advantageous to allocate their risks in this way but also imperative.

For a number of reasons, Kosovo businesspeople never truly developed sophistication in arm's length contracting. There is clearly a tradition of dealing with friends and relatives based on a handshake, a cultural desire to "see before buying," and a relatively long history of trade that limited Kosovo businesses to dealing with public and socially owned enterprises on terms set by the state.

Ultimately, a number of issues, including many outlined in other chapters of this report, have combined to create a "perfect storm" against

⁴⁶ One of the principal risks, broadly speaking, referred to here is called "ex post opportunism" by Kenneth Dam in his book *The Law-Growth Nexus: The Rule of Law and Economic Development*. Whenever one party has the opportunity perform later in time than the other, there is a risk that that party will take the opportunity for more advantageous, but not contractually contemplated, performance.

growth of the agribusiness sector. None of these issues exist in a vacuum—all are interdependent with the others. Without the development of a culture of contract in the lowest levels of the value chains, and without a clear understanding on the part of processors of their role as supporting institutions, contract farming and out-grower schemes, so vital to Kosovo's future growth, will never expand. On the other hand, until processors/exporters are able to better enforce their contracts with farmers, and until farmers are treated as businesses, contracting and support will be very slow to develop. Whatever the mix and relative weight of the various problems, however, it is abundantly clear that many of the more readily resolved problems are in the relationships and roles between and among the farmers and the processors, rather than in the legal framework or in the courts. The legal framework is more or less sound, and the courts are years away from being a trusted and efficient resource for the business community. Only by carefully targeting the lower levels of the value chains will there be substantial reform and growth in agribusiness.

Kosovo lags far behind its southeastern Europe neighbors in commercial growth with exports now representing only about 5 percent of trade. This is largely due to a lack of sophistication in the way business is conducted. There is no culture of contracts in Kosovo. Commercial agreements are typically limited to extended families and close circles of known associates. Businesses rarely negotiate terms of agreements at arm's length before performance. Many agreements remain purely verbal, and, when written contracts are used, poor drafting results in agreements that are difficult to enforce and leads to intractable disputes, most of which never reach resolution, that impede commercial development and the establishment of a business-friendly environment. Businesspeople in developed countries always prefer to do business with sophisticated partners because parties that do not understand their contracts often breach those contracts.

The lack of a culture of contract was popularly recognized as the "mentality problem" by a number of AgCLIR interviewees. As some commercial lawyers have suggested, it is difficult to enforce contracts in the agricultural sector where there lacks real understanding and definition of the legal entity of the contracting parties, i.e., distinction between personal and corporate entities. For instance, when claimants go to court, disputes typically center on commercial issues that municipal courts have little experience with.

Commercial litigation is low in Kosovo. The Commercial Court typically receives about 50 new cases per month. This means judges and litigators have little experience handling commercial disputes. At the same time, commercial lawyers, private businesses, and trade associations perceive courts negatively. Courts are believed to be inefficient, corrupt, and favoring publicly owned companies or individuals at the expense of private businesses. This, combined with the absence of alternatives to court litigation, has limited the growth of domestic business activity and kept foreign businesses from investing. An effective and reliable provision of commercial legal services and a commercial framework that is predictable and transparent would contribute to economic activity.

Finally, the private sector and the commercial legal community remain largely separate. Kosovo is not geared towards a demand-driven, private sector led, commercial legal reform structure. Kosovo businesses rarely resort to legal assistance before a dispute arises. Kosovo businesses are reluctant to rely on preventative legal advice because they either do not understand the importance of a risk-allocating contract or are willing to take a chance on whether a dispute will arise. As business activity grows so will the importance of lawyers as facilitators and voices of reforms demanded by businesses.

Kosovo abounds with stories of foreign trade shows at which Kosovo businesses successfully

promote their products only to be rejected in the end for reasons that have little to do with the products themselves. Buyers are often happy with the sample product, typically impressed with the service orientation of the producer, and satisfied with the offered price.

Then the buyer asks to see a pro forma invoice, inquires about the price-delivery terms, probes the letter of credit conditions, or wishes to discuss dispute resolution clauses. What might have been a successful business relationship dissolves before it even begins.

RECOMMENDATIONS

RECOMMENDATION: INCREASE THE LIKELIHOOD THAT CONTRACTS WILL BE USED AND ENFORCED BY PAYING MORE ATTENTION TO THE CONTRACTUAL RELATIONSHIPS AND INCENTIVES AT ALL LEVELS OF THE VALUE CHAIN.

General: Improve dialogue, capacity, and business sophistication in the relationships between farmers and processors, and between processors and customers.

Short Term

- Focus on building the contractual relationships between farmers and processors/exporters through risk allocation seminars and dialogue.
- Follow the “culture of contract” skills building with model contract farming programs.
- Establish default treatment of unregistered businesses as legal entities.
- Establish a professional legal clinical program designed to raise capacity of commercial lawyers and provide free advice and capacity building to small-holder farmers and SME processors.
- Establish small-scale, subsector-specific (e.g., fruits, dairy, non-wood forest product (NWFP)) pilot arbitration programs to resolve low-value disputes between farmers and processors/exporters.
- Provide incentives for commercial lawyers to visit trade shows with producers.
- Clarify that arbitration centers outside the KCC are permitted.

Long-term

- Establish Commercial Benches with specialized judges in the municipal and district courts and transfer commercial case jurisdiction from the Commercial Court.
- Build capacity for arbitration in the Kosovo Chamber of Commerce Arbitration Center.
- Develop outgrower and contract farming support programs



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