TRADE LIBERALIZATION, FOREIGN TRADE AND INTEGRATED EXPORT POLICY IN KOSOVA

By Muhamet Sadiku, PhD [1]

The Trade Liberalization

Trade liberalization is the key to building an open economy and strengthening the competitiveness of the domestic economy to face imports in the domestic market and improve export performance. Small economies like Kosova should especially opt for a free market, open economy and liberal trade. However, the context and process of liberalization should be discussed.

Trade liberalization in Kosova was performed in very specific circumstances[2] and it differs from the experiences of other transition countries. Whilst other transition countries carried out trade liberalization as part of general economic reforms, in Kosova this was done without a consistent transition and economic recovery strategy and under the pressure of the emergency reconstruction needs and the collapse of the production sectors during the war.

In circumstances in which there is a lack of integrated economic policies, the international administration is continuing to carry out comprehensive trade liberalization. This is having a negative impact on the growth of both producers and exporters, who are still in the early phase of their development. The emerging economy of Kosova was unprepared to cope with the consequences of liberalization in the circumstances of the new emerging industries, unfair competition and the weak state of the law and asymmetric trade relations with neighbours (FYROM, Serbia/Montenegro). Moreover, this process has not been accompanied by an active policy of export promotion in order to alleviate undesirable effects. Whilst in other transition countries the EU, through the PHARE program, provided a package of special measures (technical assistance) supporting trade policies and trade promotion, in Kosova, under the pressure of reconstruction there was no orientation toward developing trade policies and enabling the country to face foreign competition.

International experience has shown that countries that introduced trade liberalization faced some difficulties, including first a decrease in budget revenue and the inability of the domestic economic sectors to cope with a major competition "shock". But, on the other hand, some countries were able to create a friendly and stable environment for foreign direct investments that provided a great inflow of foreign capital (Poland, Hungary, Czech Republic). However, rapid liberalization has been a relevant topic for discussion for all transition countries.

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[2] The consequences of war, 10-year delay in transition, lack of economic and social sustainability, a low level of producers, asymmetric trade instruments, lack of policies toward producer protection in the initial phase of trade liberalization.

In countries where trade liberalization is in line with economic policies, the transition process was more successful[3]. In this regard, transition countries can be divided into two groups: (i) countries with a significant increase in trade volume, such as Hungary, Poland, Czech Republic and Slovenia and (ii) a second group of countries that suffered heavily from the abolition of trade relations with the former Soviet Union, or from economic crises and civil wars (Trade Policy during Transition, Lessons from the 1990s, CERT).

From the Kosovar perspective it can be seen that in the circumstances of unilateral liberalization and asymmetric trade instruments (customs duties are only paid on imports from Albania, while Serbia/Montenegro do not pay custom duties, and imports from FYROM only pay 1% administrative fee) a consolidated budget has been created, but on the other hand there is a lack of a favorable environment for business growth which will have an impact on budget revenue consolidation in the long run. Also, several other obstacles were underestimated, including: institutional obstacles, the inadequate banking system, lack of export credit and customs inefficiency.

Trade liberalization in Kosova is being undertaken without a selective approach[4], since all economic sectors are facing equal pressure from foreign competition "shock". It is obvious that for an emerging economy such as Kosova's, straightforward liberalization is not sufficient. Data in the second chapter will demonstrate this point. These factors will not bring the desired effects to a turbulent environment without other indirect measures that will increase competitive capability (taxes, financing, promoting activities).

In the case of Kosova, where sustainable development is absent and where economic policies are not sufficiently stimulative to encourage the growth of business enterprise, changes influenced by trade liberalization are being considered due to:

- Difficulties in structural transformation of businesses ;
- Small number of producers and productive businesses;
- Symbolic participation of exporters in international trade;
- Unfavorable business environment for new business initiatives;
- Difficulties in building the competitive capability of domestic businesses to compete in regional and foreign markets.

The Trade Regime of Kosova

The first step towards building the trade regime was made by setting up the customs border checkpoints with neighboring countries (Albania and FYROM), although not with Serbia and Montenegro[5]. The establishment of the Customs Authority of Kosova was conducted according to UNMIK Regulation 1999/3, transforming Kosova into an autonomous customs territory. This regulation and other UNMIK regulations that were approved during the last four years represent the main legal framework for the promotion of a trade regime for Kosova.

The current trade regime of Kosova is considered to be liberal, transparent and easy to administer. This regime consists of uniform customs tariffs (0% for imported goods from

[3] Rapid trade liberalization in some transition countries was not accompanied by the necessary institutional support, but it has been shown that the establishment of the supporting institutions cannot be done within one night. Establishment of administrative and institutional capacities is considered to be a key element for the success of trade policy reform (Trade Policy during Transition, Lessons from the 1990s, CERT).

[4] One of the transition problems relating to trade policies was the ability to predict which sectors would be more competitive and more exposed to international competition.

[5] Trade regime of Kosova with Serbia and Montenegro, UNMIK considered as an internal trade.

Serbia/Montenegro, 1% - for goods imported from FYROM and 10% - for goods imported from other countries), and is notable by the absence of non-tariff measures and quantitative restrictions. A positive aspect is its reliance on a convertible currency, which came about when the Deutsche Mark was introduced as the legal currency (which also had the effect of controlling inflation, establishing a consolidated budget and the reconstruction of the economy). In contrary with other transition countries, Kosova has started its reconstruction introducing stable currencies such as DM and Euro**.**

UNMIK used the trade regime as a main mechanism in collecting budget revenues. The share of tax revenues collected at borders to budget revenues is around 80 %. This can be considered as a reasonable approach, not just because the administration was limited in number and experience, but because it was also a simple and straightforward way to collect revenues for immediate needs.[6] However, in spite of the fact that in most of the developing countries customs duties present the main revenue source, it is generally accepted that it is extremely important to strive to reduce dependence on these sources of revenue in favor of internal fiscal instruments (VAT, wage tax, profit tax). Tendencies for decreasing the tariffs will overcome the difficulties of Kosova economy being part of the free trade zone within SEEC.

The measures and key instruments of the trade regime

In spite of the achievements in building the trade policy, there are several issues that leave room for further concern. Since many trade laws have still not entered into force (including standard and technical barriers, sanitary measures, intellectual ownership and competitive policies), there are gaps in the Kosovar trade regime. Hence, a clear definition of these policies and approval of the laws is of significant importance, removing the possibilities for a different interpretation[7]. Another weakness is the asymmetric trade relations with other countries in the

- Custom duties (uniform tariff of 10%, for all goods imported into Kosova, excluding pharmaceutical products, fertilizers, goods imported by international organizations. Whereas, customs tariff on exports is zero.
- Quantitative quotas – import licenses (on import of live stocks, import of pharmaceutical products, and materials for producing pharmaceutical products). This policy does not include import and export quotas.
- Registration of all importers and exporters within the UNMIK Customs Office, and arranging all customs documents.
- Import and export of weapons, explosion materials, ammunition and dangerous materials is prohibited within the Washington Convention, although there is no specific UNMIK Regulation relating to this.
- Excise duty on soft and alcoholic drinks, tobacco, fuel, mobile phones, cars, televisions and satellites. Excise duty tariffs are similar for imported goods and for domestic producers. Excise duty on goods is on an ad-valorem basis, excluding coffee.
- VAT, with a 15% rate on imported goods and zero rate on exported goods.
- Control and Inspection of sanitary and veterinary products

Source: Kosovo's Integration into the Regional Free Trade Network", A Report for the USAID Economic Reconstruction Project in Kosovo, by Farhat Youkim Farhat

[6] See: "Key Issues in Building Taxation Policy in Kosova", Research Report, Riinvest 2001.

[7] See: "Kosovo's Integration into the Regional Free Trade Network", A Report for the USAID Economic Reconstruction Project in Kosovo, by Farhat Youkim Farhat.

region. For example, the Preferential Agreement between FYROM and FRY[8], involves a loss of tax revenue for the Kosovar economy, since the Macedonian counterparts, despite discussions held with UNMIK, have violated this agreement and have applied asymmetric customs measures. As a consequence, the country of origin of many non-Macedonian goods can be falsified in order to benefit from preferential treatment, leaving room for fiscal evasion. Furthermore, Kosova's imports and exports are discriminated against during their transit through Serbia and Montenegro by being charged special taxes (3% and 5%, respectively). At border crossings, Kosovar products pay a transit tax that makes these products more expensive, causing serious distortions in the market and the competitive capability of Kosovar producers.

However, progress has recently been made with an initiative to negotiate a network of free trade agreements (FTA) within South Eastern countries (SEC). With considerable delay Kosova is now part of this initiative.

The Free Trade Agreement with Albania is now in operation and it is expected that similar agreements will be reached with some other countries. Free Trade Agreements could have negative impacts on Kosova's Budget in the short run, but on the other hand they are necessary to promote economic growth within Kosova through an export strategy and FDI.

FOREIGN TRADE

(i) Impacts of the Extreme Trade Balance on macroeconomic imbalances

Extreme imbalances in foreign trade generate macroeconomic disproportions with long-term implications for economic growth and sustainability. Therefore, alleviating such disproportions should be a long-term priority. Economic policies aimed at overcoming this situation should focus on increasing the manufacturing of goods and services, competitiveness and export promotion.

In Kosova, as in other transition countries, foreign trade liberalization has been accompanied by considerable imbalances between exports and imports. However, in Kosova, in contrast to other transition countries, the typical problems that characterize early transition are taking a longer time to solve. Despite the fact that exports have increased by 36% during the period 2000-2002, they are still only symbolic in relation to imports. In the same period imports have increased by 64%. Foreign trade constitutes a high share of GDP in Kosova (46.2% in 2000; 50.6% in 2001; and 51.0% in 2002), principally due to the high share of imports in GDP. Imports also account for a high share (45-50%) of total consumption.

The foreign trade deficit has continuously increased during the period 2000-2002, from €616 million to €961 million at the end of 2002. During the period January-June 2003 the negative difference of the foreign trade balance rose to €427 million.

Table 1: Kosova's trade balance (in mil. €)

	Exports	Imports	Trade Balance
2000	18.89	635.20	- 616.31
2001	10.64	874.35	- 863.71
2002	27.32	988.73	- 961.41
2003	15.36	442.94	- 427.58

Source: Monthly Macroeconomic Monitor, MFE (2003)
Note: Data for 2003 includes only the first half of the year.

[8] According to this agreement, 10% custom duty is not paid for Macedonian goods, but only a custom fee of 1%.

It is believed that these foreign trade imbalances have been covered by inflows of Kosovar diasporas remittances and international donations. However, the continuous decrease in donor inflows will worsen the macroeconomic stability if Kosova's exports do not improve soon. The increase in the trade deficit was influenced by the difficulties in post-war reconstruction, current economic policies, asymmetric trade policies as well as administrative obstacles created by some neighboring countries. This has brought about a very low level of imports coverage by exports (2000: 2.97%; 2001: 1.22%; 2002: 2.76; 2003 3.47)

(ii) Exports

The volume and structure of Kosova's exports during the past four years illustrate the obstacles that Kosovar business are facing, especially the production sectors, within the existing economic policy framework. The collapse of the socially owned sector during the 1990s, as a consequence of the forcefully installed administration, as well as the delay in ownership transformation of socially owned enterprises (SOE), resulted in a drastic fall of exports and a loss of foreign markets[9]. In this situation foreign trade was dominated by imports taking into consideration the destruction of key exporting sectors. After 1999, the Kosovar economy was faced with the consequences of war, and achieved a very low level of exports compared to the volume of imports, being continuously and heavily dependent upon imports.

Despite its continuous increase (except in 2001), the level of exports still remains at a symbolic level. From 2000 (€18.8 mil) until 2002 (€27.3 mil), the total value of exports has increased by around 30%. Data presented in Table 2 understates the overall value of exports because it does not account for unreported so-called internal exports[10], which includes the sale of goods and services to foreigners (domestic sales to foreign firms and other international institutions) in Kosova.

Exports are mainly destined for the markets from which Kosova is mostly importing. As shown, in 2000 the most attractive markets for the Kosovar exporters were markets in the countries of the region (50%) and then the European Union together with Switzerland (30 %). During 2001 and 2002 there was a significant export growth to the EU and Switzerland (45% and 43% respectively), whereas there has been a slight decrease of the share of exports to countries of the region (40% and 34% respectively). In fact, in the first half of 2002 about 80% of Kosovar exports were destined for the markets of the EU, Switzerland, and regional countries. F**rom the perspective of export countries in 2001 is achieved this share: Macedonia (18.7 %), Serbia/Montenegro (9.8 %) and Bulgaria (8.0%)**

Kosovar exports, by destination, expressed in mil € and in %

	Total	EU and Switzerland	Countries of the Region	Others
2000	100.0	30.0	49.2	20.7
2001	100.0	45.6	40.6	13.8
2002	100.0	43.2	34.3	22.5

9 In 1989, taken as the beginning of the abrogation of Kosova's autonomy, Kosova exported about €200 mil. In the context of these exports, these enterprises accounted for large share: (i) Industry of batteries €31 mil. (15.5 %),Shock absorbers industry, €10 mil. (5%), Ferronickel €95 mil. (47.5 %), Electromotors €20 mil.(10 %), Textile and leather-shoes, €12 mil.(6 %), Auto parts €9.5 mil. (4.7 %), and winery €8.5 mil.(4.2 %)

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2003	100.0	38.6	40.9	20.5

Intra-regional exports are destined mainly to former Yugoslav countries. As official statistics show, in relative terms, Kosova's imports and exports with these countries looks quite good, but the huge trade deficit with these countries is apparent. A special case is the biggest exporter in the Kosovar market – FYROM, which in 2001 exported 145 times (in value terms) more goods to Kosova than it imported. This clarifies the picture in terms of the resistance by Kosovar institutions and businesses to maintaining the Free Trade Agreement with Macedonia.

The structure of exports is dominated by products such as leather, beer, wine, wheat and flour, and mushrooms, a few types of unfinished metals, nickel and other metal remnants which are based on the functioning of state-owned mining companies as well as leather and textile products. The export structure lacks highly finished products (see Figure below).

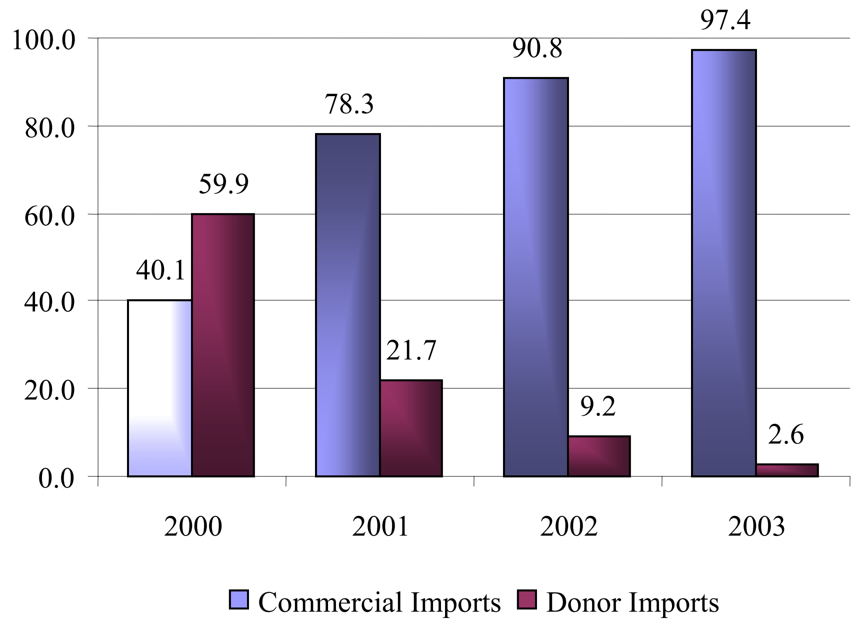
In terms of the quality of exports, the domination of raw metals and other unspecified commodities should be stressed. The structure of exports is an indicator of the quality of economic reconstruction and the development phase of the private sector as well as the difficulties in the transformation of existing businesses.

(iii) Imports

The volume and structure of imports indicate that the important elements of import demand stem from consumption and from the demand for inputs into the production sector. This is due to the reconstruction phase which accelerated an excess demand for construction materials in the market, out of proportion to Kosovar production possibilities. The consequence has been that the domestic market has been flooded with imported goods. During the emergency reconstruction phase the volume of donor imports was much larger than the volume of commercial imports, particularly in the aftermath of the war and so donor imports had a higher share in the overall structure of Kosovar imports. The data presented in Figure 1 shows that the share of donor imports in 2000 was around 60%, while the share of commercial imports.

High share of donor imports was based on donations financed by the international community for the reconstruction of Kosova. The end of the emergency phase of reconstruction was followed by a decrease in donations and in the share of donor imports. Commercial imports have increased constantly and their share in overall imports is now about 97%.

Share of Commercial and Donor Imports in Overall Imports (in percent)



Source: Monthly Macroeconomic Monitor, MFE (2003)
Note: Data for 2003 includes only the first half of the year

Developing an integrated export policy [11]

An integrated approach

The UNCTAD approach to export policy identifies three elements in an integrated export policy. The first element is a range of so-called *border-in issues* that emphasize measures that can be adopted to increase the competitiveness of companies in the domestic market. The second element is a range of so-called *border issues* – measures designed to improve the procedures at borders and to reduce the transaction costs facing businesses when they cross borders. These are sometimes referred to as "trade facilitation" measures. The third element encompasses the so-called *border-out issues*. These are the traditional export promotion policies that focus on improving the performance of domestic enterprises in foreign markets through the provision of market information, partner-search measures such as trade fairs and trade missions, marketing and publicity for exporting enterprises, the creation of export websites and exporter databases, training in export techniques and procedures, and other similar **soft** export promotion measures.

The need for a policy network

An integrated export policy should focus on competitiveness as much as on trade facilitation and export promotion, but the wide variety of issues involved is too large to be tackled by a single institution. The issues cut across many areas of policy-making and involve many policy institutions, ministries and agencies. The issues involved are inextricably linked, as UNCTAD observes.

[11] For more details see the report: " An integrated export policy for Kosova", prepared by Dr. Will Bartlett, Riinvest, 2003.

A network approach is an alternative policy design to the "one-stop-shop" approach delivered through an export promotion organization. The network approach emphasizes competitiveness enhancement, rather than simply market development or trade facilitation. The network will involve the participation of a number of specialized institutions working in concert with one another, exchanging information, cooperating and communicating with each other to deliver a range of services to enhance competitiveness and improve the delivery of trade support services. The network approach would work with existing institutions to redirect the national development effort towards a priority for competitiveness enhancement and trade promotion.

The competitiveness of domestic companies (Border-in policies)

An essential part of creating a competitive export-led economy is, paradoxically, the creation of a strong domestic base of competitive enterprises. The first step in an effective export strategy should be to improve the competitiveness of the economy's enterprises in the domestic economy. The reason for this is simple enough. Firstly, by successfully competing against foreign competitors in the domestic market, enterprises can develop their competitive capabilities. Secondly, by operating successfully in the domestic market and increasing their market share, Kosovar enterprises will increase their scale of production, reduce unit costs and hence become yet more competitive as a result. Thirdly, the policy instruments which need to be developed to support competitive domestic producers on the home market will also be needed to support successful businesses when they decide to enlarge their market share by competing in export markets. Therefore focus on developing the small-scale private sector needs to be given priority.

[1] Price competitiveness can be improved by cutting costs, or by raising tariff barriers and other barriers against imports. UNMIK has already decided to phase out tariff barriers and so measures to cut costs will be required to increase the price competitiveness of Kosovar companies. In any case, cuts in import duties, in so far as they affect inputs of machinery and raw materials, will ease the cost conditions for Kosovar producers that rely on imported inputs. The main elements of costs include, (a) wage costs, (b) raw materials, (c) energy costs, (d) taxes and customs duties, (e) depreciation and (f) capital costs.

[2] Quality competition involves shifting the production process to higher value added production activities, upgrading skills, the use of information and communication technologies – which could be supported by an SME support program, FDI promotion, business network alliances and clusters.

The concept of integral export policies in Kosova

I. Price competition • Wage costs • Raw materials, • Energy costs, • Taxes and custom duties, • Capital costs
II. Quality competition • SME Support program, • FDI Promotion, • Network alliance clusters, • Training
III. Trade Facilitation Program • Custom procedures, • World Bank TTFSE program, • Visas/Documents, • Regional Cooperation Cross Border program
IV. Export promotion programs • Information on foreign markets, • Partner search and mach making, • Export Data Base, • Marketing Publicity, • Training of Exporters

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