Agriculture Finance in Kosovo

Creating an Agri-Finance Market

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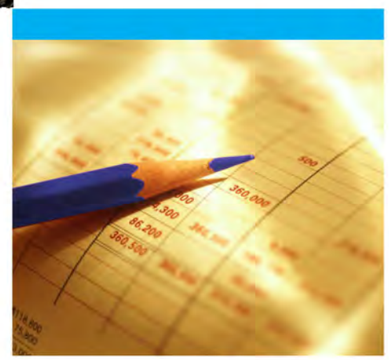

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List of Abbreviations

AAD	Agency for Agricultural Development of MAFRD
AFK	Agency for Finance in Kosovo
AGRO	USAID Agricultural Growth and Rural Opportunities program
AMIK	Association of Microfinance Institutions of Kosovo
ARDP	Agriculture and Rural Development Plan of MAFRD
CEFTA	Central European Free Trade Agreement
CBK	Central Bank of Kosovo
DEAAS	Department of Economic Agriculture Analysis and Statistics – Ministry of Agriculture
Danida	Denmark's development cooperation
EBRD	European Bank for Reconstruction and Development
EU	European Union
FADN	Farm Accountancy Data Network
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign direct investment
FI	Financial institutions
LFS	Labour Force Survey
GDP	Gross domestic product
GI	Geographical identification
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit *(German Corporation for International Cooperation) GmbH*
GoK	Government of the Republic of Kosovo
GVA	Gross Value Added
HACCP	Hazard Analysis and Critical Control Points
IACS	Integrated Administration and Control System
IPA	EU Instrument for Pre-Accession Assistance
IFC	International Finance Corporation
IPARD	EU Instrument for Pre-Accession Assistance for Rural Development
IPM	Integrated Pest Management
IT	Information Technology
KARDP	WB Kosovo Agriculture and Rural Development Project
KAS	Kosovo Agency of Statistics
KBA	Kosovo Banking Association
KCGF	Kosovo Credit Guarantee Fund
KfW	KfW Entwicklungsbank (KfW Development Bank)
KRK	Kreditimi Rural i Kosovës
LFA	Less Favorable Areas
LFS	Labor Force Survey conducted by the KAS
LPIS	Land Parcel Identification System
MAFRD	Ministry of Agriculture, Forestry and Rural Development of Kosovo
MIS	Market Information System
MFI	Microfinance Institution
MSME	Micro, Small and Medium-sized Enterprise
MTI	Ministry of Trade and Industry of Kosovo
NDVI	Normalized Difference Vegetation Index
NOA	USAID New Opportunities for Agriculture program
NPLs	Non-performing loans
PCB	ProCredit Bank Kosova
PDO	Protected Designation of Origin
PPSE	Swisscontact's Promoting Private Sector Employment program
RBKO	Raffeisen Bank Kosovo
SAA	Stabilization and Association Agreement with the EU
SDC	Swiss Development Cooperation
USAID	United States Agency for International Development
VC	Value Chain
WB	World Bank
WTO	World Trade Organization

1. Executive Summary

This study, conducted between March and June of 2018, was commissioned by the International Finance Corporation (IFC), a member of the World Bank Group, **to assess the current state of agricultural finance in the Republic of Kosovo (Kosovo) and determine ways to improve the provision of finance to Kosovo's growing agricultural economy.** The study is aimed at informing the full range of stakeholders about the best options to scale up financial services for agriculture. The study relies on data from available statistics as well as on individual and group discussions with stakeholders.

Kosovo's business environment is improving, despite slow advancement in the capacity and function of the public institutions responsible for providing guidance and direction to the industry. Government focus on the World Bank (WB) Doing Business indicators[1] has produced encouraging results. According to the Doing Business 2018 report,[2] Kosovo is currently ranked 40th in the world, up from 126th in 2012, a leap of 86 places. In ease of starting a business, Kosovo very substantially improved its ranking, by 160 places. A law on strategic investments is under consideration, and attention is being given to support public institutions that improve the business environment, such as the Business Registration Agency, which ultimately will support investors. These developments are taking place in an economy marked by high general unemployment (30.5 percent) and very high youth unemployment (52.7 percent). The public sector remains the dominant employer and pays higher wages on average than the private sector. The supply of skilled workers is insufficient to satisfy private sector demand. Small and medium enterprises dominate the economic landscape; while these are increasing in number, few grow into larger entities.

The informal sector dominates the economy, skewing competition and acting as a strong disincentive to formalization. Investment, dominated by the public sector, has been a key growth driver. Nonetheless, the ration of debt to gross domestic product (GDP) remains modest at 16.6 percent, indicating opportunity for enhancing rational public spending investments.

Remittances constitute a significant share of national income and have a significant impact on shaping the size of the agricultural market in Kosovo. According to the Central Bank of Kosovo (CBK), remittances received amounted to €691 million comprising about 12 percent of GDP and represent the largest category within the secondary income account.

Agriculture has traditionally played an important role in Kosovo's economy, but now less than previously. The contribution of the agricultural sector to GDP is around 11 percent; 60 percent of Kosovo's population lives in rural areas. Both indicators are slowly, but constantly, decreasing, indicating that: (i) other economic sectors are developing faster than agriculture, and (ii) regardless of its high population growth, migration to urban areas and migration to the European Union (EU) and other countries is still the preferable option for many of the rural inhabitants. The total value of agricultural production, including services, is estimated at €736.8million, with plant-based products generating 56 percent of the total at €412.3 million, livestock products contributing 41 percent at €302.4 million, and services generating 3 percent at €22.1 million.[3] There is now a need for a more focused approach and for the identification of both comparative and competitive advantages of Kosovo in the Western Balkans region and other current and potential markets. Since Kosovo's public institutions are young and weak and often present obstacles to development, a critical part of this strategy must be institutional development.

Kosovo's agricultural sector has significant room to grow. The sector is dominated by smallholder farmers (owning from 0.5 to 5 hectares of land), and this situation is not expected to change in the near future. Agriculture currently contributes 18 percent of Kosovo's exports, up from 15 percent recorded in 2016.[4] Recent experience with soft fruits shows enormous expansion potential in producing high value crops using the existing smallholder structure, targeting micro, small and medium-scale production on plots of up to 5 hectares of land, which in 2016 represented 94.2 percent of all land holdings. Efforts to promote agri-sector growth should therefore be focused on holdings between 1 and 5 hectares. Expansion will come from a transformation from cereals to higher-value crops. Since only 10 percent of Kosovo's arable land is used for higher-value production of fruit, vegetables and wine grapes, there is clearly potential to expand. Growth in the sector will not only fuel exports, but can contribute to reducing the current agricultural trade deficit of over €610 million. Recent data indicates exports of only €45 million of agricultural goods and imports—fuelled by increasing consumption—of €658 million of agricultural goods.

In order to stimulate this potential growth, the production structure must be changed to increase production diversification and further develop value chains (VCs). Inefficient production of maize and wheat, while important socioeconomically, consumes public subsidy budgets for diminishing returns year-on-year. Successful results from small farms have shown opportunities for diversification with soft fruits, medicinal and aromatic plants and intensive horticulture enterprises generating attractive returns. This diversification is the result of a focused VC approach with small producers aggregating their product through private sector collection centers and processors. Although still at a modest level, success thus far indicates the potential that exists for the focused VC approach. The VC approach demonstrates that it is critical to establish linkages between producer and market and implement knowledge transfer mechanisms. Without this, smallholder agriculture has little chance of market success.

There is ample room for improving efficiency and generating good gross margins on small farms that use family labor (with typically low overhead and acceptable returns) by implementing modern production technologies. In a number of locations, opportunities also exist to expand the area under cultivation and make better use of water resources available from public systems. In addition to expanding the production base, there exists substantial opportunity for investment up the VC by developing VC financing instruments and methodologies as farmers gain confidence in market linkages and the value of formal contracting.

Government grants and subsidies are substantial, with approximately €25 million annually of subsidies (direct payments) and €25 million of grants. Stakeholders indicate that the results of this investment are disappointing, citing a lack of regional focus, consistent agricultural strategy or policies, and—critically—focus on all elements of VCs. There is an apparent need for grant scheme and grant policy improvement. Although there are investments in the field, there is no obvious improvement in sector performance. A lack of proper analysis for direct payments and the enormous inspection load imposed by the large number of beneficiaries leads to marked inefficiency. The Ministry of Agriculture, Forestry and Rural Development of Kosovo (MAFRD) is aware of these problems and is interested in making changes. However, in general, agricultural policy in Kosovo is a restrictive mix of EU accession aspirations and local politics common throughout the Western Balkans. Policy changes are frequent and appear to have little real influence on the development of the sector.

Local policy changes are heavily influenced by the regional situation. Agricultural production and trade in the Western Balkans are highly interdependent: policy or market developments in one country have follow-on effects on the others. Most tariffs were abolished decades ago; the market-leading agribusinesses operate in all the countries and the service companies (input suppliers and consultancies) are also present regionally. Consequently, Kosovo's agriculture sector is heavily influenced by regional trends: for example, the development of berry cultivation in Kosovo resulted from development of the industry in Serbia and then Bosnia and Herzegovina.

A dearth of information on market opportunities has been a key issue, combined with too few aggregators with insufficient installed capacity. Dissemination of information on new opportunities, best practices and paths to aggregation and the market has been

[1] See https://datacatalog.worldbank.org/dataset/doing-business.

[2] *Available at* http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf.

[3] Green Report 2017.

[4] Green Report 2017 and KAS.

fragmented and, at times, inconsistent. Farmers are traditionally focused on the local market, since local market information and feedback are easily obtained. Quality standards and parameters and aggregation are viewed as less important. This default position can be changed only by linking smallholder producers to a larger aggregation system through the VC. Also, there is a strong need to improve the financial literacy of producers who until now have had little or no exposure to the financial sector. In addition to the lack of information at the farmer level, banks are losing out on opportunities to process the "big data" that exists. Climate models using Normalized Difference Vegetation index (NDVI) data, market developments and trends, and regional statistics for example are not analyzed by financial institutions, further restricting their vision for the sector.

Access to finance remains an issue. Despite its contribution to the country's GDP (10.5 percent of GDP as of 2016 and 12.9 percent in 2017) and employment (29.8 percent), Kosovo's **agricultural sector remains underserved** by financial institutions (FIs).

Banks are healthy, liquid and making excellent returns, but their underlying challenge remains access to capital. The Kosovo Credit Guarantee Fund (KCGF),[5] an independent loan guarantee facility, provides portfolio loan guarantees to financial institutions to offset risk for loans to micro, small, and medium enterprises (MSMEs), and this support may well be advanced to microfinance institutions (MFIs) in the near future. Nonetheless, financing agriculture remains a challenge. Collateral—still traditional fixed and moveable assets—appears to be reaching its limits. Liquidity in the land market is very low, forcing very low valuations. This, combined with problems in land ownership and titling, further reduces the available collateral. Despite stakeholders' best intentions, **no agricultural insurance is available,** and there are no community warehouse receipting systems or discounting on invoices available to producers. The lack of insurance is a strong hindrance to improving access to finance. At the same time, banks are raising the floor on their agricultural lending, with the result that more and more small farmers (as noted above, the bulk of expansion potential in Kosovo is in smallholdings of 5 or fewer hectares) do not have access to bank finance, at a time when interest rates have declined to 10 percent or less for qualified borrowers.

The portfolio of MFIs shows a much higher proportion of agricultural lending, with at least 25 percent of loans going to agriculture over the past 6 years. These loans however come at a high cost, however, with interest rates over 20 percent, making MFI loans unrealistic for much of the sector. This situation means that the MFI's are taking away from the banks the core of the expansion potential in Kosovo, serving this critical sector with unsustainable interest rates and at the same time are facing insecure financing themselves. This is likely a crucial reason why the agriculture finance portfolio in Kosovo is the only portfolio not showing strong growth, and why the use of personal resources is the accepted norm among farmers in Kosovo, with recourse to bank finance an unfamiliar option and support from relatives and friends the preferred financing method.

It is apparent that banks are not being pushed by the market to work outside their existing comfort zone. The introduction of a disruptor in the sector could improve this situation. Experience from the region shows that it is possible to make significant improvement in a relatively short period of time.

Bank interest rates for agricultural loans remain high in comparison to other sectors domestically and to agricultural loans in other countries in the region. Interest rates varied from 6 to 27 percent, depending on the size of the loan and the repayment period: the higher the loan size, and the shorter period of repayment, the lower the interest rate and vice versa. Although banks have standardized products with standardized interest rates for small clients, they are ready to adjust credit terms and interest rates for larger clients. Interest rates for agricultural loans in Kosovo are among the highest in the region (agricultural loan rates in 2017 were 5.5 percent in Bulgaria, 6.2 percent in FYR Macedonia and 5.1 percent in Serbia). In Kosovo, agricultural producers, especially small ones, must often accept interest rates that are above 20 percent from MFIs. Kosovo's agriculture is not sufficiently profitable to afford such interest rates; high interest rates contribute to making Kosovo's agri-products uncompetitive in comparison to those of its neighbours.

Demand for agricultural finance is growing. Modest success in VC development is spurring growth. International markets are beginning to see Kosovo as a potential origin of importance. The whole Balkan region is gaining prominence as a supplier to international markets. Innovation is, however, a requirement. Unfortunately, all banks in Kosovo dealing with agriculture use similar methodology and have the same approach to credit evaluation, without going deeply into understanding of the agriculture and investment methodology improvement.

[5] See http://fondikgk.org/en/about-kcgf.

Key Recommendations

To facilitate the provision of agricultural finance, action is needed by all stakeholders, including the government of Kosovo (GoK). The existing gap between demand and supply can be met by ensuring that banks keep up with the rapid changes taking place in the agricultural sector. Banks should be encouraged to see agribusiness as a sector in which all bank products can be sold. Working through the Kosovo Banking Association (KBA),[6] CBK, MAFRD and KCGF, standardized gross margin books can be produced, giving financial institutions and all stakeholders current and accurate knowledge of the elements of each VC and its risks and opportunities. Closer linkages with agricultural statistics will enhance validity and utility of information that would be used by banks.

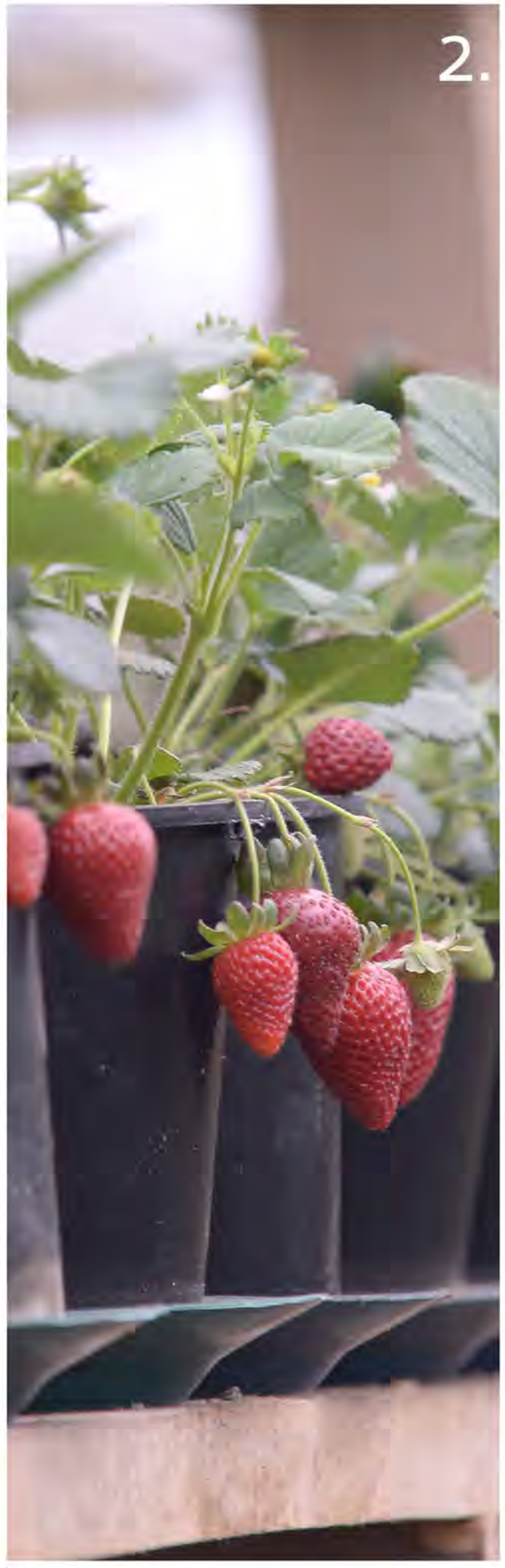
Financial institutions have the power to foster change among clients. Increasingly, banks must focus on client productivity and reward those that show progress. Increasingly, banks and MFIs should take advantage of financing along the VC, using the rapidly changing contract environment to reduce risk, seeking out aggregators that successfully grow their downstream producer and upstream market linkages. Banks should increasingly test out new models of financing though the VC, seeking to mitigate risk by securing transactions all along the VC.

The public sector must improve access to, as well as the accuracy of, national databases. Farm Accountancy Data Network (FADN), statistics, price and market information, and business registry data need improvement both in terms of access and accuracy. Training and information are paramount; donors should play a role in harmonizing this training across public and private sectors.

Agricultural insurance must be made available, and greater attention needs to be paid to the systems and strategy for direct payments and grants in order to improve effectiveness and to bring them into line with the reality of the changing landscape of Kosovo's agri-sector.

Finally, big data provides tremendous opportunities to improve productivity with new analytical tools and improved access to and use of available data. Investing in information technology leads to improved efficiency and accuracy. Banks and MFIs must have staff members who understand and are able to make use of digital technologies applicable to agriculture.

[6] See https://www.bankassoc-kos.com/En/.



2. Introduction and Methodology

Despite its contribution to Kosovo's GDP (10.5 percent of GDP as of 2016 and 12.9 percent in 2017) and employment (29.8 percent), the agricultural sector remains underserved by financial institutions, for many reasons. The IFC aims to shed light on the specific needs of Kosovo's agricultural sector, particularly in respect of financing, and the challenges faced by financial institutions in the provision of services to the agricultural sector and in supporting a positive view about agricultural finance and the opportunities it presents to the country's economic development.

To get a detailed picture of the main characteristics of the supply of financial services to the agricultural sector and the demand patterns of the agricultural sector, IFC commissioned this agricultural finance study in Kosovo, which included an assessment of:

- the business environment for the development of agricultural credit, including institutions responsible for market development;
- demand for agri-lending focusing on sub-sector analysis, trends, market integration, agricultural policy, investment climate and barriers to development; and
- the current supply of agricultural financial services provided by both banks and MFIs, focusing on the main trends and market development, as well as the capacity and methodology used for credit evaluation.

The commission called for conclusions and recommendations on how to develop agricultural credit markets in Kosovo and specifically detailing the potential role of the IFC in supporting these markets.

The study's aim was to assess the exiting situation and provide the various stakeholders with expert analysis of future trends, based on experience from the region and EU, and presenting best options to scale up financial services for agriculture in Kosovo.

The study was prepared by Goran Živkov and Fatmir Selimi (the Consultants).

The agri-finance sector study was conducted over the period February to May 2018. This report is based on primary and secondary data collected over the course of the project. The methodology used is outlined below:

i. **Desk research:** collect and process data and information obtained from studies prepared by state institutions (primary MAFRD, CBK and Kosovo Credit Guaranty Fund) and bilateral and multilateral institutions. The data used relied heavily on official statistics provided by MAFRD Department of Economic Analysis and the Kosovo Agency of Statistics (KAS). For production data, the team used statistics from the KAS and FAO. Import and export data are based on KAS, COMTRADE and ITC statistics. Data regarding budget and support policy were received by MAFRD Department of Economic Analysis and Agricultural Statistics. The analysed data is considered reliable, though according several key sources production data could be challenged.

ii. **Field assessment:** More than 15 interviews were conducted with agribusinesses and other principal stakeholders (FIs, banks and MFIs) and the CBK, KAB and Association of Microfinance Institutions in Kosovo (AMIK) with the main objectives of: (i) collecting information and opinions from the main stakeholders and (ii) testing findings through individual meetings and focus groups with key informants. Interviews with selected suppliers of agri-finance products including commercial banks, MFIs, leasing and insurance companies, international donor organizations, and regulatory and governmental authorities were conducted in person during all project preparation phases. Unfortunately, no banks responded to the request to answer a questionnaire prepared by the Consultants. The banks felt that answering the questions posed would reveal confidential information. The Consultants met with the main banks and discussed other issues, including major obstacles and potential recommendations for developing the sector.

3. Kosovo Business Environment

Table 1: Economic Indicators, 2017

INDICATORS	FIGURES
Population	1.8 million
Life expectancy at birth (years)	71
GDP/Average GDP growth last 5 years	€6.07 billion/3.6 percent
GDP per capita, in Euros	€3,902
Unemployment	27.5 percent (average for the region 19.4 percent)
Public and publicly guaranteed debt (percent of GDP)	16.5 percent (average for the region 56.1 percent)
Trade balance (percent of GDP)	26.8 percent (average for the region -13.7 percent)
Remittances received/remittances as a percentage of GDP (2017)	€759.3 million/ 11.5%
Inflation	1.5 percent
Private credit growth	8.8 percent
Public expenditures (percent of GDP)	28 percent (regional average 36.9 percent)
Public revenues (percent of GDP)	26.6 percent (regional average 35.6 percent)

Figure 1: Main Features of Kosovo's Economy

POSITIVE DEVELOPMENTS

- EU enlargement as a driver for change
- Profitable banking sector with long experience working in the Kosovo environment
- Commitment to improve the business environment, but capacity lacking
- Steady, though slow, institutional development

NEGATIVE DEVELOPMENTS

- Political instability
- Sizable grey economy
- Excessive political influence in the economy and institutions
- Lack of production capacity

RESULTS

- Improving trends in a majority of the economic indicators, particularly GDP and investment
- High unemployment
- High level of economic informality
- Low public and private debt levels

The economy is growing faster than institutions are developing.

Despite its turbulent history, Kosovo has succeeded, over the last 20 years, in developing its economy to a certain level. Kosovo has experienced relatively high growth, driven by investments and high consumption. The Average annual real GDP growth over eight years (2008-2016) was 3.6 percent (growth in 2016 over 2015 was 4.1 percent). GDP at current prices in 2016 was €6,070 million, while GDP per capita was €3,386, while in 2017 it was €3,902. The drivers of growth in Kosovo continue to be robust private consumption (3 percent increase in 2016), supported by significant inflows of remittances, combined with strong investment performance (9.1 percent increase in 2016) including public investments in infrastructure (such as the 65-km section of highway connecting Pristina to the border with FYR Macedonia). Growth in the agricultural sector was 7.6 percent, in trade, 4.8 percent, and in financial services 12.4 percent. Real GDP growth by economic activity according to data from

KAS in the fourth quarter of 2017 was as follows: financial and insurance activities (30.4 percent); manufacturing industry (7.4 percent); transport and storage (6.8 percent); wholesale and retail trade (5.7 percent); real estate business (4.2 percent); mining industry (4.0 percent); hotels and restaurants (3.9 percent); agriculture, hunting and forestry (3.4 percent); and construction (2.6 percent).

The business environment is improving, albeit from a low base, and there have been some improvements in institutional development. According to the WB Doing Business 2018 report, Kosovo is ranked 40th in the world, up from 126th in 2012, a positive improvement of 86 places. In the Starting a Business component, Kosovo is ranked 10th, dramatically up from 170th in 2012. These improvements highlight the commitment of the GoK to improving the business environment in order to stimulate economic growth.

New investment climate measures have recently been introduced. These include a new law on strategic investments, designed to simplify the process for investors and boost foreign direct investment (FDI).

The GoK is working on institutional development, but lacks a long-term country strategy for economic development that includes an action plan for the development of the main institutions.

The labor market is characterized by a high unemployment rate, combined with a low participation rate of employees in the private sector. According to the results of the Labor Force Survey (LFS) conducted by the KAS in 2017, the unemployment rate is 30.5 percent. The employment rate in the LFS for 2017 is 29.8 percent, up from 27.5 percent in 2016. The highest unemployment is among females, at 36.6 percent, compared to males, at 28.7 percent, while the most pronounced unemployment rate is in the age group of 15-24, at 52.7 percent. (LFS data includes individuals from the age of 15). The number of employees in the public sector is high; public sector salaries are higher than in the private sector, creating problems for the private sector in attracting skilled labor and developing their businesses. Companies have problems finding and keeping qualified personnel at all levels, but most acutely in middle management.

Kosovo is targeting EU accession and working towards it. Visa liberalization in the near future may negatively affect labor availability and increase production costs, reducing current comparative advantage for Kosovo. The labor force is mainly concentrated in the services sector (77.3 percent), followed by industry (16.8 percent) and agriculture (5.9 percent). The WB noted that services still represent the largest sector in Kosovo's economy, with a share of value added of 54 percent of GDP during 2008-2015. Industry is smaller, especially by regional standards at 16 percent of GDP, agriculture is still important at around 11 percent of GDP and manufacturing is at 10 percent.

The MSME sector plays and will continue to play a major role in development. The largest number of registered enterprises continues to be concentrated in the trade sector with 2,738 enterprises, followed by the manufacturing sector with 1,181, agriculture with 1,090 and hospitality with 1,017 enterprises (CBAK 2016). A recent WB jobs diagnostic (published in 2017 and based on 2016 data)[7] concluded that micro firms (up to nine employees) dominate the private sector and, while they contribute substantially to employment, very few have expanded, with only 4 percent having grown beyond nine employees within five years. Over 90 percent of Kosovo's registered firms are micro firms, and most start-ups are micro. These firms have reportedly been shedding more jobs than they create. According to the WB diagnostic, the greatest source of formal job creation has been start-up firms, but the rate of new firm entry remains relatively low and these have been formally registered mainly due to the requirements of grant making institutions.

Trade is the highest contributor to GDP. Domestic demand has been growing in recent years as consumer purchasing power has increased, particularly in urban areas. Based on the 2017 LFS report, trade is leading in terms of employment with 14.7 percent, followed by 13.2 percent, in production, 12.9 percent in construction and 9.5 percent in education. This is evidenced by an increasing trade deficit. Kosovo recorded a trade deficit of 8.5 percent in FY2017. Exports and imports are low, at 9.9 percent.

According to KAS data, in 2017 major exports were in the metal industry, which accounted for 42.8 percent of total exports, followed by the food industry, accounting for 12.3 percent, and the agriculture and agribusiness sector, accounting for 5.9 percent. Major contributors to imports were mineral products comprising 15.3 percent of total imports; machinery at 14.2 percent; food, beverages and tobacco, 13.3 percent and 4.7 percent of imports were crop products. Evident in the data is a substantial agricultural trade deficit.

Remittances play an important role in Kosovo's economy and have a significant impact on consumption and the construction sector. According to the CBK 2016 Annual Report, remittances represent the largest category within the secondary income account, amounting to €691 million, a 3.8 percent year on year increase.

Kosovo's grey economy is estimated at more than 30 percent of GDP or €1.8 billion a year. The highest rate of informality is in the construction, agriculture and services sectors, due to the informal and/or seasonal nature of businesses in these sectors. The GoK has yet to develop a system of capturing data on the informal sector.

Investments are a key driver of growth. A new law on strategic investments was signed by the President of Kosovo in February 2017. The law targets the reduction of bureaucratic procedures and other barriers to investment. In future, if a project (which may be in agriculture) is classified as strategic, investors should be able to obtain all the necessary licenses and permits within 15 days.[8]

While total investments have increased significantly, public sector investments continue to dominate. The increase in public sector investments is in line with the GoK's focus on improving infrastructure, thereby laying the groundwork for improving private sector productivity. Investments in agriculture follow the same pattern. The GoK is using public sector resources to incentivize private investments via different investment support mechanisms, mainly grants. According to CBK reports,[9] FDI declined in 2016 to €215.9 million from €308.8 million in 2015. The CBK's 2017 report cites FDI increasing to €281.3 million. Foreign remittances totalled €759.3 million in 2017, up 9.8 percent from the previous year. The main sectors attracting investments from remittances are real estate and business activities.

Public debt in 2017 was 16.6 percent of GDP, far below the Western Balkans average of 47.2 percent. In real money terms this amounts to €853.7 million, while in 2015 public debt was €750 million, according to CBK data. Obviously, there is room for fresh loans for development purposes.

Since Kosovo aims to join EU and align its standards and legislation with EU requirements, the EU integration agenda dictates many policy processes. While legal documents and strategies are drafted in accordance with these requirements, many are not implemented in practice. The GoK is working to align with EU standards, yet the lack of visa liberalization has created boundaries for businesses to access new markets and reduces domestic companies' competitiveness. The lack of free movement for people is an obstacle which Kosovo has to overcome in order to become a country with a stronger economy and open to opportunities for development.

The financial sector is healthy, but the IMF notes[10] that there are limitations to agriculture accessing credit. The bulk of credit goes toward less productive sectors like trade and construction. Credit penetration remains low and certain sectors, such as agriculture and MSMEs, are underserved by the banks even though growth in credit has increased over the last few years. The GoK needs to maintain the strong reform momentum of recent years in reducing structural bottlenecks to lending. The GoK should also continue to strengthen the supervisory framework.

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[7] See http://documents.worldbank.org/curated/en/814361497466817941/pdf/ACS21442-WP-PUBLIC-ADD-SERIES-KosovoJDWEB.pdf.

[8] EBRD Transition Report 2017- 2018, available at: https://www.ebrd.com/documents/oce/pdf-transition-report-201718-kosovo.pdf.

[9] See https://www.bqk-kos.org/?id=102

[10] See https://www.imf.org/external/research/index.aspx.

4. Kosovo's Agricultural Sector

4.1.Basic Facts and Figures

Table 2: Key Facts and Figures

INDICATORS	FIGURES
Total surface	10,906 square km
Area under cultivation	415.8 thousand hectares
Land distribution	Pastures and meadows 218,808 hectares (38 percent); Arable (productive land) 185,705 hectares (33 percent);Fields and gardens (Cereals 134,571 hectares (24 percent); fruits 8,785 hectares (1.6 percent); vegetables 17,395 hectares (3 percent)
Number of farmer households	108,803 (MAFRD registry, 2016)
Number of employed workers in agribusiness	10,024 in primary production and the agribusiness sector
Share of agriculture in GDP	12.9 percent (2017), 13.6 percent (2010)
Value of agricultural production (2016)	Total value: €736.8 million Value of plant products: €412.3 million-(56 percent of total) Value of livestock products: €302.4 (41 percent of total) Value of agri-services: €22.1 million (3 percent)
Share of import & export in overall trade	Export share 15 percent; import share 24 percent (2016)
Average growing rate of trade (2012-2016)	Export share 46 percent; import share 14.5 percent
Average farm size	1.5 hectares on average
Distribution of value of production by subsectors	Crop production: 69.5 percent; livestock: 30.5 percent
Total imports of agricultural goods value in Euros	€658 million
Total exports of agriculture goods value in Euros	€45 million

Figure 2: Key Features

POSITIVE DEVELOPMENTS

- Agriculture is now seen as an opportunity for investment
- Good examples are showing that it is possible to make agriculture profitable
- Presence of donor organizations with a systematic approach towards agricultural development
- Significant GoK support

NEGATIVE DEVELOPMENTS

- Lack of market information
- Missing support institutions, both public and private
- Very inappropriated production structure with domination by low value crops
- Small land parcel and very weak land market development

RESULTS

- Very low agriculture output per unit
- Extremely low export and high import of agricultural products
- Low level of investments
- Donor- and GoK-driven investment

Agriculture is of high importance to the economy, but the sector's achievements are limited.

Agriculture has traditionally played an important role in the Kosovo economy, but less than before. The contribution of the agricultural sector to GDP is around 11 percent and 60 percent of Kosovo's population live in the rural areas. Both indicators are slowly, but constantly decreasing indicating that: (1) other sectors are developing faster, (2) regardless of its high population growth, migration to urban areas and migration to EU and other countries is still the preferable option for many of the rural inhabitants. The food and agriculture sector has the potential to contribute significantly to overall economic development, contributing 15 percent of total exports in 2016 and 18 percent in 2017. The total value of agricultural production including services was estimated to be €736.8 million, with plant-based products generating 56 percent of the total at €412.3 million, livestock products contributing 41 percent at €302.4 million, and services generating 3 percent at €22.1 million. These are satisfactory results which are reflected in the economic indicators and in agriculture specifically, yet there is a need for a more focused approach and for the identification of both comparative and competitive advantages of Kosovo toward the region and other potential markets. A critical part of this strategy must be institutional development, since public institutions are young and weak and often present obstacles to development.

4.2. Assessment of Production and Farmer Profiles

4.2.1. Production Structure

The structure of agricultural production needs rapid change.

Kosovo has 179,000 hectares of arable land and 219,000 hectares of meadows and pastures, according to MAFRD's 2017 Green Report, an overview of the agricultural sector.[11] Fruit, vegetables and vineyards are planted on less than 10 percent of overall arable land. The high percentage of meadows and pastures and a low contribution of livestock production indicates that these areas are not efficiently used. Cereals still dominate the structure and as a result, the opportunities to increase competitiveness are low.

[11] Available at: https://www.mbpzhrks.net /repository/docs/Raporti_i_Gjelber_2017_Eng_Final.pdf.

Table 3: Area Planted in Selected Crops (in hectares)

HECTARES	2010	2011	2012	2013	2014	2015	2016
Cereal	119,871	121,095	137,215	141,912	131,949	134,886	134,571
Vegetable	16,356	16,196	14,557	16,356	15,854	14,656	17,395
Fruits	6,578	6,733	7,082	8,342	6,921	7,998	8,785
Wine grapes	2,504	2,510	2,517	2,408	2,420	2,321	2,348
Table grapes	636	648	702	751	781	747	769
Forage	99,043	98,833	94,444	110,314	106,554	97,183	97,936

Source: KAS

Kosovo has limited diversification of agriculture production where plant production dominates. The total value of agricultural production including services is estimated to be €736.8 million, with plant products comprising 56 percent valued at €412.3 million, livestock products at 41 percent or €302.4 million and services at 3 percent or €22.1 million.

Table 4: Main Economic Accounts for Agriculture (Millions of Euros)

ECONOMIC ACCOUNTS FOR AGRICULTURE	2010	2011	2012	2013	2014	2015	2016
Cereals (including seeds)	93.5	107	107.1	102.1	92.1	89.5	103.7
Industrial plants	0.05	0.05	0.14	0.12	0.26	0.17	0.3
Forage plants	51.2	56	67.8	95.2	67.3	71.7	87.5
Vegetables and garden products	123.3	119.6	104.1	154.4	82.9	107	122.2
Potatoes	26.6	20.2	12	19.6	23	23	30.5
Fruits	26	23.2	32.9	51.9	54.6	55.2	63.7
Other plant products (seeds)	3.4	3.7	3.5	4.2	4.5	4.1	4.3
Total plants products	324	329.7	327.6	427.6	324.7	350.7	412.3
Livestock	97.6	96	92.3	117.3	85.9	120.3	153.7
Livestock products	148.8	155.8	174.2	181.1	173	158.6	148.7
Total livestock products	246.4	251.9	266.6	298.4	258.9	278.9	302.4
Total plant and livestock products	570.3	581.6	594.1	726	583.7	629.7	714.6

Source: KAS

Fruits and vegetables dominate high value production in Kosovo. In some areas, such as the Dukagjiini valley, intensive irrigated vegetable cultivation is the main economic activity. In principle, vegetable production is still seasonal; the domestic market cannot be supplied continuously throughout the year. In 2016, 17,395 hectares were planted with vegetables, a 19 percent increase in planted area from 2015. The Dukagjini region dominates fruit and vegetable production, due to its climate conditions: over 60 percent of fruit and vegetable production is situated there.

Fruit production remains underdeveloped, though it is considered a high priority sector with good potential for job creation and income generation. Kosovo's market has been characterized by high import levels to cover domestic demand for fruits. Top fruits like apples and sour cherry have good potential to substitute imports and eventually for some exports, with opportunities for juice production.

Soft fruits (over 2,000 hectares in raspberries, 50 hectares in blueberries and 200 hectares in strawberries) have exhibited rapid development. Soft fruits have had a positive impact on the development of the agricultural sector over the last five years and have shown that agriculture can be very profitable if it is properly organized and managed and there are attendant market opportunities. This positive development shows that Kosovo could export quality products to Europe and reduce its trade imbalances. Around 80 percent of raspberries and strawberries are produced in the southeast region (Podujevo, Pristina, Ferizaj and Shterpce); around 60 percent of blueberries are produced in the Peja region (Peja, Decan, Junik, Gjakova), with the remaining 40 percent in Podujevo and Vushtrri.

The production and collection of non-wood forest products and medical and aromatic plants is growing, effectively harnessing their comparative advantage. Kosovo is very well known for the quality and variety of its non-wood forest products and medical and aromatic plants. The low cost of labor contributes to the competitiveness of these and other agricultural products. This sub-sector is moving toward cultivation, which reduces overharvesting of wild resources i.e. negative impact on the environment. It has great potential for profit and job creation, especially for small farmers in less-developed areas and marginal sites.

Vineyards are well established and enjoy a suitable climate and geographic location for both wine and table grape production. The vineyards are mainly situated in hilly areas (350-600 meters in elevation) that are well exposed to the sun. The area under cultivation is stable, but efficiency of production is low. Improving efficiency, yield and quality are crucial. Table grape production is expanding, but few new plantations are based on modern vineyard technologies, reducing opportunities for optimal yields. There is a high level of support from the GoK, with subsidies of €1,000 per hectare, as well as support through grants for primary production and wine processing.

Production in the livestock sector is stable, while the value of production is increasing. In 2016, bovine stock increased by 3 percent compared to the previous year; however, compared to the average of the three

previous years, it decreased by 6 percent. The number of dairy cows increased by 1 percent compared to the previous year; compared to the average of three previous years, there was a decrease in the number of dairy cows of 9 percent. This is an indicator of sector legalization, productivity and added value. The sector is focusing more on quality. GoK support is high: farmers receive support per head of animal and for quality milk, as well as investment grants from MAFRD. Demand for products complying with food safety standards is increasing, while competition from imports is high. The grey economy (unregistered businesses) has a negative impact on the competitiveness of the livestock sector, at the expense of those who are working legally in the sector and paying taxes.

The milk sector is an important sector with high capital investment and potential for expansion. In recent years, efforts were made to move milk production from own consumption towards production for the commercial market by improving herd genetics, introducing good agricultural practices in dairy farms and increasing farmers' capacity to produce high quality milk. While these investments have met with success, imports remain high. Dairy cows represented 52 percent of the total number of bovine animals in 2016. Of the total milk supply, 80 percent was domestically produced, and the balance was covered by imports. Total milk production in 2016 was 285 thousand tons, marginally higher than in 2015.

The meat sub-sector is considered to have good potential in Kosovo, but foreign competition is stiff. Demand for meat products is high. Only a very small number of farms are focused on intensive fattening. Most of meat used for processing is imported. Only a few small processors use domestic meat, although there are local consumers ready to pay for freshness.

Table 5: Livestock Population and Milk Production Figures

	2010	2011	2012	2013	2014	2015	2016
Cattle	356,496	361,688	329,213	321,113	261,689	258,504	264,971
Sheep and goats	229,157	231,209	247,901	216,577	212,014	224,096	212,040
Pigs	50,580	50,580	55,775	49,198	34,188	44,149	42,309
Poultry (millions)	2,347	2,347	2,318	2,244	2,692	2,576	2,740
Milk production (millions of metric tons)	390,065	393,389	368,605	369,702	278,933	282,534	285,261

Source: KAS

Half of the arable land in Kosovo is cultivated with cereals, predominantly wheat and maize. Support from the GoK is more than €10 million through subsidies to this sector alone. Further support to this sub-sector will not have positive development impacts since production has low output per unit. Kosovo producers have small land parcels, usually split into 5 to 8 small plots. The high costs associated with farming small, sometimes dispersed plots makes it difficult to compete with imported products. There are no visible economic results of the aforementioned public-sector support, no positive trends in production or yield, and no reduction in imports. Farmers see wheat as a strategic crop, while maize is used for livestock. This public support will help farmers to continue cultivating land, yet it will not support economic development or improve trade balances. There is a need for better planning and identification of new crops that are more profitable and productive to replace these dryland systems.

4.2.2. Production Regions

Three main production regions (central Kosovo, Dukagjini and the mountainous areas) offer many production possibilities. These regions offer diverse agriculture production potentials and opportunities for more specialized regional production that will stimulate the development of necessary infrastructure. Each region is characterized by specific features for production and marketing of agricultural products. The central Kosovo region doesn't have a long tradition in some sub-sectors like horticulture, but it is close to markets and consumers. Consequently, it has the highest number of agricultural enterprises. Dukagjini is the region with the most potential for agricultural expansion due to the good climate for out of season production, fertile land and irrigation availability. The mountainous areas are least favourable for development of conventional crop-based agriculture, but they are suitable for livestock production and different niche products (organics, medicinal plants, non-wood forest products). The main potential and focus for the development of the sector should be in Dukagjini and in the central Kosovo region for small and medium farms. The model for success in mountainous area must be aggregation of small farms.

Table 6: Production Regions and their Characteristics

	MAIN CHARACTERISTICS	SPECIFICITY FOR FINANCING
CENTRAL KOSOVO REGION	- Less access to irrigation (Iber Lepenci irrigation provider has 30,000 hectare capacity, of which only 10-20 percent is used, due to low demand farmers) - Soils rich in organic matter, of types including reddish brown soil, podzol, vertisol, cambisol - No tradition of intensive agricultural production - Mainly production of cereals (wheat and maize); potatoes also important - Plains well suited to cultivation of industrial crops like winter cereal and potatoes - Region with fastest agricultural development in recent years, based on raspberry VC - Limited areas under irrigation - Harsh continental weather conditions above 500 meters of elevation - Potential crops: wheat, rye, barley, maize, potatoes, onions, beans, peas	- Growing raspberry VC and other soft fruits - More open to new opportunities/-new VCs - Interested in new technologies - Existence of storage capacities - VC financing could be organized - Central location and vicinity to urban areas - Farmers relatively well organized
DUKAGJINI REGION	- Water availability from rainfall and irrigation with two irrigation providers, Radoniqi (more than 50 percent of capacity used) and Drini I Bardhe- (antiquated system, not properly used) - Longer growing season, milder temperatures, higher rainfall, and high quality alluvial, vertisol, and reddish-brown soil types make Dukagjini ideally suited for cultivation of labor intensive horticultural crops in deciduous fruits and vegetables - At least 10 big dairies based in the region - High production of vegetables and top fruits, including melon, pear, cherries, watermelon, pepper, tomatoes, cucumbers, cabbage - Four storage and packaging facilities - At least five fruit & vegetable processors - Highest potential for wine growing, with at least seven wineries	- Possibility of acquiring large tracts of land - Intensive crops like peppers, tomatoes, cucumbers, cabbage - Potential for increased surface under top fruit cultivation - Aggregation of products - Focus on high-value VCs - Development of local brands - Livestock production: meat and dairy - Supply contract financing - VC approach to financing could be implemented
MOUNTAINOUS REGION	- Mountainous agri-forest area - Characterized by cooler temperatures, shorter growing seasons, and soil types that limit possible agriculture production to crops including select nuts and berries - Medicinal and aromatic plant collection points (57 all over Kosovo) - Berries - Non-wood forest products: wild forest fruits (mushrooms, medicinal and aromatic plants) - Honey production - Cherries, hazelnuts, chestnuts	- Aggregation function - Driers - Small scale financing - Association or cooperative financing - Linkages to bigger collection centers - Supply contract financing

The largest amount of direct support is targeted to the Pristina and Gjakova regions. MAFRD is spending in the order of €23 million annually on direct support to the sector through different subsidy schemes

Table 7: Direct Payments 2012-2016

	2012	2013	2014	2015	2016
Wheat	3,795,094	5,824,268	5,555,218	6,417,047	7,526,999
Wheat seed	25,020	63,720	107,391	86,063	196,678
Corn	575,459	943,028	1,268,719	2,735,462	2,870,969
Barely	-	-	-	-	25,118
Rye	-	-	-	-	19,977
Sunflower	73,711	41,439	44,853	20,322	1,316
Vineyards	-	1,124,516	2,290,783	2,046,167	2,117,978
Open field vegetables	-	-	1,026,735	1,564,692	1,981,617
Existing orchards	-	-	-	692,256	1,112,032
Organic agriculture	-	-	-	-	14,626
Dairy cows	2,104,800	2,105,950	2,211,750	3,790,990	4,609,990
Sheep and goats	1,327,450	1,159,720	1,210,120	1,921,365	1,933,245
Honey Bees	358,610	500,660	777,610	1,129,580	2,158,770
Laying hens	-	240,305	231,648	210,868	346,259
Quail	-	-	-	-	22,083
Pig	-	-	6,220	11,240	14,040
Milk	-	-	491,884	711,644	1,082,829
Reported cattle slaughter	-	-	-	2,520	15,780
Seedlings	-	96,264	75,791	98,522	76,933
Total	8,260,144	12,099,869	15,298,721	21,438,737	26,127,237

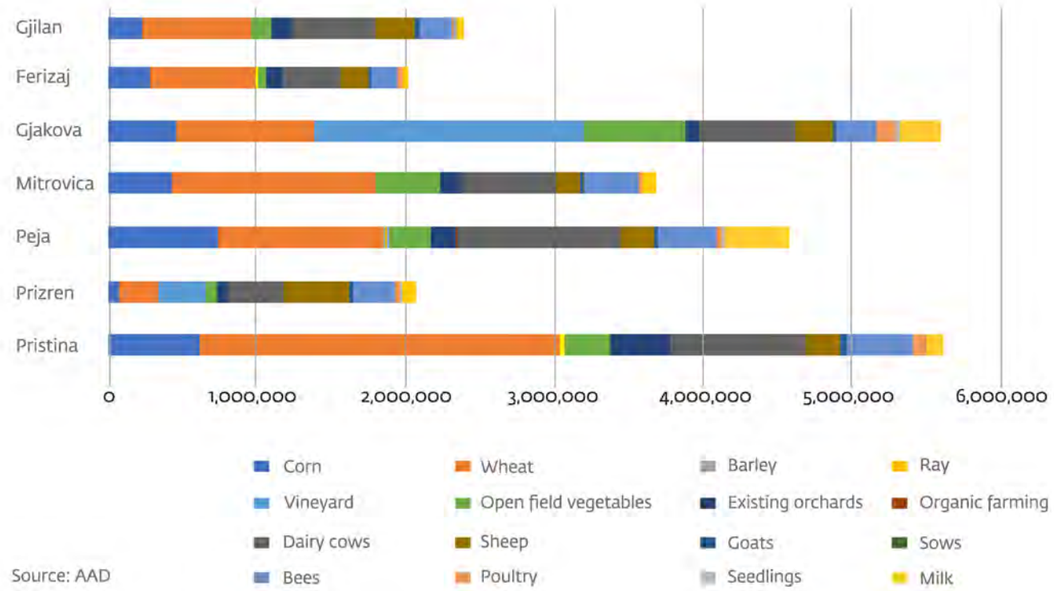
Source: MAFRD Agency for Agricultural Development (AAD)

In addition to these programs, a further €26 million is distributed as grants. The rural development plan for 2016 included the following measures:

- Measure 101: Investments in physical assets and agricultural households (€14.5 million)
- Measure 103: Investments in physical assets for processing and trading of agricultural products (€5 million)
- Measure 302: Diversification of farms and business development (€1.5 million)
- Measure 303: Preparation and implementation of local development strategies: LIDER (€0.2 million)
- Measure 501: Technical assistance (€0.3 million)
- Measure ____ : Irrigation of agricultural lands (€1 million)
- Measure ____ : Compensation for damages from natural disasters (€0.5 million)

The majority of rural development funds is dedicated to the Pristina region, primarily due to its high participation in cereals production, and the Gjakova region, because of a high level of support of vineyard production. Peja has received the highest average amount (above €620 per beneficiary farm) due to a high participation in the milk quality premium and organic production of different medicinal and aromatic plants, while the Pristina region has the lowest individual average (below €570), followed by Mitrovica (€588) and the Gjakova (€596).

Graph 1: Distribution of Subsidies by Region, in Euros



Source: AAD

Regional specialization is occurring along certain VCs. Specialization should be further promoted since it leads to increased production, better marketing and aggregation. Most grants, loans and other supports currently target issues in specific sub-sectors, such as primarily production-level support aimed at increasing farmers' incomes; however, a few interventions—such as the USAID Agricultural Growth and Rural Opportunities (AGRO) program—address entire VCs and promote regional specialization. These programs have allowed farmers and the GoK to establish communication and trust and, in some cases, to reach new markets. However, such programs need to focus more on problems affecting the entire VC. Incomplete VCs, for example, will not support increased development. In addition, commercial banks must understand the VC in order to develop innovative services. This approach requires familiarity with local markets, production costs, best practices and other knowledge often missing at government and bank levels.

4.2.3. Farmers Profiles and Land Use

Farmers are becoming more creditworthy.

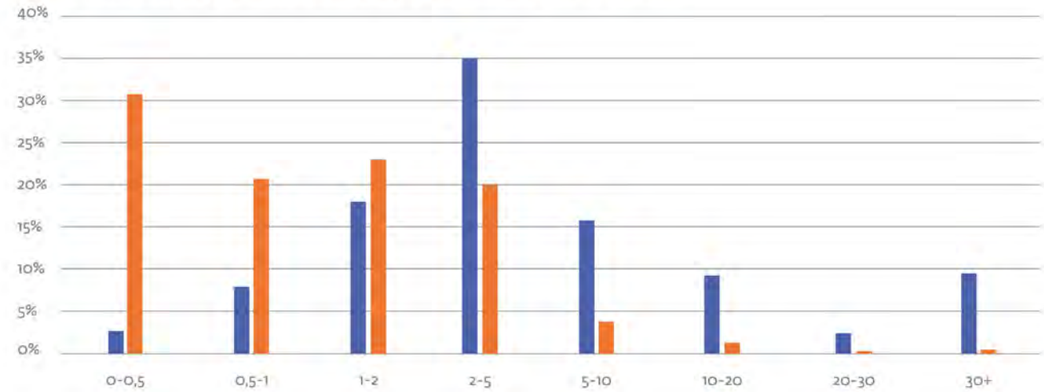
Agriculture in Kosovo will continue to be based on small scale family farms, a structure that is not appropriate for large scale investment. A VC-based approach, working with smallholders, presents untapped potential for growing the agricultural economy without recourse to large single investments or land reform to consolidate land. Expectations of quick structural changes in land reform are not realistic. A long-term approach to small- and medium-scale farmers will be the key to sustainable development. Even though Kosovo has good potential to use its young population as labor, in the near future, with visa liberalization, labor shortages may appear. In any case, family labor, small farms and better organization of farmers will be crucial to the future development of VCs requiring intensive manual labor.

Table 8: Overview of Producer Types

PRODUCER	DESCRIPTION	INVESTMENT/CREDIT CHALLENGE
MICRO FARMERS	- Less than 0.5 hectares of land - Dependent on other sources of income - Resident in mountainous areas - Limited knowledge of production and market - Limited human capacity - Limited growth potential	- Limited collateral pledge - Lack of contracting - Lack of scale in production - Documentation - Ownership of land and assets
SMALL AGRICULTURE HOLDINGS/ SMALL FARMERS	- Producer with 0.5-1.5 hectares or 1- 3 cows - Without incentives for investment due to age or physical capacity or environmental disadvantages - Segregated parcels of land in several plots (5-8 plots) - Predominant group in agricultural production - Distance to the market - Other income or collection of wild forest fruits - No knowledge of the market - Lack of technical knowledge - Not focused, but looking for opportunities	- Important in terms of household food & income security, so important to ensure continued access to input, but may be excluded from commercial policy - Excluded from most bank lending - MFIs provide short-term loans with high interest rates - May have other source of income - Borrow from family members - Reduce interest rates - Ownership of land and assets
MEDIUM HOLDINGS/SEMI-COMMERCIAL FARMERS	- From 1.5-5 hectares or 4-20 cows - Very short market chain: direct sale to local collection centers or green markets - Other source of income - Segregated parcels of land in several plots (5-8 plots) - Lack of knowledge of new VCs - Willing to copy peers	- Encourage switch to high-value crops, size up-scaling and/or improvement of horizontal organization to extend market chain - Need for proper credit valorization - Obtain all needed financing - Invest in marketing and promotion - Ownership of land and assets
COMMERCIAL FARMS	- Appropriate size, investment and knowledge to ensure competitive position in regional and international markets - More than 5 hectares and 20 cows - Rents land from neighbors or private companies that privatized land - Contracts with processors and/or collection centers - Tends to become a processor - Marketing and promotion is not important	- Ensure further development and enlargement, scaling-up - Keep proper financial records - Constant credit users, but full amount not drawn on at any given time - Formal supply contracts - Food safety and security standards - Add value to products with-semi-processing - Complete financial documents, maintain records - Register business
PRIVATIZED FARMS/ EX-SOCIALLY OWNED ENTERPRISES/ GRANT HUNTERS	- Tend to face greater problems if exclusively primary producers rather than vertically integrated entities - Lack of knowledge - Do not have skilled managers and technicians on staff - Invested in production before completing infrastructure - Search for grants as a means of sustaining business - Mainly privatized - Relatively large land resources - Often vertically connected with processing and retail facilities - Working on both credit and cash basis - Majority are entrepreneurs from other sectors (construction, real estate); some were bought during mass privatization - Potentially a vital part of agriculture with positive regional impact (e.g., Frutomania) - Interested in collection and processing to add value	- Should be engines of agricultural growth, strategically very important, but need to be qualified for financing - Out of investment credits due to lack of collateral and complicated decision-making processes for loans; mainly searching for grants as financing opportunity - May have access to short term credits used in barter arrangements - Need investment for infrastructure, improvement and enlargement of production, should be priority in targeting by banks - Difficult to assess credit worthiness because significant part or their economic activity is not registered as company - Need investment in storage, processing, standard - Represent middle management with insufficient knowledge of market, need training and information - Credit for finalization of privatization, competitiveness improvement and preparation for EU market

Kosovo's landscape is dominated by small farms of between 0.5 and 5 hectares. Agricultural holdings can be divided into three main categories, based on 2016 data: (i) approximately 94.2 percent (102,530 farms), were in the smallest size category, 0.5 to fewer than 5 hectares; (ii) 4.16 percent (4,531 farms) were in the medium size category, 5 to fewer than 10 hectares; and (iii) only 1.6 percent (1,742 farms) were larger than 10 hectares. Recent data shows that the number of smallest-scale farmers (up to 1 hectare) is significantly declining, with a 27 percent decline in the last two years. This likely indicates that, in the majority of cases, these land owners are registered as farmers but are not active, and are renting their land to other farmers or leaving land fallow.

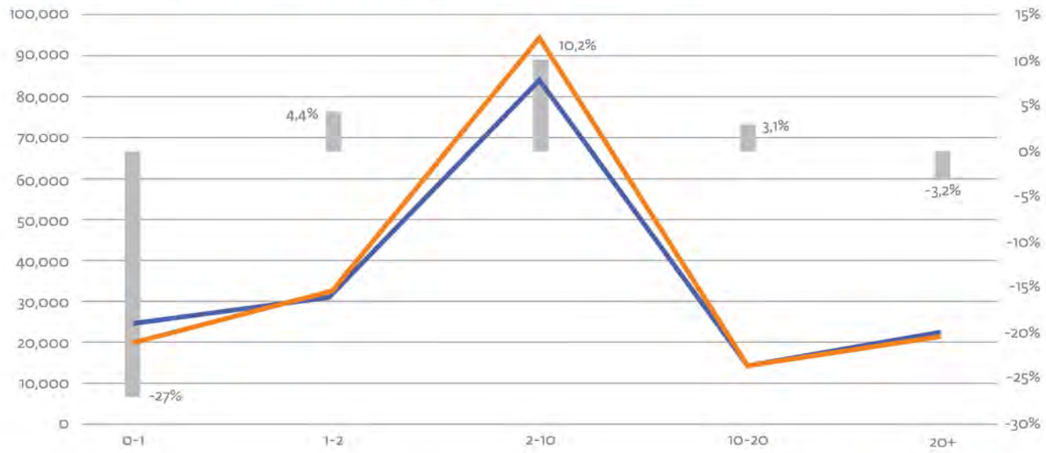
Graph 2: Distribution of Farms by Share of Total and Surface Area in Hectares



Source: KAS

Share in surface (%) Share in holdings (%)

Graph 3: Changing Numbers of Farmers by Size of Land Holding in Hectares



Source: KAS

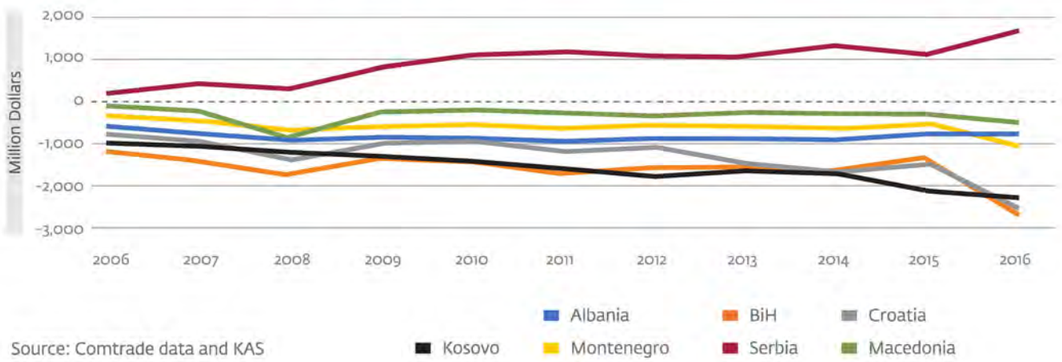
Change 2014 2016

4.3. Agricultural Foreign Trade Trends

Kosovo has the smallest agricultural exports of any country in Europe.

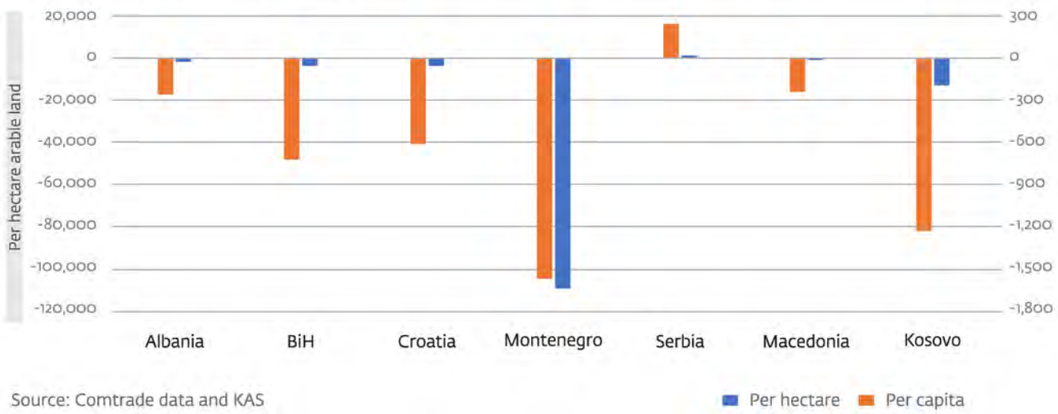
Kosovo has a small agricultural export level and a highly negative trade balance. Despite the constant increase in agricultural exports, at an average rate of 46 percent per annum, Kosovo's agricultural exports have increased by more than 100 percent, but still they remain at a low level. The main reasons are high local consumption, limited land under production, and underutilized resources in the processing industry. Kosovo has extremely high imports as well. Imports have increased by at least 80 percent, fuelled by the increase in consumption. The share of food imports as a share of imports is around 24 percent.

Graph 4: Agricultural Trade Balance in Selected Countries



Source: Comtrade data and KAS

Graph 5: Agricultural Net Export Deficit



Source: Comtrade data and KAS

Kosovo's small agricultural exports contribute significantly to the total export value and are showing an increasing trend-in 2016 contribution was 15 percent while in 2017 it was 18 percent of total export. The share is improving due to the improvement in horticulture production which contributed to the increase in exports in 2016 and 2017. However, following the April 2016 implementation of the Stabilization and Association Agreement with the EU, Kosovo benefits from duty-free exports of 2,560 different agricultural products to EU countries. Slowly, these changes will encourage farmers to increasingly see export opportunities and direct investments in this direction.

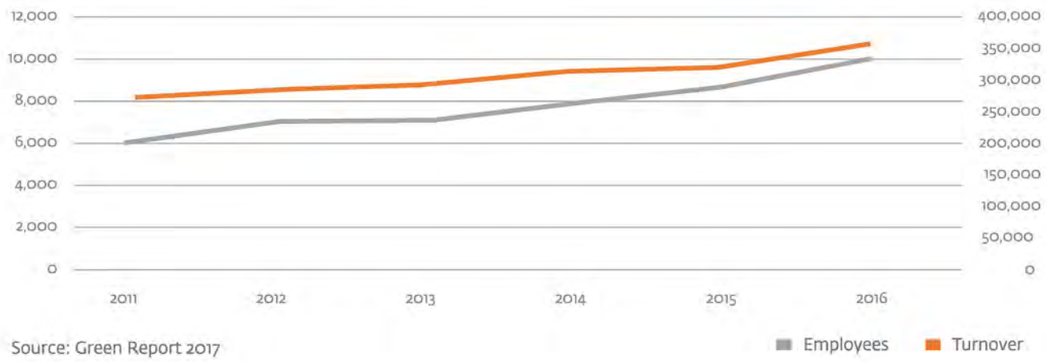
4.4. Food Processing Sector

There are successful food processing business stories in Kosovo and their number is increasing.

The agribusiness sector is an important part of Kosovo's overall development and it is constantly growing. This increase has been particularly noticeable since 2014, when the average share of agricultural activities in the business register was 7.6 percent; by 2016, this had increased to 10.4 percent. The most important sectors of the food industry in Kosovo are: bread production and flour processing, dairy, beverage manufacture and meat processing. As of 2016, 2,314 companies were operating in the agribusiness sector, an increase of 33 percent over five years. Similar trends are noticeable in overall turnover and number of employees. The largest turnover (€186 million) in 2016 was achieved in food processing, followed by beverages (€84 million turnover) and plant and animal products, hunting and related services (€35 million turnover). The highest number of employees was in the food processing sector, which employed 5,427 workers.[12]

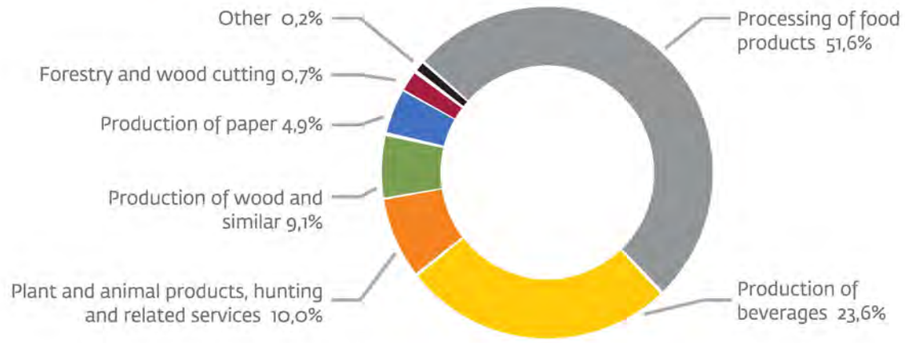
[12] 2016 data from KAS, processed by DEAAS -MAFRD.

Graph 6: Development of Turnover and Number of Employees of Agribusiness Companies



Source: Green Report 2017

Graph 7: Distribution of Agribusiness Companies' Turnover by Sector



Source: Green Report 2017

These companies are different in size, have different structure, market position, investment possibilities and standards adopted, however, they are facing almost the same challenges. Currently the main challenges are:

- Predominance of the grey economy (companies that are not registered and do not pay taxes) with resulting unfair competition
- Low level of aggregation and cooperation of farmers, resulting in higher-cost and inconsistent quality of raw materials provided
- Lack of uniform standards, tolerated by authorities, but not consistent with an export orientated paradigm

Table 9: Overview of Processing Industries

FACILITY TYPE	MAIN CHARACTERISTICS	SUITABILITY TO FUTURE DEVELOPMENT
PRIVATIZED FACTORIES WITH SIGNIFICANT CAPACITY; HAVE BECOME PROFITABLE UNDER NEW MANAGEMENT- (E.G., ABI, KORAL, MEAT FACTORIES, STONE CASTLE)	- Covers most of the market - Lack of market knowledge - Rehabilitation of physical facilities and installation of most urgent new equipment along processing lines (almost all investment included new processing and packaging equipment), funded by grants - This category of processors currently uses maximum 50 percent of processing capacity - Attention focused on equipment and construction, little focus given to development of human resources - Mix of production - diversification: dairy, fruit and vegetable, meat useful for distribution and marketability - reduce the cost of transportation - Vast majority lack middle management - Organize supply with raw material (production) on need basis locally or regionally - Sales contracts with local market and supermarkets	- Need to build marketing capacity in order to compete internationally - Competitive, but need investment in infrastructure (equipment, new technology and buildings) and human resources - Complete food safety investments - Most loans have been used for infrastructure improvements; additional funding needed for working capital - Majority of processing services are not cost-effective - Processors are reluctant to enter into contract farming arrangements - Highly dependent on local market and supermarket chains
NEWLY BUILT FACILITIES WITH MODERN TECHNOLOGY	- Usually smaller capacities adjusted to someone who is entering the market, but also investment possibilities - Most built with bank credits; global financial crisis (started in 2008) made repayment difficult - Most have excess capacity - Lack of financing capacity from companies - Lack of financial records - Lack of sufficient turnover to complete investments - Grant hunters, dependent on donor strategies - Experience problems caused by supermarket payment delays - Lack of knowledge of marketing	- Due to investment in new technology, are often already at the level of EU competitors - Most plan to extend their capacities after paying back credits - Most are innovative and willing to take risks to develop the company - Majority lacks a product diversification strategy - Only a small number of processors are aware and implement sound marketing and promotion strategy - Limited capacities and experience in contract farming
SMALL PROCESSING FACILITIES THAT FUNCTION AS FAMILY BUSINESSES, REGISTERED WITH THE MINISTRY OF TRADE AND INDUSTRY OF KOSOVO (MTI) AND THE KOSOVO VETERINARY AND FOOD AGENCY	- Very flexible in adjusting to the market - Oriented either to exports (pickles) or the local market - In general, end products inconsistent with EU quality standards - Lack of financing capacity - Lack of financial records - Lack of sufficient turnover to complete investments - Grant hunters, but with limited success due to lack of documentation and/or certification - Majority operate as micro enterprises with fewer than 10 employees, primarily family members	- Management improvement needed as well as support with marketing activities - Need credits for enlargement and standards fulfilment - Large potential to operate as companies producing for third parties (private labels) - Room for improvement in financial record-keeping - Contract farming is a good strategy to establish relationships with primary producers - Diversification of products is also important, to compensate with excess capacity of seasonally-used machinery
COLD STORAGE AND COLLECTION CENTERS	- Limited number of cold storage facilities, mainly in soft fruits production (raspberries, strawberries) - Only a small category of products is collected through the system of Collection Centers - Majority of premises not food safety certified - Limited capacities in human resources and knowledge transfer - Lack of working capital, especially with respect to high-value goods, such as berries	- Substantial expected increase in production capacities will force collection centers to develop further, filtering successful ones - Have to further add value to products and diversify in the face of competition - Need to contract with farmers and provide better services to ensure constant and quality supply of raw material - Need appropriate financial instruments to deal with increasing turnover - Need to strengthen market intelligence and promotion - Need to develop new market channels - Need to develop human resources to meet growth potential

Box 1: Frutomania Brand Juices– Investors coming from other sectors are ready to do things "by the book"

The company MOEA LLC started in 2010, processing fruits, mostly into natural (not from concentrate) juices, under the brand Frutomania. The owner had experience in the information and communications technology sector and decided to invest in agriculture, initially with small quantities and a limited number of suppliers, but with steady growth in the first years of operations. The company now processes more than 14 types of fruits, with the majority being apples. In 2017, Frutomania processed more than 1,000 metric tons of apples, purchased in Kosovo and regional countries as well. The growth of the company can be attributed to an effective planning process and financing support through grants and loans. Loans were provided based on the collateral of the production unit of the company, which operates as an independent entity. Nowadays, the company has available storage for more than 2,000 metric tons, supplied from Kosovo and other countries in the region, and exports to more than five countries. The demand for Frutomania products is very high, stimulating the company to purchase larger quantities of fruits every year, stressing its cash flow and straining the relationship with the banking sector.

The highest number of employees in agribusiness is in the Central Kosovo Pristina region. The highest turnover, number of agricultural companies and number of employees in enterprises registered in the agriculture, forestry and fisheries sector were in the Pristina region, with a share of about 25 percent of all companies, turnover and employees, followed by the Prizren region with about 20 percent, while Gjakova, Peja and Gjilan account together for 33 percent, and Ferizaj and Mitrovica had the lowest participation, with each accounting for about 10 percent.

Table 10: Agribusiness Turnover by Region

Source: KAS, processed by DEAAS -MAFRD

4.5. Market and Opportunities

The domestic market is large and growing, offering many opportunities for small farmers.

Agriculture is a good business opportunity for Kosovo. Given the low development of valued added food processing in Kosovo, great potential exists for increasing domestic agricultural production and expanding food processing. Recent positive developments, combined with government support for the sector, have challenged farmers and even the urban population to get involved in production of crops—most notably, berries—with good profit potential. This is due to examples of high value added crop production (raspberries in Podujevo, medical and aromatic plants throughout the country, top fruits, etc.) and the development of necessary infrastructure (cold storage) by the private sector with MAFRD support. Success stories have had a positive impact, resulting in increased area under cultivation and exports (in the case of raspberries, area under cultivation has grown from 100 hectares to 2,000 hectares in four years). New markets have been identified for organically cultivated medicinal and aromatic plants and a more focused approach has resulted in these new opportunities increasing Kosovo agriculture exports.

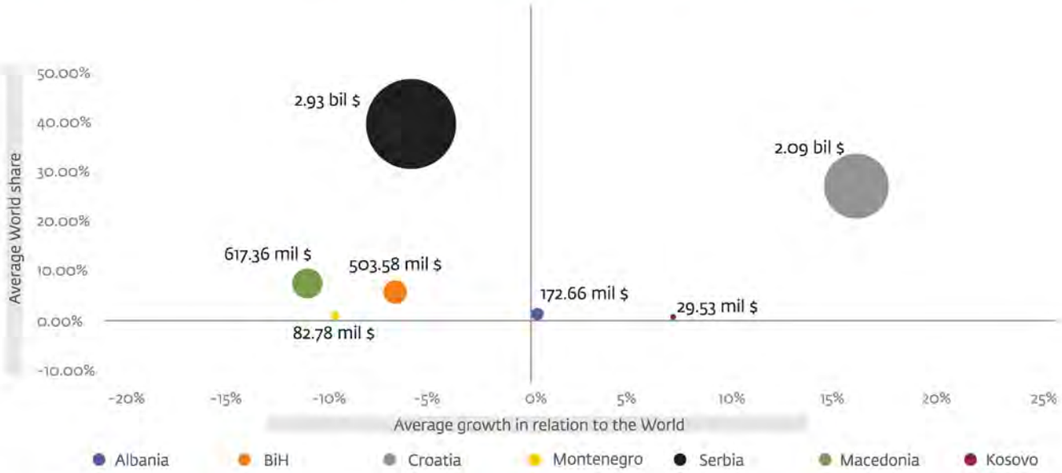
Farmers and agribusinesses are oriented towards the domestic market. Consumer purchasing power relies heavily on the remittances that comprise about 12 percent of GDP. Exports of agricultural products have increased at the same rate as imports have increased; meaning that food consumption has increased. Market linkages with international markets are still weak, but they are improving, and farmers are developing stronger

linkages with local markets and supermarkets. These could be improved with better organization of farmers around aggregation centers, and with education of consumers about the advantages of local products.

The level of cooperation among farmers in Kosovo is low. International and regional experience shows that farmers benefit from horizontal and vertical cooperation.

In Kosovo, however, there is only a small number of functioning associations and cooperatives. Farmers are mainly organized around collection centres. Donor projects assisting cooperation among Kosovo's farmers include USAID's New Opportunities for Agriculture (NOA) program, which identified new crop opportunities with high potential for production and export, and AGRO program, which is scaling up the identified opportunities.

Graph 8: Export of Agricultural Products from Kosovo (Comparison with Regional Competitors)



Source: ITC and COMTRADE Data

Box 2: Financing Potato Processing: Success Story Working with FI (EBRD)

The Pestova Potato Processing Company has a processing facility situated in Pestova village, Vushtrri/Vucitrn municipality. The company usually rents land—about 200 hectares—and signs contracts with larger farmers (owning at least 5 hectares) at the beginning of the year for an additional 200 hectares of potatoes for processing (in total, around 40 farmers). Selected farmers must fulfil certain criteria and provide soil and water analyses of their land. After the selection process, farmers sign contracts with the company and receive potato seed, fertilizer, and other inputs. The fields are GPS registered and farmers must adhere to GlobalG.A.P. standards.[13] Technical assistance is provided to all farmers from the planting period through different stages (irrigation, fertilizer use, treatment and harvest). Farmers without the necessary equipment are supported with farm machinery to harvest potatoes; all product from the contracted farms is delivered to the company. Before being paid, farmers repay the previous year's debt to the company while new farmers purchase inputs from the company, for which they pay in advance. The results are excellent: the company has become a leader in potato chip production and already has around 50 percent of market share in Kosovo and exports to the region and to markets in the Middle East.

[13] See https://www.globalgap.org/uk_en/.

4.5.1. VCs and Diversification

Aggregation around a single VC remains the best route to market expansion.

Along the soft fruit, vegetable and medical and aromatic plants VCs, Kosovo's producers have seen opportunities and are willing to respond to market and aggregator demand. Small producers are linked to domestic and global markets through aggregators — collection centers or cold storage facilities — as individuals or through associations or cooperatives. These aggregators, ideally, provide the necessary advisors to help farmers produce quality, keep records, coordinate development of infrastructure, gain better access to finance, implement food safety standards and better understand market requirements. This coordinated VC approach can increase export opportunities and reduce imports. The main drivers for the changes in a VC are:

- Diversification of crops and products to focus on value added products
- Coordinated attention by all parties on a focused approach to the VC
- Direct support to complete the VC
- Highlight successful examples, such as raspberries
- Organize small farmers through collection centers
- MAFRD grants scheme and donor support (MAFRD subsidies artificially keep cereal production high, while fruit and vegetable sector is profitable and can cover the cost of investment)
- Access to EU and regional market, vicinity to large consumption markets
- The need to develop human resources
- Increased competition from internal and external players
- Opportunities to improve productivity
- Cost effectiveness

Box 3: Case Study of the Value Chain Approach: Gherkins For Pickling

Kosovo used to import gherkins for processing purposes from FYR Macedonia and other countries in the region. The NOA program supported a collection center in the Mamusha municipality (with an ethnically Turkish minority population) with sorting and grading equipment and technical assistance, while encouraging farmers to implement food safety standards and sign contracts with the aggregator.

The impact was very positive: the collection center became an aggregator for up to 60 farmers and now produce more than 2,000 tons of gherkins annually, fulfilling the needs of Kosovo pickle processors. Farmers have increased their profitability by at least 50 percent and created jobs in the Mamusha municipality. The collection center thus helped to stimulate demand for fresh vegetables and encouraged other partners, like supermarkets, to sign contracts with local farmers for the supply of other commodities, including tomatoes, peppers, cabbage and carrots.

4.6. Agriculture Policy and Investment Climate

Kosovo's agricultural policy—lacking in vision but motivated by hopes of EU accession and local politics—is typical for the Western Balkans.

A strategy paper exists, but presents no clear vision for the sector. The agricultural sector is well covered with strategic documents, programs and other development documents, but these are focused mainly on short term goals. MAFRD has developed an Agriculture and Rural Development Plan 2014-2020 (ARDP), which to date has not been officially signed by the Minister. The ARDP follows EU requirements and represent a good guide for general development; however, it gives little or no direction to critical VC development and policies that could boost the selected sub-sectors. MAFRD is using this document in its programming while the Green Report is serving for statistics and the development of new programs on yearly basis. Usually MAFRD is including all main stakeholders during the development of yearly program for grants and subsidies, but changes to strategy are minimal and the focus continues to cover the whole country and all sectors, resulting in poor results.

Agricultural policies change too often. Local politics and policies change with each time a new minister is appointed, though the overall agricultural development program

continues in place. This leaves agricultural policy to the vagaries of political expediency. The main changes are reflected in the annual support program (grants and subsidies), which changes every year. MAFRD must develop a long-term vision in order to improve the results of current programs. The general policy objective of the GoK is: "To further advance and improve the situation, agricultural policies are oriented towards increasing sustainable agricultural productivity, including policies that affect the agricultural business environment and the manner of using natural resources to support structural transformation and innovation in agriculture". Implementation of such a general policy is difficult, due to a lack of detailed information, effectively disseminated to the potential beneficiaries. The agricultural sector does not have a well-developed civil society or strong associations to address issues from different perspectives and to put pressure on the GoK to implement proposed policies. Usually the policies are developed on an ad hoc basis and are not planned based on the performance of sub-sectors.

The GoK budget allocated for the agricultural sector stands at 1 percent of GDP or around 3 percent of the total budget, which is substantial, but this is not producing the desired results in terms of sector contribution to GDP. The MAFRD budget for supporting agriculture was €46 million in 2017, which is above average in the Western Balkans, relative to the size of Kosovo's agriculture sector (per hectare and per farmer). The sector has been supported through direct payments (subsidies) and rural development measures (grants). Both measures are equally distributed. The lack of focus on more profitable enterprises, targeting all opportunities without an attempt at regionalization of production, has led to poor results and a dissatisfied farming community. The program is still supported by the WB's Kosovo Agriculture and Rural Development Project (KARDP), and there have been no substantive modifications.

MAFRD has spent more than €200 million in grants and subsidies since 2011, with limited results. Grants were used to support investments in the primary sector, as well as in the processing industry and rural agri-tourism development. Many individual grants were effective, but the main purpose of boosting the agriculture sector has not been achieved at the desired level. MAFRD grants should be the main driver for developing the agricultural credit market, since the implementation process requires that farmers and agribusinesses first implement the grant and then receive the approved 50 percent funding via the grant. There are certain problems with implementation, as the GoK is sometimes slow in payment, creating problems for the beneficiaries and banks, and grants are sometimes not implemented according to plan. According to 2016, a total of 483 grant applications were approved, and the amount of the grants was €22.5 million.[14]

Even though the grant disbursement was completed and documentation was evaluated, the program suffered from insufficiency of staff qualified to monitor and advise beneficiaries, often resulting in the poor management by farmer's and results failing to meet expectations. Initially the WB jointly with Danida has supported MAFRD (through the KARDP) to develop the grants evaluation criteria and control, monitoring and payment systems. An additional objective is to encourage farmers to invest in the sector.

Half of MAFRD support is directed toward direct payments, without proper analysis. Approximately 50 percent of MAFRID's support budget goes to direct payments supporting production of agricultural crops (40 percent of overall support goes to the cereals sector alone) and livestock. In 2016, the total support via direct payments was €26.1 million, although the budget initially planned was €23 million. Direct payment support in 2016 was increased by 22 percent over 2015. The number of beneficiaries of the program in 2016 was over 43,000 farmers. The effect of this MAFRD grants is mostly socio-economic support of the rural population. The GoK is slow to consider alternative approaches, such as subsidy delivery by unit of production rather than herd size or area under cultivation.

The Law on Rural Development and Agriculture Insurance has been analyzed yet has not been implemented by MAFRD. IFC has initiated a project that will enable MAFRD to include this product in its program. The MAFRD was to include it during 2018, but, due to the political situation and pending approval of the Law, this was delayed for the following year until all the legal aspects are completed.

There are some positive changes at MAFRD. There is new approach toward larger investments and better access to finance and transparency:

- Around €6 million will be invested in different sub-sectors (minimum investment size €0.5-2 million) in fruits and vegetable, organic fertilizer, meat and market infrastructure via 50 percent grants
- The WB is funding a $25 million project to upgrade one of the irrigation provider Iber-Lepenci
- The MAFRD continues work with KCGF, a now well-established institution with an Agro Window supported by KfW
- The MAFRD may grant €3 million to USAID for the AGRO project to test expansion of the positive results of the VC approach in berries and medicinal and aromatic plants

Donors are continuing to support the agriculture sector. USAID's AGRO, Swiss contact's Promoting Private Sector Employment (PPSE) project, GIZ and the WB are involved at country level while there is a good number of smaller project in specific regions like RESI in Pristina, Novo Brdo and Kamenica or InterDev in Shterpce, Dragash and Viti.

[14] Green Report 2017.

4.7. Main Barriers to the Development of Agriculture

There are (too) many barriers to the development of the sector.

Lack of market opportunities and search for new markets. According to all stakeholders, including banks, the market is key constraint to further investment. Kosovo's market is limited and finding new markets is a challenge for local companies. There are some positive developments in the berry and medicinal and aromatic plant VCs, where market opportunities have been identified and processors are working on education of farmers, implementation of food safety standards and improved post-harvest practices to meet market requirements. Opening new markets and supporting companies to identify markets will increase opportunities for small farmers and make Kosovo known for quality products.

Lack of aggregators of the products and storage facilities. New markets require more product and better quality. Aggregators and collection and cold storage centres should play a central role in VCs. Increased production of some products (raspberries) and lack of the aforementioned facilities created extra costs for companies and increased investor interest in developing new collection centers. This case positively encouraged existing and new collection centres: for example, Podujevo municipality increased its surface under raspberry cultivation from 20 hectares to 1,000 hectares in 4 years, and cold storage facilities increased from 500 tons to 5,000 tones and from 3 small cold storage units to 7 storage units with capacity to fulfil the requirement for raspberries and other berries, such as industrial strawberries.

Small farmers' potential is untapped. Farmers in Kosovo have, on average, 1.5 hectares of land divided into 5-8 plots, which doesn't allow them to compete with traditional crops grown without aggregation. The positive side of this issue is that farmers can use family labor to reduce production costs. Projects like USAID AGRO have demonstrated that farmers can be successfully organized with support to aggregation/collection facilities, which serve as an anchor for their VCs, ensuring market availability, information, knowledge and finance at a single location. In future, these farmers need to consolidate and move toward more stable production, linked by contracts and implementation of food safety standards.

Small farmers tend not to keep proper financial and other records, which makes it difficult for them to provide supporting documentation to credit providers. Most farmers don't keep financial records, nor are they legally obliged to do so. This limits their access to credit and grants. Improving the documentation is an important aspect for farming business seeking to develop commercially. Only formal financial accounts (reported to the tax authorities) are used for loan approval. The necessity of keeping such accounts is a good method to discipline the companies. Improved financial record keeping will support farmers and businesses to qualify for better loans and increase the confidence of the banking system in the information they receive from prospective borrowers.

Lack of information and knowledge. Kosovo has good access to EU and regional information, yet expertise is limited to a small number of people. Development of human resources will help the development of the agricultural sector at the producer level as well as in FIs. A separate problem is that the information and knowledge disseminated by the GoK is sometimes not standardized, creating confusion among those to whom it is transmitted. A recent study by KEP Trust concluded that information and advice availability is one of the main barriers to increased investment and better results in farming.

Adoption of new technologies. In recent years, international projects have demonstrated best practices and use of new technologies in agriculture production. Positive results encouraged farmers to use new varieties and breeds, new technologies and information technology (IT) solutions in farming. Kosovan companies like Agmia and Frutomania have made successful use of IT, for example meteorological stations and orchard cameras. At the same time, the association of raspberry growers - Mjedra e Kosoves - has registered all raspberry plots in Kosovo and created a GPS map. The mobile telephone Company IPKO, with assistance from the USAID AGRO project, has installed over 20 meteorological stations around the country and will deliver advice by SMS to producers in some VCs. Some of these new technologies will help banks to improve their assessments and make better decisions with their clients.

Increased use of irrigation system. Kosovo farmers are using only 30-40 percent of existing irrigation capacities. Other farmers use underground water, depleting water tables, resulting in issues with water availability in summer, affecting final yields and quality of products. Improved use of irrigation and water resources is one of the most important issues in the overall development of agriculture. Some farmers are not willing to use irrigation systems to avoid payment of water fees, due to a perception of a lack of market opportunities for their products.

Development of the land market is one of the key challenges to Kosovo's agriculture. Opaque land ownership is a serious problem for the development of the land market. Farmers may have their land registered under the name of their parents, cousins or sometimes even grandparents or previous owners. To improve the situation, MAFRD is giving extra points in grant applications to farmers who have regularized their land ownership. However, this incentive is sufficient to solve the problem. Banks use land as collateral, yet the valuation of land is not done according to market prices, but rather

is deflated two to three times, in accordance with bank standards. This is a result of general lack of clarity and liquidity in the market.

Financing of the agriculture sector is still low. Banks in Kosovo averse to agricultural lending, emphasizing high risks, low profitability and issues with collateral. The KCGF has boosted the interest of banks to lend to the sector. Agricultural insurance will further reduce risks, but time, information and knowledge are needed to increase the number of loans and the participation of the sector in banks' broader loan portfolios. Most of companies in Kosovo are still investing in infrastructure and have significant problems with access to working capital, while banks concentrate on collateral and are not yet willing to use other means of securing their loans, such as cash flow lending.

4.8. Regional Dimension of Agriculture and Links to Kosovo

Agriculture production and trade in the Western Balkan region are highly interdependent. Policy or market developments in one country will affect others in the region. Market trends can be understood only if we accept the region as a single market. Almost all tariffs were abolished decades ago; the leading food producers, retailers and service providers operate in all countries in the region. Consequently, Kosovo's agriculture sector is heavily influenced by regional trends. For example, Kosovo's berry cultivation industry was influenced by earlier development in Serbia and Bosnia and Herzegovina. Likewise, Bosnia and Herzegovina first produced pickles for export, followed by Serbia and now Kosovo. Set out below are the main regional policy and market trends that can be expected to influence production and trade in Kosovo.

Main regional policy trends:

- Government budgets for agricultural support are stagnating and even decreasing in most Western Balkan countries
- Increase of rural development payments is expected, both from the National budget and via the EU's Instrument for Pre-Accession Assistance for Rural Development (IPARD) on the account of direct payments (rural development payments will imcrease and direct payments will decrease)
- Focusing on activities in the Paying Agency and fulfilment of EU requirements for accessing IPARD and EAFRD grants scheme by establishing a Land Parcel Identification System (LPIS)[15] and implementing the Integrated Administration and Control System (IACS)[16]

Main sector trends:

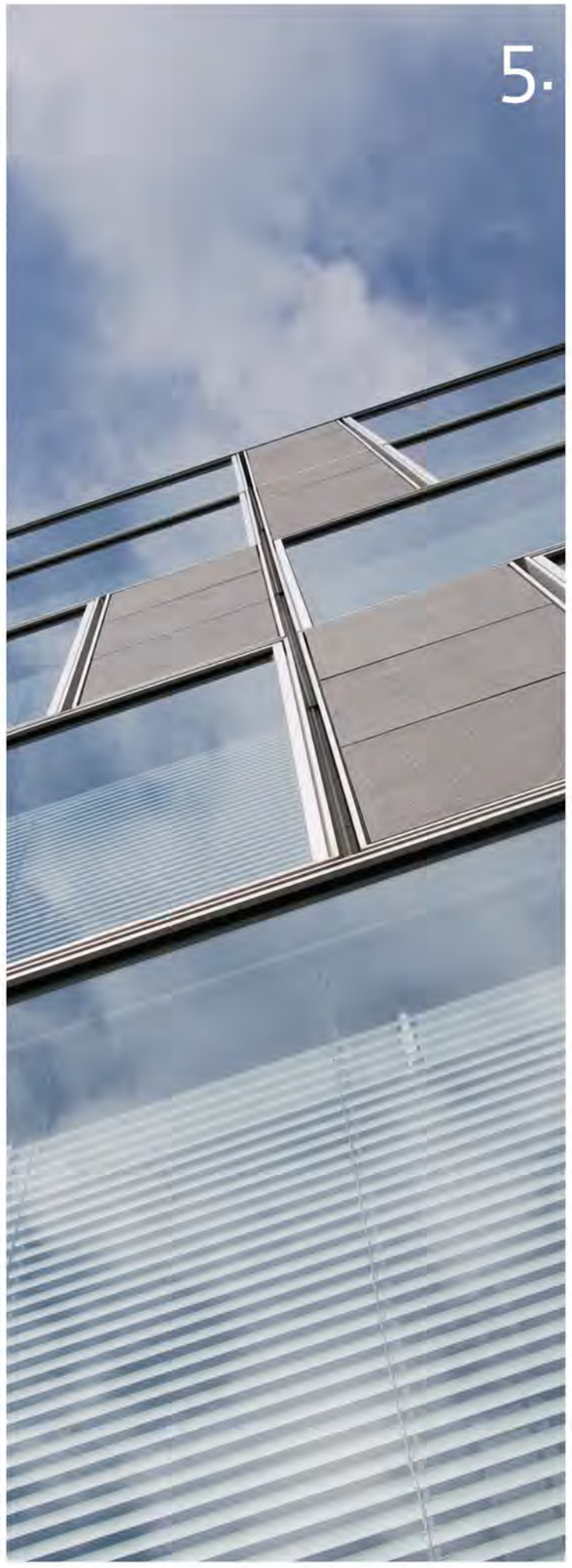
- Increasing top fruit production and export, particularly apples, pear, plum, cherry, sour cherry and peach. The main driver is the Serbian preferential possibility to export to Russia, which has increased demand in the entire region, as well as high EU market prices for plums and sour cherries
- Increased demand for cattle production as a result of export quotas allocated for export to the Turkish market by several countries in the region
- Significant increase in the production and exports of peppers, particularly high-quality product to EU countries
- Continuation of increasing production and export of cucumber, blueberries and high quality processed meat products
- Reaching regional self-sufficiency in poultry meat based on local production
- Re-orienting raspberry production from frozen to the fresh market, as well as potential for moving up the VC towards retail for frozen product
- Organization of organic production at a higher level

The region faces several risks that can seriously affect the agriculture sector in all of the countries:

- Potential shortage of agricultural labor
- More market driven EU policy (e.g., abolition of milk and sugar quotas), including the opening of the Central European Free Trade Agreement (CEFTA) market for EU products

[15] A national system for identifying land, based on aerial photographs and satellite images.

[16] A system for the management and control of payments to farmers made by EU member states under the Common Agricultural Policy.



5. Supply Side Analysis

5.1. Banking Sector

Table 11: Relevant Banking Sector Figures

INDICATORS	FIGURES
Number of banks/number foreign owned	10/8
Average RoE	19.7 percent (2016)
Loan-to-deposit ratio	82.4 percent, increasing by 4 percent in the last four years
Average loan growth /deposit growth	10.4 percent/5.6 percent
Banking sector profit	€85.5 (2017), €77.5 million (2016)
Total bank assets (IQ, 2017)	€3.877 million of which loans €2.485 million deposits €3.092 million
Loan Loss provisions to nonperforming loans	155 percent
Interest rate for banking sector (2016/Q1, 2017)	7.2 percent/6.8 percent
Credit registry	274 users; number of surveys on the obligations and credit history of credit applicants 645,246 surveys in 2016
Number of branches/sub-branches/employees	45/182/3,301
Non-performing loans (NPLs) as a percent of gross loans	8.5 percent (2014) 6.5 percent (2015) 4.9 percent (2016) 3.1 percent (2017)
Share of the agricultural loans in overall portfolio	3.6 percent (December 2017)

Figure 3: Main Features of Banks in Kosovo Regarding Agri-Lending

POSITIVE ASPECTS

- Mainly international banks with long experience of agri lending in mother banks
- Extensive branch networks
- Regulations of the Central bank in favoring further development including a weel functioning Credit registry

NEGATIVE ASPECTS

- Small market to attract big banks usually present in the region
- Comfortable position due to the lack of competition and high levels of profitability
- High turnover of staff

RESULTS

- Very profitable and liquid banking sector
- Low interest from the banking sector to invest into agriculture
- A mostly negative atitute towards the banking sector from Kosovo population and even clients

Kosovo has healthy banking sector and low competition.

Banks in Kosovo are extremely profitable. Return on Average Assets (ROAA) in 2016 was 2.6 percent, while the Return on Average Equity (ROAE) was 21.9 percent. Total profit for 2017 was over €85.5 million which in comparison with the regional countries and the size of the Kosovo banking sector was a remarkable result.

Business loans are highly concentrated in three banks. In 2017 around 60 percent (in 2016: 60.6 percent) loans to enterprises were concentrated in the three largest banks. An even greater concentration in the three main banks was in loans to the trading sector (63.7 percent in 2016) and manufacturing sector (74.1 percent), while in agriculture from all portfolios, the concentration was highest in 2016 with around 60. percent for three largest banks. In 2017, the share of the three main banks in the overall agricultural portfolio was 70 percent.

All banks in Kosovo dealing with agriculture are using similar methodology and have the same approach for credit evaluation. High levels of movement of credit officers and loans portfolio managers within the banks is causing a slow equalization of the credit evaluation methodologies.

Banks have good cooperation with MAFRD and other service providers in agriculture, but there is space for improvement. Primarily when talking about information exchange, such as data from the farm registry, reliability of farmers in utilising grants, agricultural prices etc, there is no services (provided by public or the private sector) who regularly offers reports on short term and long-term price estimation, yield calculation, price analysis, agricultural opportunities identification, price estimations etc. Banks are able to find some of this information (mainly prepared by MAFRD or donors), but not regularly and this comes without validation.

Banks in Kosovo are very open to cooperation and testing of innovative approaches in agri-lending. Banks in Kosovo are surprisingly open with each other. Cooperation between banks and with the KCGF, insurance companies, donors, the GoK and central bank bodies is ongoing. Generally, there is openness to new ideas. This makes the potential for rapid development high, provided the banks make the decision to advance agricultural lending.

5.2. MFIs

Table 12: MFI Statistics

INDICATORS	FIGURES
Number of the MFIs of which foreign owned	21/14
Average RoE	18.8 percent
Total assets/loan portfolio	€204 million/€153 million
Loan Loss provisions to nonperforming loans	190 percent
Share of the agricultural loans in overall portfolio	26.7 percent (December 2017)
Average interest rate on loans	22.7 percent
Number of offices/employees	129/1.069

Figure 4: Main Features of MFIs in Respect of Agri-Lending

POSITIVE ASPECTS

- High number of MFIs present of the market with good branch network and long experience
- Inclusion of MFIs in the formal banking system
- Good knowledge of clients and market

NEGATIVE ASPECTS

- Highly concentrated portfolios
- MFIs are not deposit-based institutions; lack of capital limits portfolio expansion
- Some MFIs lack proper methodology for credit evaluation

RESULTS

- Significant portfolio, constantly growing
- High interest rates on loan provided by MFIs
- Few NPLs

MFIs in Kosovo are successfully responding to market demand.

MFIs in Kosovo are organized as NGOs or joint stock companies. Kosovo's Law on Banks, Microfinance Institutions and Non-bank Financial Institutions (Law No.04/L-093) defines an MFI as "a legal entity organized as either an NGO under the NGO Law or as a joint stock company under the Law on Business Organizations, which provides as its primary business loans and a limited number of financial services to micro and small legal entities, low-income households and low-income persons."

MFIs loans are more expensive in comparison with bank loans, but they serve more farmers than banks. MFIs played a very important role in the early development of Kosovo's economy and credit market; now, however, the developing banking sector is reducing MFIs' role. However, they are still present in the market, providing service to underbanked clients, such as small farmers. For their services, MFIs charge high (perhaps justifiable) interest rates. With the average MFI interest rate at approximately 20 percent, an MFI loan is the last resort for farmers who have exhausted other options. The typical client for an MFI loan is a small-scale farmer with diversified production, low mobility, additional income from other sources, and relatives or friends to cover the credit repayment if necessary: a typical small-scale farmer in Kosovo.

Access to funds is the key challenge for MFIs in Kosovo. Since they are mainly registered as NGOs, MFIs do not collect deposits (this will not be changed with the new Law on Microfinance Institutions, which has been drafted and is expected to be passed in late summer 2018) and have to find external sources of funding. It is estimated that many MFIs will not continue to receive funds or grants from donors in the future, making their continued presence in Kosovo uncertain. MFIs nonetheless still play a significant role in serving underbanked clients.[17] It is expected that MFI loans will end up concentrated among the several of the biggest MFIs (a process that is already underway, since four of them, FINCA Kosovo, KEP Trust, Kreditimi Rural i Kosovës (KRK) and Agency for Finance in Kosovo (AFK) together have around a 90 percent share of agricultural loans).

Under the new Law on Microfinance Institutions, MFIs will be able to provide payment services and use the KCGF. Approval of the law will enable MFIs to be registered and provide additional services. Furthermore, AMIK is negotiating with the KCGF to benefit from the latter's guarantee scheme. It is clear that, as banks raise their loan floors, there will be an increasing role for the MFI's to play.

5.3. Agricultural Loans

Table 13: Agri-Lending Statistics

INDICATORS	FIGURES
Number of FIs involved in agri-lending	8 commercial banks, 11 MFIs
Total portfolio (March 2018)	€78.6 million, across 63.8 banks and 14.8 MFIs
Average portfolio growth, December 2012-December 2017	Total 6.9 percent, banks 5.5 percent, MFIs 14.5 percent
NPLs (December 2016)	4.9 percent for all sectors; slightly higher for agricultural loans
Number of agricultural loans	Approximately 19,000
Average loan size	Around €4,200
Maximum maturity period	10 year
Interest rate on agricultural loans	7.65 percent (for around 10 percent) higher than in other sectors (see graph 12)
Average interest rate growth	Average yearly decrease in period 2017/2012 of 10 percent

[17] Zeqiraj, Veton & Murati, Fitor. (2016). "Microfinance Institutions in Kosovo Regulation and Supervision Issues and Challenges." SSRN Electronic Journal. 10.2139/ssrn.2878055.

Figure 5: Main Features of Agri-Lending

POSITIVE ASPECTS

- Good macroeconomic situation
- Very profitable and liquid banking sector
- Effective credit bureau
- Sustainable Credit Guarantee Facility (KCGF)

NEGATIVE ASPECTS

- Low competition among banks
- Difficult to collateralize agricultural land and to take possession of collateralized property
- Lack of information (no agri-market information system, incomplete farm registry, no user friendly company data, poor record keeping by farmers)
- Lack of credit analysis capacity as a result of small number of evaluations

RESULTS

- Conservative approach by banks
- Modest agricultural portfolio with little growth
- Low level of NPLs (in comparision with region)
- High interest rates (in comparision with region and other sectors)

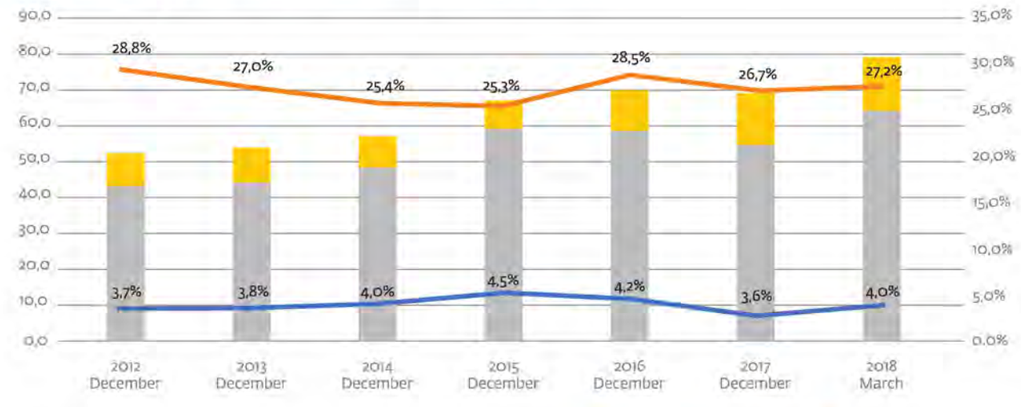
Agriculture is the only banking portfolio not recording strong growth.

Agricultural loans are provided by banks and MFIs. Of the total of 10 banks, 8 are involved at different levels in agricultural lending, namely: Banka për Biznes, Banka Ekonomike, Raiffeisen Bank Kosovo (RBKO), ProCredit Bank (PCB), TEB Bank, ZiraatBank, NLB Prishtina and Banka Kombëtare Tregtare. Additionally, of 13 Microfinance Institutions, 11 provide agricultural loans: Qelim Kosovë, Timi Invest, Start, Perspektiva 4, Mështekna, KRK, KosInvest World Vision, KGMAMF, KEP Trust, Finca and AFK.

The share of agricultural loans in overall bank financing was only 3.6 percent in December 2017 and is decreasing. Agriculture is not a popular sector for bank lending. Agriculture's contribution to GDP is significantly higher than the loan portfolio share and investment needs. In December 2016 this share was 4.2 percent, down from 4.5 percent in December 2015. MFI loans significantly exceed the contribution of agriculture to the overall economy: they account for 26.7 percent of total MFI portfolio. This share has been stable above 25 percent over the last six years.

The overall outstanding agricultural loan portfolio is stagnant at a level of €70 million. Outstanding bank loans to agriculture as a proportion of lending remain essentially unchanged.

Graph 9: Share of Agricultural Loans in Bank and MFI Loan Portfolios



Source: CBK

Graph 10: Seasonal Fluctuations in Agricultural Lending

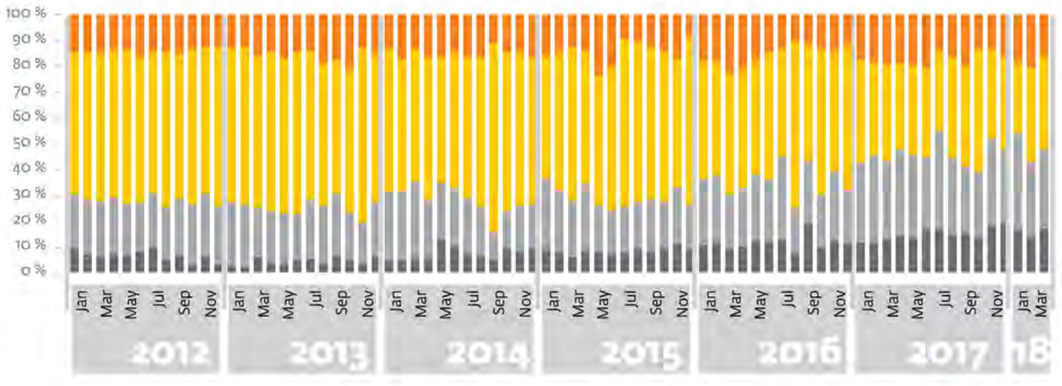
Source: CBK

Banks MFIs Total

There is seasonality of the agricultural loans. The highest peak of new credits is in March followed by September and October. This is a clear indictor of demand for working capital for planting. The seasonality exists among the other sectors as well, but in agriculture this is accentuated.

MFIs are taking the agricultural credit market from the banks. Banks are constantly increasing their credit floor for agriculture. The obvious MFI strategy is expanding into agriculture (not only among private individuals, but even more among businesses), opposite to conservative approach of the banks. This is the main reasons why MFIs are constantly taking a higher share in the outstanding portfolio of agricultural loans and in particularly among new credit.

Graph 11: Distribution of new loans by type and providers (percentage of million Euros)



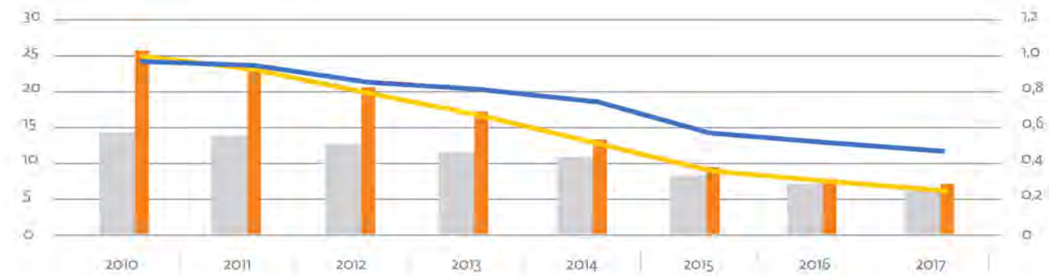
Source: CBK

MFIs - Business MFIs - HH Banks - Business Banks - HH

Interest rates for agricultural loans are high in comparison to other sectors and regional countries. Interest rates varied from 6 percent to 27 percent, depending on the size of the loan and the repayment period-the higher the loan size, and the shorter period of repayment, the lower the interest rate and vice versa. Although banks have standardized products with standardized interest rates for small clients, they are ready to adjust credit terms and interest rate for larger clients. The interest rate for a medium sized credit of around €100 thousand taken by a reliable client with good credit history is between 6 and 7 percent.

Interest rates are decreasing faster in agriculture than in other sectors. Since 2010, interest rates on agricultural loans have decreased by 68 percentage points, compared with a decrease in other sectors of 48 percentage points. This contributes to an apparent trend toward equalization of the agricultural interest rates with those for other businesses. In 2010, the interest rate for agricultural loans was 78 percent higher than for other sectors; in 2017 it was only 8 percent higher. Many factors contributed to this trend, notably the development of agricultural departments in banks and MFIs' increasing sophistication in assessing agricultural risks, which was not the case in 2010.

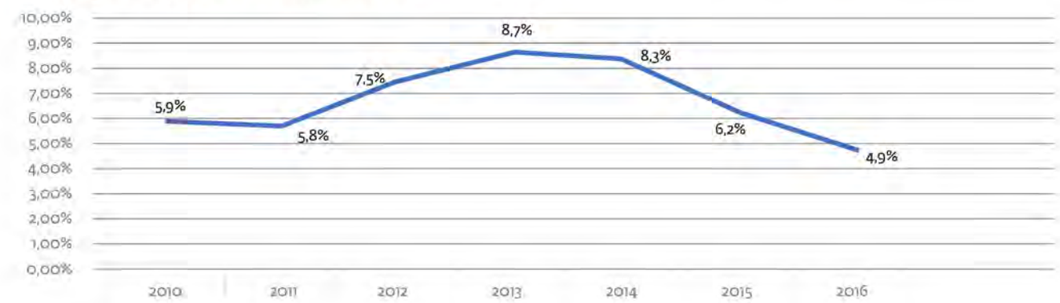
Graph 12: Interest Rate of Agricultural Loans-Real and Index (2010=1)



Source: CBK

IR other loans IR agricultural loans
Index other credits Index agri credits

Graph 13: NPL of the Business Loan Portfolio



Source: CBK

Agri-sector NPLs are reasonably low. The share of loans in arrears over 90 days is at 5 percent for all agri sectors and in the last has never exceeded a level of 8.7 percent, even during the global financial crises, nor in 2012 when severe drought affected the whole region and when agricultural NPLs in Serbia were at 22.5 percent and even higher in Bosnia and Herzegovina and Croatia. Official data for NPLs with agricultural loans doesn't exist, but according to interviews with banks, it is clear that it is slightly above the NPLs for other sectors. The main reason for low NPLs was reasonably efficient and improving methodologies for risk evaluation used by banks and MFIs and a high proportion of the small loans.

Four main banks are contributing 70 percent of overall agricultural loans while 4 of the main MFIs 90 percent of overall agricultural loans. Dominating disbursed Agri-loans are PCB, RBKO, TEB, and NLB while BpB is achieving very good numbers over the last two years, followed by MFIs: KRK, KEP Trust, AFK, and FINCA Kosovo.

Banks offer a range of similar banking products. Standard bank offerings of the majority of banks include:

- Fixed asset loans for purchase of livestock, agricultural land, new or second-hand agricultural machinery and transportation vehicles, processing and packing equipment, and construction and modification of greenhouses, water-supply systems, processing and packing equipment, and other facilities and infrastructure. Such loans generally mature within 12 to 84 months, with the trend toward increasing tenor.
- Working capital loans for seeds and plants, fodder, pesticides, fertilizers, fuel, spare parts for agricultural machinery, fodder and crop protection products.

MFIs' offerings are similar to those of banks, with greater flexibility as to the use of loans and repayment terms. MFIs also offer revolving products.

Some banks and MFIs are exploring the possibility off offering innovative products to the farmers and agribusinesses and include developments to date.

Loan maturity is up to 60 months, with flexible payment terms. The usual grace period is 3 to 12 months, but can be as long as 18 months. Most loan repayment takes place after the harvest season. Currently, no banks offer of longer-term (more than 10 years') credit for land or capital acquisition. Banks state that there is no demand for such loans; farmers and companies, on the contrary, express interest in longer term credit.

For small loans provided by MFIs, collateral is not required. For medium and larger loans, MFIs have

collateral policies that are highly unfavorable to clients. Banks are open to the use of different collateral types. Common collateral types are movable assets and real estate mortgages (regardless of whether there is clear title), but also include other instruments like cash, financial guarantees, treasury bills, shares in companies, livestock, inventory and, in some cases, receivables and promissory notes. Collateral is usually not required for smaller loans, but is obligatory for medium and large loans, starting at €10.000. The ratio of the fair market value of the collateral to the loan amount varies from bank to bank, and also depends on the collateral type, ranging from 100 percent for cash collateral to 30 percent for livestock or machinery/equipment. Agricultural equipment for example as common collateral is valued at around 60 percent of fair market price.

Some banks are withdrawing from the small loan segment. The floor on agricultural loans is currently €30,000 for many banks; it is expected that this will soon rise to €50,000. Other banks have not set a specific floor, but are focusing on medium and larger clients. Small clients will be better served by MSME-friendly banks and by MFIs.

5.4. Financing Demand with Non-Loan Resources

Own resources are a preferable option, but not always possible.

Kosovo's farmers have many options to finance investment: some more and some less favorable. There are several options for financing investments in agriculture: own resources, government subsidies and grants, loans received from input providers or final product buyers, loans from friends and relatives and of course credit from banks or MFIs.

When available, own resources are a desirable option. Own resources may be earned in agriculture or in other fields. A significant share of agribusiness investors have earned money outside of agriculture. In Kosovo, there are some encouraging examples (Frutomania and Agmia) of individuals from the IT sector who have invested in agricultural production and processing. These investors have continued to finance their activities using public sector grants or bank loans. Where profitability has been high, farmers have invested their own money to expand, but are always interested in grant opportunities from the GoK.

GoK grants scheme contributing to investments. Direct subsidies are not designed as investment, but rather to support existing businesses to maintain the cash flow and working capital required for ongoing operations. The GoK's grants program contributes to investment and has played a positive role in increasing the capacities of existing and new agribusinesses, but results are thought to be lower than expected. Grants from the European community are seen to have been better utilized and more focused and have generated significant capital growth in sectors such as dairy, meat, and fruit and vegetable processing.

Value chain financing is limited, but has great potential. Processors of agricultural products extend some credit to their supplying farmers, but in general there are no credit lines for agribusiness companies to support their VCs. Credit comes from firms' own financial resources and risk is entirely with the firm. Limited examples of guaranteed purchase arrangements exist, for example with the Pestova potato processing company, a good example of full VC development, including extension of credit to contracted producers. Credit is linked with technical advice, contracts, implementation of food security standards and a guaranteed market. Pestova–supported intermittently by European Bank for Reconstruction and Development (EBRD) investment—has successfully established a full potato processing VC.

Support from relatives and friends is widespread in rural communities. Diaspora support is a critical link in capital investment. Diaspora friends and families often have little idea of opportunities in Kosovo, especially when it comes to VC opportunities in agriculture. With a more focused approach, diaspora support could be organized around VC finance, increasing jobs and sales, and could also be linked to bank funding or yet-to-be-developed specific government incentive programs.

Alternative financial products, such as crop insurance, warehouse receipts and community-based microfinance are not available. These products may not be suited to the VCs already being targeted in Kosovo. There is however, an awareness at policy maker level as well as with other stakeholders that these instruments have potential, but feasibility studies have not been fully articulated (except perhaps for crop insurance) and no initiatives have been taken due to the shared belief among all stakeholders that Kosovo's agri-sector structure, development and institutions are not ready for these instruments.

5.5. Kosovo Credit Guarantee Fund

Table 14: Main Figures of Kosovo Credit Guarantee Fund

INDICATORS	FIGURES
Number of banks using KCGF support/ percent of total	**6/10**
Total capital	**€15.7 million**
Share of the agriculture in overall guarantee schemes	**Around 8 percent**
Cost of guarantee for the banks	**2 percent**
Number of employees	**5**

Figure 6: Main Features of the KCGF

POSITIVE ASPECTS

- Good capitalization
- High quality management able to follow the market and make changes accordingly
- Donor technical assistance support, and goverment understanding and support

NEGATIVE ASPECTS

- MFIs cannot currently use KCGF
- Not all banks and MFIs see an interest to participate

RESULTS

- Still limited utilization (all banks are under quota)
- More then 1000 credits guaranteed and constantly increasing
- Interested IFIs for further capitalization

The KCGF sets an example beyond Kosovo.

The KCGF plays a role in facilitating MSMEs' obtaining more financing for growth. The KCGF is a local, independent, sustainable credit guarantee facility that issues portfolio loan guarantees to financial institutions to cover up to 50 percent of the risk for loans to MSMEs. Efforts to capitalize the KCGF are ongoing. With the commitments of the GoK and donor agencies, including USAID and KfW, the KCGF has reached €15,790,921. Additionally, the KCGF has signed a Guarantee Agreement in the amount of €10 million with the Swedish International Development Cooperation Agency to provide support to the KCGF guarantee portfolio, which will enable the latter to issue more credit guarantees.

Banks are using the KCGF for riskier agricultural loans. March 2018 figures show that the total amount of approved loans by all banks submitted under guarantee coverage reached €40.7 million, distributed over 1.095 loans. This represents year-to-year growth of more than 400 percent. More agricultural loans are guaranteed (7.95 percent by number of loans and 8.12 percent by value) than are guaranteed in the overall loan portfolio for all sectors (3.6 percent). Banks use the KCGF for loans, based on attractive good business plans, but these loans are not well collateralized. According to data collected by banks and the KCGF, the total amount of guaranteed agricultural loans—€3.3 million—is modest in relation to agriculture's share of GDP.

5.6. Insurance Sector

Table 15: Insurance Sector Statistics

INDICATORS	FIGURES
Total number of insurance companies/number foreign owned	13/8
Companies registered to provide agri-insurance	4 (SIGAL, SIGMA, Siguria, Kosova e Re)
Total assets	€175 million/€153 million
Value of written premiums	21.2
Value of claims	12.1
Average interest rate on loans	22.7 percent
Number of offices/employees	472/2,061
Share of the agricultural loans in overall portfolio	Insignificant
ROAE3 (Return on average equity)	15 percent

Figure 7: Main Features of Insurance in Kosovo

POSITIVE ASPECTS

- Building from the beginning based on experience from other countries
- Interest from all stakeholders to establish/improve system: donors, GoK, farmers, etc.
- Existence of high number of insurance companies which are majority foreign own with experience from other countries

NEGATIVE ASPECTS

- No tradition of insuring agricultural production
- Bad production structure (many low value crops) and structure (too many small-scale farmers) to develop insurance market
- Missing big insurance companies that are leading agricultural insurance in the region

RESULTS

- No viable system in place with extremly limited number of insurance contracts

Initiatives related to establishment of the agri-insurance system have been activated.

Demand for insurance products is high; supply is low. Of the thirteen licensed insurance companies, those involved in agricultural insurance are: Kosova e Re, Sigma, Sigal and Siguria. Penetration of insurance products in the agriculture sector is so limited as to be almost non-exist. Insurance companies are aware of the high investment needed for a limited market, generating initially small margins. Consequently, they are not much interested in developing agriculture insurance products due to perceived higher risk, lack of knowledge of the sector and as yet unmet expectations for support from the GoK. The lack of an agricultural insurance system seriously hinders farmers' access to loans. Donors and the GoK are discussing development of an agri-insurance system. The new products will support farmers to reduce the risk of loss. Banks and other FIs will be more confident that farmers will not default (even though their default rate is only 3 percent). The result will be increased trust between the stakeholders and confidence of all parties in the system. Insurance companies will develop their business with MAFRD support and the program will have an impact on Kosovo's broader economic development.

5.7. Agricultural Sector Constraints on Lending

Farmers see banks as a last resort after exhausting all other options for financing.

The current production structure, in which a large numbers of small scale farmers grow low value crops, is not favorable for bank lending. Assessing multiple small farmers is costly, requiring high interest rates to cover administrative costs. Hence, agri-financing is becoming more and more the domain of the MFIs and their higher interest rates, and high interest rates in turn lead to lower borrowing.

The market structure reflects high levels of import dependency and low production, due to two fundamental problems in market function. The first is the small number of independent agricultural producers included in market chains. These make independent market decisions, resulting in a fractured supply, multiple quality offerings and low pricing and are largely uncompetitive. They operate through informal channels and at low levels of efficiency and their production costs are high. The market chain is characterized by low levels of innovation at processing facilities, limiting ability to penetrate new markets. This is clear when it comes to the full range of international food safety standards.

No clear access to land ownership. Collateral is one of the issues preventing farmers from applying for larger loans. Banks are focused on covering their risks and it appears only with collateral. Banks usually value land at 30-50 percent of its value, since, in the event of loan failure and recovery through liquidation of assets, land is difficult to sell in a timely manner. Formalization of mortgages is also a problem: even after seizing collateral, it is difficult to transfer the land title. This is an ongoing and seemingly intractable problem.

Agribusinesses and farmers have little knowledge of new VCs, their financing or management requirements. Banks are in the same position. While some banks have invested in agri-sector teams, all lack deep knowledge of VCs. Lack of knowledge on both sides significantly limits possibilities for agri-loan portfolio growth.

Lack of information on investment opportunities. Potential investors (foreign and domestic) have limited knowledge of opportunities. They do not know how to identify potential targets, how to set up a business plan (in the case of domestic investors) and how to mitigate risk. An MTI agency, provides general information, but lacks capacity to provide guidance. The MAFRD does not engage in investor support. A USAID project provides some direct guidance to potential investors at initial stages. There is a great need for more information about and promotion of investment opportunities in Kosovo.

Box 4: Raspberry Expansion in Podujevo

In 2011, raspberry production was at 30 hectares and mainly scattered in mountainous areas. The USAID NOA program tested new varieties in 2012 and 2013, but there was little increase in surface. In 2014 Kosovo there were 100 hectares of raspberries throughout Kosovo and the AGRO program jointly with the municipality of Podujevo financed 20 new hectares (Polka variety) and provided technical assistance to 28 *selected* farmers while promoting the new crop with best practices. The cold store capacities in Podujevo were around 800 tones. As a result, over last four years Kosovo has increased its area under raspberries to at least 2,000 hectares, of which 1,000 hectares are in Podujevo alone. In 2017 cold storage facilities increased to 5,000 tons. This resulted in export of over €10 million and creation of 3000 jobs in rural areas in 2017.

Market fluctuations, risks inherent in open field production and low productivity are characteristic of Kosovo agriculture. Borrowers face substantial uncertainty concerning the profitability of planned projects. This is especially true of open field production and even more so rain-fed projects. Without firm arrangement on price, delivery, packaging, etc, risk is difficult to quantify and therefore high. Agri-sector investment is considered too risky without means of reducing production risk and mitigating some of the price risk.

Farmers and processors have limited borrowing capacity. Investment is limited by the lack of borrowing capacity of processors and farmers and by the difficulty of enforcing contracts. While the banking system is liquid and profitable, banks rely solely on collateral and do not consider contracts or cash flow lending, so farmers with little collateral cannot access investment capital.

Farmers work in the grey zone, without accounting. Analysis of farm revenues is complicated and requires knowledge and good methodology on both sides: farmers must prepare business plans based on records of past performance and banks must assess risks based on analysis of these records.

New investors from other sectors are often not aware of the specificity of agriculture. Larger investments flow to larger farms that have been privatized by different businesses; often, they invest without adequate knowledge of the sector and its technical and managerial requirements. As a result, outputs may be far below the potential, do not generate profits and contribute to the common belief that agriculture is not a profitable business.

Farmers see banks as a last resort. Simply, a significant number of farmers do not see banks as sources of support for development, but as adversaries, whose objective is to foreclose on their assets. Consequently, they avoid developing a credit history and may never qualify as borrowers.

Agriculture is a sector in which it is difficult for banks to sell the entirety of their services (savings and current accounts, cards, payments, consumer credits, etc.), as they do when doing business with larger companies. Small farmers, as a rule, operate in the grey zone and do not keep their money in banks, and it is rare for the ratio of credits to deposits to exceed 10 percent.

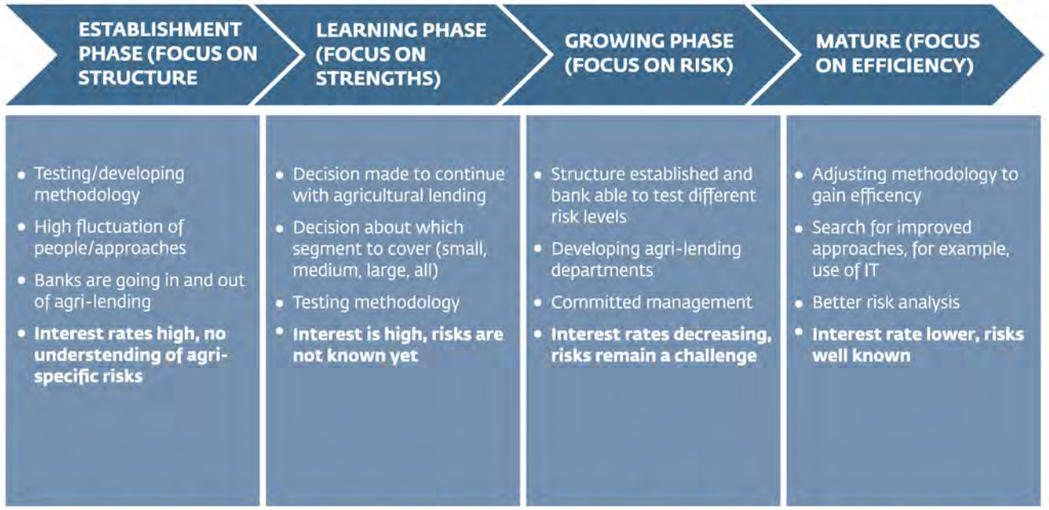
Agricultural production is exposed to external factors, such as floods, hail and drought, while insurance does not function in Kosovo in a way that would guarantee security from those external risks. A new IFC project under Agri-finance Program in Europe and Central Asia region is working on the development of agricultural insurance and it is expected to start a new MAFRD program in 2019. Currently, no insurance is provided to farmers in Kosovo.

5.8.Constraints on Bank and MFI Agri-Lending
Banks are content in their comfort zone.

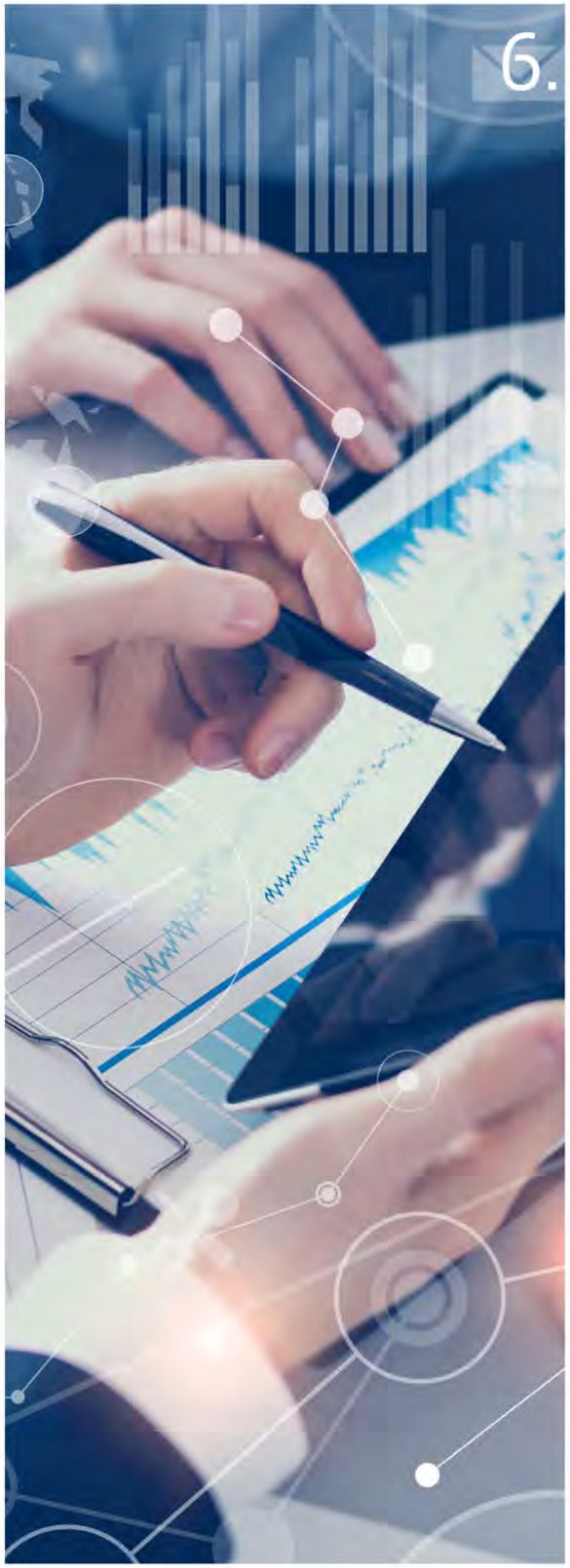
Lack of information, documentation in the agricultural sector and clearer opportunities in other sectors cause a conservative approach to evaluation of collateral and business plans in the rural areas. Regardless of historical low NPLs combined with experience in agricultural credit evaluation, banks and most MFIs in Kosovo are taking a conservative approach. Almost all banks are between the learning and the growing phase, still investigating potential markets and clients, by focusing primarily on risk and risk coverage, but not looking seriously at efficiency. The main reasons for this approach are:

- Lack of information about agriculture (prices, expected yields, cost of production, market possibilities, etc.). Data availability and reliability is very often a problem for the banks. Neither the GoK nor banks are ready to invest in building up and maintaining their own databases.
- Having opportunities in other sectors with rapid production or sales cycles, and where assets, such as stock and physical plant can be used as collateral makes looking into agribusiness a costly and risky alternative.
- Inability of farmers and agribusiness to qualify their financial statements, ownership and market possibilities with adequate documentation.

Figure 8: Phases in Developing the Agricultural Credit Market



Majority of the banks and MFIs have capacity for agricultural credit evaluation, but the market is not pushing them to work out of their comfort zone and take more a risky approach. Kosovo's banks are not motivated to develop a strategy for rural areas, especially when there are plenty of business opportunities in the urban environment. The investment into training, network of personnel and the methodology for evaluating agricultural credit risk is not a priority of most of Kosovo's banks. Some may have agricultural departments, specialized personnel dealing with agri-loans, a well-developed and proven methodology, but they are not working "on the edge" and they do not have authority from management to significantly increase agricultural portfolios. The result-status quo. Much talk about agribusiness and very little action.



6. The Agricultural Financing Gap

The agricultural loan portfolio could be doubled—without compromising loan quality—just by fine-tuning the system.

The agricultural loan portfolio is modest and has significant potential for growth. Approximately 135,000 agricultural loans in a total amount of €461.8 million were made from 2010 to 2016. Demand for agricultural loans substantially outstrips supply. The portfolio is serviced at a significantly lower level than the sector's importance in the economy. Banks and MFIs are not able or ready to satisfy demand, since they either do not understand or they are not able to adequately assess the production and market risks faced by agricultural producers.

The main obstacle to taking on more agricultural credit is high cost. Interest rates on agricultural loans in Kosovo are among the highest in the region. Small agricultural producers reliant on MFI financing must often borrow at interest rates above 20 percent. Average 2017 agricultural loan interest rates were 5.5 percent in Bulgaria, 6.2 percent in FYR Macedonia and 5.1 percent in Serbia. Kosovo's agriculture is not sufficiently profitable to justify such high interest rates, which put Kosovo's producers at a regional competitive disadvantage.

To narrow the financing gap, the GoK, FIs and the agricultural sector must maximise opportunities.

Lending to farmers remains costly because:

- The agriculture sector is highly uncompetitive, due to the unfavorable production structure, low level of investment in technology and human capacity, and an undeveloped land market
- For banks and MFIs, agricultural lending is viewed as high risk, costly and complicated and a sector where is difficult to sell follow-on banking products
- Additional legislation, and implementation of existing legislation, is needed to improve the business environment

Experience from the region shows that it is possible to make significant improvements in a relatively short period of time. For example, in 2013 in Serbia agricultural NPLs were above 20 percent, the interest rate for agricultural loans of €100,000 for reliable farmers was 6-8 percent; a few years later, NPLs have been reduced to 11 percent, new portfolio NPLs were below 3 percent, and interest rates on the aforementioned loans were 3-4 percent. Portfolio growth in the period 2013-2018 was 63 percent. In Croatia banks were never interested in agriculture and did not have a proper methodology for credit evaluation in the sector. This resulted in a small agriculture credit portfolio and NPLs above 40 percent in 2013. Bank consolidation, EU accession, reduced state influence and other measures contributed to the improvement of agricultural lending in Croatia.

Table 16: Development of Key Agricultural Lending Indicators

	KOSOVO	SERBIA	CROATIA
Environment			
Institutional Institutional set-up (including permitted collateralization, rule of law, legal framework, law enforcement, infrastructure)	- Difficult to collateralize land - Good credit bureau - Good credit guarantee fund - Legal system in the process of development; lengthy decision-making and enforcement	- Land as main collateral (high values and easy to secure and sell) - Warehouse and pre-crop finance law in place, but not functioning well	- Land as good collateral, but lower valuation than elsewhere in the region - Very good agricultural infrastructure - Lender supports and guarantees available from development banks, SME development agency
Macroeconomy Stability, predictability, reliability of statistics	- GDP growth of around 3.5-4.5% - Low public debts of 16.5 percent to GDP - High population density and growth rate	- Modest GDP growth in comparison with region - High public debts of 66.3 percent to GDP - Significant population decrease due to emigration	- GDP growth based on tourism increase - High public debts - Population decrease due to emigration
Security Business security, ownership security	- Difficult to take possession of the collateralized property	- Medium level of business security due to political situation	- High level of business security

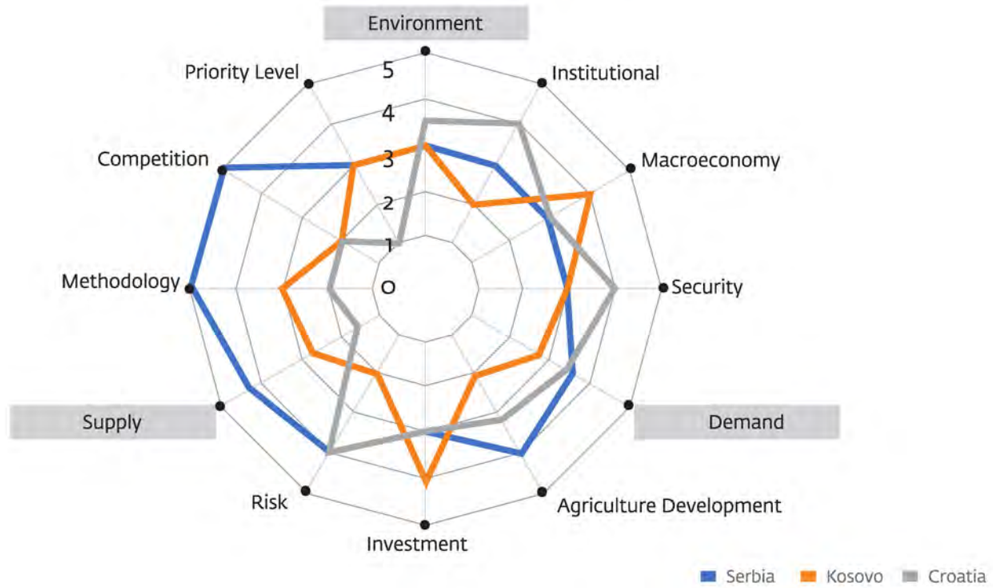
	KOSOVO	SERBIA	CROATIA
Demand			
Development of Agriculture Level of technology, knowledge, VC development market penetration	- Limited land resources; agriculture based on small scale farmers - Short VCs - Import products are main market drivers	- Plenty of medium size farmers in Vojvodina and small farmers in central Serbia region - Several well-developed VCs, mainly in fruit sector - High exports and low imports	- Overly rapid market development; small scale farmers were not able to follow ("missing middle farmers") - High potential for agricultural products driven by tourism development
Investment Level of demand for agricultural loans	- Very low level of investment - High influence of grant schemes on agricultural investment	- Market-driven investment - Low level of state investment support (IPARD assistance started in 2018) - Long-term (13 year) interest rate subsidies provided by MoAFRD	- High level of EU funds (€333 million annually) is main driver for investment - Well-equipped large farms
Risk Possibility and level of risk mitigation (insurance, irrigation)	- No agricultural insurance system - Low level of canal irrigation - Possibility of ground water irrigation, but high cost due to small structures required	- Partly developed indemnity insurance (for high value crops) - High level of irrigation coverage - Subsidies for hail net purchase contributing to widespread usage	- Low interest for insurance beside government subsidy program - Possibility of expanding irrigation and groundwater access infrastructure
Supply			
Methodology Methodology for credit evaluation (level, consistency of applications, trained analysts)	- Methodology imported by regional banks, then spread to a majority of banks - Methodology further adapted to Kosovo environment and banks' strategy, which leads to a conservative approach - Widespread use of specialized staff dealing exclusively with agri-sector clients and risks	- Long-tested methodology revised and improved after the global economic crises in the world and Europe - Specialized departments and staff focused on agricultural lending - Agri specialized banks are having more than 50 production technological cards when evaluating different agri sectors	- No agri departments in the banks - Several months since last credit evaluation - No specialized methodology for evaluation of agri-sector clients - Specialized methodology for EU Rural Scheme grants
Competition Number of banks/ MFIs	- Low competition among banks due to low number of banks in the market - High competition among MFIs	- Participation by international and regional banks present - Ongoing banking sector consolidation	- Intensive consolidation - nearly all small local banks have been acquired and absorbed into bigger banks - The state development bank (HBOR)[18] is the main service provider and market maker
Priority level Which level of agriculture is the priority for banks in comparison with other businesses and sectors	- Medium to low	- High to medium	- Low

[18] Hrvatska Banka za Obnovu i Razvoj, (Croatian Bank for Reconstruction and Development).

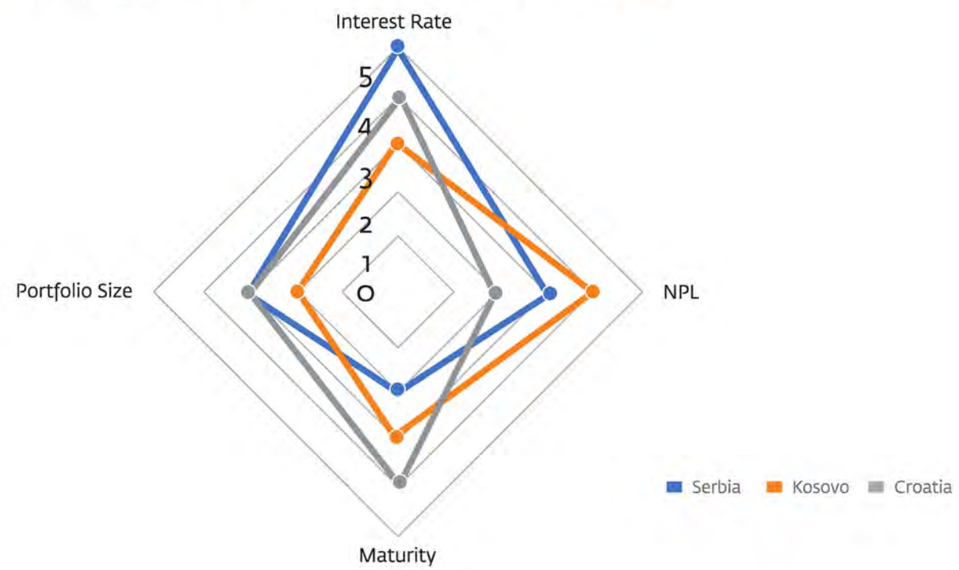
Since many factors influence agricultural lending, only a comprehensive approach can achieve results. Experience in the Western Balkans region shows that the most important factors for successful agricultural lending (affordable credits with low interest rate) are:

- Competition among banks
- Good access to information about farmers and the agricultural sector
- Possibility to collateralized agricultural land
- Lower possibility for extraordinary income in other sectors

Graph 14: Relevance of the Factors that Determine Agri-Lending in Kosovo, Serbia and Croatia



Graph 15: Results of Agri-Lending in Kosovo, Serbia and Croatia (1 is worst, 5 is best)



6.1. Demand Side Opportunities

Drivers of agricultural growth are waiting to be activated.

Domestic demand is growing as consumer purchasing power increases, particularly in urban areas. Demand for fresh food is growing and this is illustrated by the growing domestic demand for milk and dairy products. The livestock and meat processing sectors are potentially good business opportunities, as domestic production does not yet meet local market demand.

Increased market opportunities in the Western Balkans region, the EU and the Middle East will bring sizeable opportunities, especially in the fruit and vegetables sector. This is anticipated by the Kosovo Investment and Enterprise Support Agency and is starting to be visible: the region as a whole increased its export of agricultural products by 8.2 percent over the last five years.

Organizing small farmers around aggregators. It is important to organize small farmers around collection centers or processors in order to utilize their potential and strengthen their production technology, quality control and food safety for processing of products/export opportunities. Value chain and aggregation approaches could qualify farmers and companies to apply for bigger and longer-term loans.

Developing companies that privatized agricultural land. Usually, those companies have consolidated land parcels, well developed infrastructure, a production tradition and other requisites to lead agricultural growth.

Shape market structure in the direction of production with highest value. To improve the importance of the sector and increase its achievements, the structure must be changed in the following direction:

- Expand production of vegetables, in particular in the areas where the infrastructure is developed and market demand has been identified by companies involved in collection and processing. Use climate conditions as comparative advantage to produce when there is better market opportunity (organize production when market demand and prices are higher)
- Focus on high value crops like soft fruits (berries), top fruits, medicinal and aromatic plants and value-added products (pickles)
- Reduce production of cereals and other low-value added crops
- Prepare for eventual reduction in milk production in the long term due to high cost of land and animal feed production accompanied by high imports from EU and countries that have a competitive advantage over Kosovo, especially in marketing and promotion of dairy products
- Continue stable production of wine with emphasis on higher quality wines due to high international competition

6.2. Supply Side Opportunities

Investment in agriculture lending by banks should be paid back.

Access to information should be improved and banks can do much without waiting for the GoK. Access to data in Kosovo is limited and its quality questionable. Data on area under cultivation, production and yield exist, but since they are not based on LPIS or IACS, their quality is not fully reliable. Even trade data is not fully accurate. The farm registry is voluntary and not fully linked with the cadastre. Price information (other than monthly statistics on aggregated and final products) does not exist. Regular updates of data on processed products and subsidies per farm are not available. This lack of data poses analysis problems for the banks; however, these banks may rely on proprietary or KBA databases. Consultancies provide price and other agricultural data using NDVI and other satellite imaging, which can be used to identify crops, but not on very small parcels.

Investigating opportunities, transferring knowledge and having a proactive approach. Banks can have a passive approach while waiting for clients to come to them. This is the common approach of Kosovo banks to agriculture-sector clients. However, there are good examples from the region where banks are showing a proactive approach, such as:

- Conducting sector analyses for high-potential VCs, then sharing findings and knowledge
- Organising promotional offers for certain equipment or sectors, in cooperation with machinery suppliers
- Sponsoring an agricultural newspaper used not only to promote financing products while disseminating information to farmers
- Organizing educational seminars on specific topic of interest to banks and farmers
- Using instant messaging to communicate with farmers to provide them weather and market information

Improvement of methodologies should be a constant effort of the banks and MFIs. Banks in Kosovo use very similar methodologies, due to high mobility of loan officers and managers, who move from bank to bank. Methodology must not simply be copied but constantly challenged and improved, especially given that the agriculture portfolio is small and concentrated among a few banks, with limited opportunities to test methodologies on large numbers of clients. There are many ways to improve methodology: collecting better information, testing options, increasing the number of production technology cards, sharing experience with other banks, etc.

Digitization of processes, improvement of storage and processing data. There is significant potential to improve processes using new technology and improvement of access or better use of information that is currently available. Investing in digitization is worthwhile leading to improved efficiency and accuracy.

Selling other banking products to farmers in a different way. Although farmers are conservative, examples from both the region and Kosovo prove that e-banking and other modern banking techniques are viable when adapted to the needs of agri-sector customers. Although the loan-to-deposit ratio among farmers will always remain low, there is a case for more effort to be put into providing financial education to farmers.

6.3. The Way Forward

Quick and radical market changes are not expected; steady obstacle removal is the best course for market growth.

No big changes are expected. Key questions are: How long will banks continue to remain in their comfort zones, while agri-producers depend on subsidies and grants rather than on private investment? Can changes be expected? Expectations for changes in Kosovo's agriculture sector are as follows:

On the demand side:

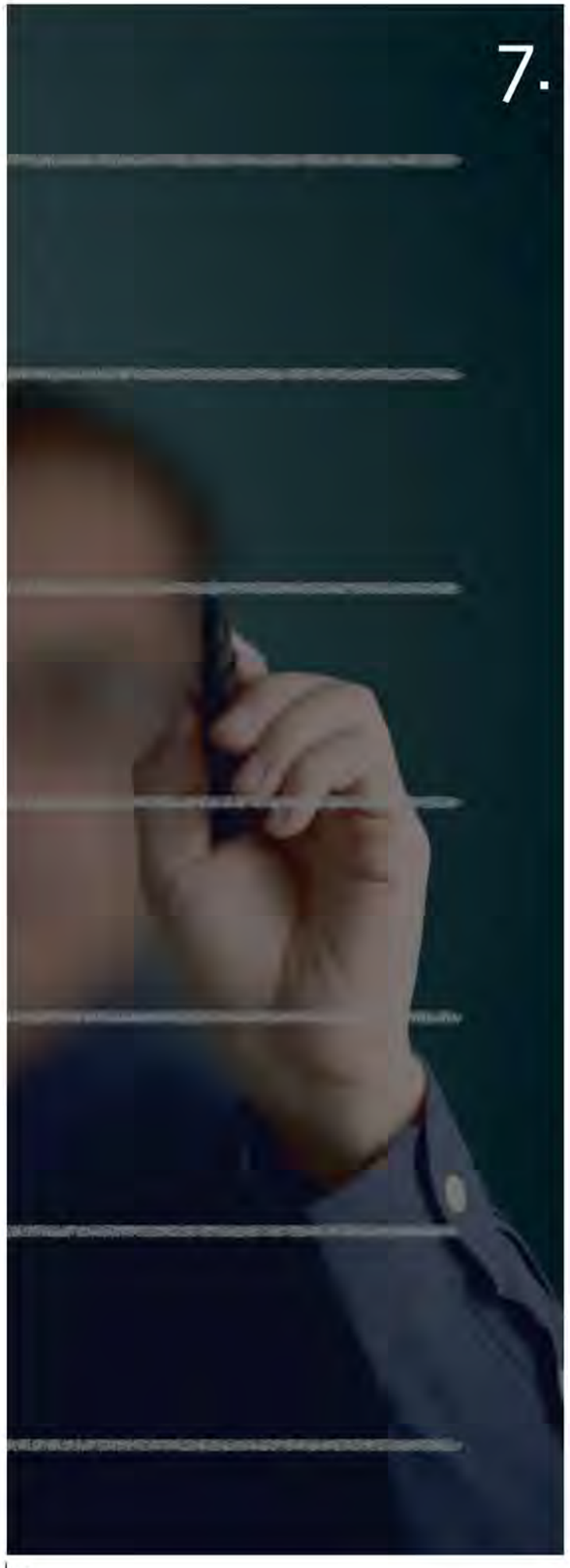
- Agriculture will continue to evolve in the direction of high value crops
- Investors from other sectors will enter agriculture, using their business assets as collateral to acquire loans for agriculture
- Grant beneficiary targeting will be improved

On the supply side:

- Banks servicing the agriculture sector can be expected to offer increasingly specialized products
- Banks will increasingly focus on particular client segments
- Banks will shift from a focus on risks to a focus on productivity
- Banks will increasingly offer multiple products — including insurance — to agri-sector clients, and provide training on how to use these products together to hedge risks and increase profits

In spite of the foregoing, the overall outlook is for slow progress:

- Portfolios will continue to grow slowly, since banks will continue to treat agriculture as a lower priority sector, while MFIs will continue to face the problem of access to capital
- Interest rates will stagnate at current levels until, perhaps, one or more FIs decides to specialize in agri-finance and lowers agricultural loan rates in order to increase market share
- NPLs will remain low



7. General Recommendations

Suggested Improvements in the Enabling Environment.

Changes are needed to improve access to agricultural finance. These include supporting the establishment of an appropriate business enabling environment, facilitating the legal framework and its implementation, and enforcing the rule of law. From the GoK, better regulations and supervision of financial institutions are needed. The KAB should play an important role in facilitating this process and lobbing to improve the situation in the sector.

The GoK is working on these issues and contributing to the development of the agricultural sector by:

- Improving the macroeconomic situation in the country
- Providing and supervising a strong regulatory framework for the financial sector
- Programming, implementing and evaluating an Annual Program for Agriculture Development (the Program)
- Running a nearly €50 million program of subsidies (50 percent) and investment grants (50 percent) for all sub-sectors of agriculture and rural development
- Developing the Paying Agency for the implementation and evaluation of the Program
- Initiating the inclusion of agricultural insurance in the Program
- Hiring consulting companies to provide trainings to farmers
- Promoting land consolidation in some areas
- Collaborating and coordinating with international donors to develop activities in support of the sector
- Producing regular reports on sector statistics, trends and developments, including MAFRD's annual Green Report

More stakeholder (including GoK) action is needed to facilitate the provision of agricultural finance. Based on the discussions with main stakeholders, provision of finance can be supported by:

- With donor support, developing and implementing an agriculture sector country strategy with clear objectives and expected long term results (over at least 10 years)
- Strengthening the implementation of supply contracts and their legal enforcement to avoid fracturing the VC process (IFC support for alternative dispute resolution processes could add value)
- Improving the system of land registration, transfer of ownership and land rights to facilitate and stabilize long-term investment and land consolidation
- Ensuring easy public access to timely and accurate agriculture statistics for the benefit of all stakeholders and to support risk management and market development
- Focusing on investment grants in targeted VCs with superior market opportunities, to improve the national balance of trade and to increase exports of agricultural goods
- Improving the quality of advice and training delivered to farmers to improve their skills, knowledge of new technologies and market opportunities
- Training farmers in financial literacy and providing advice on market and investment opportunities
- Improving donor coordination
- Providing guidance to the GoK on agricultural sector strategy

New products in agricultural finance should be tested, while those that don't support the strategy should be modified or discarded. Kosovo's banks are, in theory, competing and trying to introduce new opportunities in lending, yet their approaches are similar. In many cases, banks are sharing the market more than they are competing. Some measures to improve competitiveness are:

- Further support the KCGF to increase the confidence of the banking sector to invest in agriculture and develop agricultural insurance products
- Re-assess the GoK's subsidy program and provide subsidies per unit of output linked with the quality rather than the number of productive units
- Focus and regionalize government grants to targeted high-potential VCs
- Avoid the provision of non-arms-length loans to family members or shareholders of bank employees or owners
- Reduce dependence on conventional collateral and accept sales contracts as collateral
- Welcome new entrants to the banking sector to increase competition
- Encourage FIs to publicly disclose their real cost of credit
- Authorize MFIs to take deposits as set out in the draft Law on Microfinance Institutions and encourage them to increase service provision in rural areas

Registry Improvement and Accessibility.

A number of registries should be in place in the agricultural sector, including a farm registry, GMO registry, animal identification registry, grant registry, land parcel registry, vineyard registry, organic producer registry, potato producer and storage registry (required to export potatoes to the EU), storage facility registry, credit registry and FADN data registry.

Registries are usually managed by MAFRD or the paying

agency and are not accessible to banks and other interested parties. Whereas, in the EU, such registries are publicly accessible and free of charge. The GoK, like its regional peers, is reluctant to open such registries to the public. **By making its registries public, Kosovo could be a leader in transparency in the region.** Taking this approach, Kosovo will improve:

- Access to credit, since banks and MFIs will:
  - Have access to more quality and timely information about clients
  - Enjoy faster and cheaper credit evaluation
- Quality of data, since public scrutiny enables prompt feedback
- Trust between MAFRD and farmers due to transparency
- Its profile as a prospective EU member willing to adopt good practices used in the EU

Intensive Training and Information Campaign.

Financial literacy is at a low level among all stakeholders — and particularly among farmers — in Kosovo, throughout the region and in other transitional economies. Farmers and agricultural MSMEs also lack entrepreneurial skills and are poorly organized. These facts ensure that:

- FIs view them as less attractive loan candidates
- They are at a disadvantage in negotiating agricultural loans

The easiest and cheapest way to increase financial literacy and business skills is through appropriate trainings and knowledge transfer to the wide range of stakeholders, primarily farmers and agribusinesses, but also banks and MFIs. Focus should be given to the following topics and groups:

- Basic business topics, such as strategic planning, financial management, the structure and functioning of markets, risk management, operational management and labor management
- Cooperatives, aggregators and VC operations
- Loan documentation and negotiation

Trainings and campaigns can be managed by the MFIs and the KAB, supported by MAFRD and donors.

Access to Advice and Information.

Kosovo is missing much data about agriculture that banks and farmers/agribusinesses are using in their daily work. Even when such data are available, their quality can be questionable.

Farm Accountancy Data Network (FADN) data must be shared. MAFRD has hired a local company to collect FADN data on a regular basis. The project is ongoing, yet the information is not yet officially available. This information can help in the development of gross margin analyses and necessary data that could be used by the banks. MAFRD has in the past engaged consultants and companies to develop similar information, but the data is not updated as it changes. MAFRD must make accurate and timely data available and provide the information on a regular basis to all interested parties.

Statistical and other public data should be more accessible. Data about numbers of animals, cultivated area, production trade, yield, production value, number and age of farmers, and product prices, etc., are collected, processed and disseminated by KAS. Some of the data useful for FIs is not made officially available.

The CBK has a large repository of data on the finance sector and usually its annual and monthly reports provide significant qualitative information on sector development. There is a need for better capture of agriculture loans data. All individual loans, even in the agriculture sector, are considered individual. However, corporate loans or food processing loans, which are considered to be manufacturing loans are not included under the general rubric of agricultural loans.

MAFRD produces annual Green Reports, which describe trends in the agricultural sector and provide general background. The quality of the Green Reports has improved over the years and they currently serve the sector well; however, they are not well publicized and few make use of the information contained in them.

Price and market information. Kosovo is the only country in the region without a market information system (MIS). An MIS' objective is to help: (i) farmers to make good short-term decisions about where and when to sell products; (ii) farmers to make long term decisions about what to crops to plant by analyzing long term price developments; (iii) the GoK to make good policy decisions; (iv) banks to offer better loan terms to farmers. An MIS collects, processes and disseminates price information from different markets like green markets, wholesale markets and processing facilities and of different types, like prices of inputs, livestock and agricultural products.

Financial statements about registered businesses (Business ID). Basic tool for banks, insurance companies, consultancy companies as well as all other business companies and people are databases. In addition to the basic feature of keeping company balance sheets, these databases contain corporate information like credit scoring, ownership, related people and companies, foreign trade, assets and collateral, management, number of employees and other features interesting to the clients. Data are sourced from different registries, primarily business registries, customs and credit registries. This service exists in the region—provided by companies like Bisnode and B2B—but does not exist in Kosovo.

The gross margin book is a tool that is extremely useful for all stakeholders involved in agriculture. This tool makes it possible to know which crop is most profitable in which year, what are the cost and norm of typical inputs used, yield and prices of final products and other data that influence gross margins. One of the greatest benefits of the gross margin book is the possibility to observe trends made apparent by the use of the same methodology year after year. Every bank collects and generates this data for internal purposes, but often for limited number of agricultural products. In other Western Balkan countries, banks specialized in agri-lending are having more than 50 technological cards and gross margin for each specific production. This type of book is common in well-developed countries: in the UK, the farm management pocket book of 2017 is in its 48th edition. In the Western Balkans, the gross margin book is just under way. Development of the gross margin book can be a public or private initiative. Banks could joint efforts and invest in production of a high quality gross margin book.

A market exists for sophisticated data made by/for banks. In their daily work, banks need accurate data that goes beyond typical credit manager needs: for example, data about product stocks; short- and long-term price estimates; growth potential for particular sectors, VCs, products and producer types; and specific risks, including market and political risks. In the region, specialized companies and institutions provide such information to banks and other consumers. In Kosovo, a few individuals collate some of this data, but no companies or institutions do so in a systematic way. Such companies/institutions can also handle processing and compilation of different data leading to better conclusions by all users.

Data should be collected processed and disseminated systemically, with the following parameters:

- Donors can start and then hand over the activity to the state or the KBA
- The maintenance of the MIS system, gross margin book, price estimation, risk calculation, etc.
- Some data must be provided by the state, such as the registries, central statistics, MAFRD and FADN
- Some have to be private (eventually public-private) initiatives like financial statements database

Access to Insurance.

Kosovo has a developed insurance sector for sectors other than agriculture. Agriculture is considered too risky; insurance companies have until now been unwilling to serve the sector. In 2012, a single company was registered to provide agricultural insurance, but had no developed products. There are currently three companies licensed to provide agricultural insurance, but are waiting for the GoK to initiate a program. It is anticipated that Government will subsidize agricultural insurance by compensating 50 percent of the premium cost for farmers. One company, SIGAL, has tried to introduce insurance cover for dairy cows, but made little effort to develop the market.

In 2014, USAID initiated study of agricultural insurance in connection with the NOA and AGRO programs and in coordination with MAFRD. These programs hired a consultant to carry out an evaluation and propose best practices in agricultural insurance. The report was completed and delivered to MAFRD. Due to a lack of capacity, no activities followed. MAFRD followed with an assessment and agreed to initiate agricultural insurance in 2018.

In 2016 IFC initiated a new project on agricultural finance and, with the support of the GoK, developed products for six VCs. Due to the domestic political situation and delays in the approval of the new Law on Rural Development (agricultural insurance is part of the law), MAFRD was unable to include agricultural insurance in its 2018 agriculture development program.

Implement the agricultural insurance program and train insurance companies. IFC should continue to roll out the program, test its implementation as soon as possible and should support insurance companies in training their staff. Banks should be involved as well, since agricultural insurance will mitigate the risk for loans.

KfW is planning to work with the KCGF on agriculture insurance. The German KfW has supported KCGF to establish an "Agro Window" project to improve the provision of agricultural loans. According to KfW, there is a plan to increase this support and include agricultural insurance in the program. It will be crucial for KfW to collaborate with MAFRD and IFC to coordinate in implementing this project and avoid duplication of efforts.

Share information with banks and the GoK. While providing agricultural insurance, insurers will create a useful database on the agricultural sector. This data can help the banking sector to improve services to the sector and better understand risks in agriculture. Accurate information on the benefits of agricultural insurance will have an overall positive impact on agricultural financing. MAFRD will also benefit from more detailed statistics: an understanding of production and market trends can help MAFRD to improve its agricultural sector policies.

Grant Scheme and Policy Improvement.

More than €100 million in grants is disbursed annually through banks and MAFRD for investments in agriculture. These funds (which do not include co-financing) are theoretically sufficient to permit development of 100 hectares of modern greenhouses, buy a thousand modern tractors suitable for the average farm size, or build more than 300 cold storage facilities for fruit and vegetables.

Although some investments result from these grants, no obvious improvement in sector performance can be attributed to the schemes. The main reason is a lack of proper selection of beneficiaries and projects. Although a scoring system exists in the Paying Agency, whose responsibility it is to select the most desirable beneficiaries and projects, some issues with selection have identified from stakeholder feedback:

- Potential beneficiaries state that the Paying Agency has limited capacities to make technical determinations and that monitoring is lax
- Selected beneficiaries could not finalise their projects since banks made negative determinations on their projects
- The final project is different from the approved project and there are insufficient instruments nor a willingness to recover the funds
- Some potential grantees are simply applying for projects that they know wills core high rather than focusing on their core areas of expertise

Many of these approaches result in funding not being used efficiently or effectively and projected results are not achieved. Banks should be involved in beneficiary selections since they:

- Have long experience and methodology in evaluating business plans
- Will ultimately be involved in financing the project since in the majority of cases, the beneficiaries are taking loans for project finance

There is an option that the grant scheme, currently implemented as a 40-60 percent subsidy, could be replaced by an interest rate subsidy. The potential beneficiary could take credit for the whole investment, thus rapidly establishing a solid credit history. After taking the credit, the Paying Agency would pay the bank a subsidy on the interest rate. This would amount, depending on the loan, to an effective contribution by the grant of 30 percent or less of the total loan amount, which is an improvement on the present 40-60 percent subsidy.

Table 17: Advantages and Disadvantages of New Scheme

POSITIVE	NEGATIVE
• **Paying agency will be less committed with field inspection and focus on other subsidies and monitoring improvement** • **Better selection of the projects** • **More projects will be financed (subsidized interest rate of 7 percent over five years lead to the overall grant of less than 30 percent, which is lower than current grants)**	• Start-ups will be difficult to be financed • Well collateralized farmers will be at an advantage in comparison with farmers with good project proposals • Fixed subsidized interest rates tend to favor good farmers with lower interest rate

The authors recommend establishing a pilot project to test the effects of subsidized interest rates. The main elements of the proposal are as follows:

- The pilot project should not be less than 10 percent of the total scheme or more than quarter of the overall grant fund
- All banks must be invited to participate in the program to retain competition among banks
- The level of the subsidies must ensure that beneficiaries have an effective zero interest rate and do not pay establishment fees
- The total subsidy should be given in advance to the banks
- Selection of beneficiaries and risks remains with the bank
- Carefully monitor results to ensure that improvements are based on lessons learned
- Establish a special program for start-ups, as follows:
    - Not more than 10 percent of overall grant funding
    - Grantees must pass through special programs designed for start-up projects

Banks' investment in understanding farmers needs and efficiency improvement.

Banks dealing with agriculture in Kosovo must improve efficiency; unfortunately, they are not under any pressure to do so. Scoring models for credit evaluation for small farmers, especially those that are part of a VC, must be refined and developed to improve efficiencies and to enable the smallholder to participate through the aggregation function of the VC.

In the region, many positive experiences and models that have proven to work. Banks and MFIs must invest in understanding agriculture, farmers, the social relationships in rural areas and other behavioral aspects of clients, which will help then to improve their product offerings.

The VC Lending Approach.

The VC lending approach is important for the development of the demand and supply of agri-finance. It secures the market for the farmers on one hand and provides payment security to banks on the other.

AGRO is a USAID project working in VC development in Kosovo. The project works through strategic partners (e.g., aggregators, processors, etc.) and provides a full package of services for selected VCs in the horticulture sector. Grants and activities are developed around strategic partners to achieve sustainability and support the development of these companies to reach markets with their products. The program has been very successful, due to which the GoK is planning to provide €3 million of grant funding to support two sub-sectors using the VC approach: berries and medicinal and aromatic plants.

Input dealers provide loans only to farmers they know. In recent years, input dealers (producers and/or distributors of inputs like seeds, equipment, fertilizer, pesticides) have played a positive role in the development of agri-finance in Kosovo. With support from AGRO, TEB Bank introduced an AGRO Card credit program and recruited farmers to participate a scheme whereby they purchase inputs on credit with the AGRO Card and pay back after the harvest. The input dealer pays a 3 percent fee to TEB Bank.[19] A newly formed agricultural input dealers' association is interested in using this service to improve farmer's access to inputs. However, consideration must be given to counteracting input dealers' tendency to provide loans only to farmers they know (perhaps through better credit risk analysis).

Good examples of VC financing are having positive impact for small farmers. Over the last five years, the VC approach has been shown to be very useful for small farmers and at the same time ensure that marketable quantities of agricultural products are available for export (e.g., raspberries, strawberries, medicinal and aromatic plants). These positive impacts have carried over to other VCs, while banks have started to work more closely with processors and aggregators to identify potential clients. Processors can provide financial support, quality inputs, appropriate advice, implementation of food safety standards, good infrastructure, contracts in advance and, finally, a market for the products. The approach focuses on regions or municipalities in which infrastructure is well developed and farmers are willing to learn about new opportunities. Financing of farmers can be done through processors or aggregators, in which case they take responsibility for the loan (as they have done for USAID grants) or provide guarantees for farmers through recovery on sales using contracts to bind producers to the firm. In the berry and medicinal and aromatic plant sectors, aggregators have contracts with hundreds of farmers and are providing advice and information to their clients on a regular basis. Banks can also support companies by providing working and investment capital supporting increased area under cultivation, in response to market demand.

FIs should improve and speed up application processes. Agriculture companies need bigger loans to complete their investments and to ensure working capital for the season. Unfortunately, banks are not responding to clients at the desired level and lack knowledge of the sector sufficient to advise on the investment and market opportunities. According to agribusiness stakeholders interviewed by IFC, the loan documentation, application, evaluation and decision-making process is too long and costly and discourages companies from expanding their businesses to meet market demand. Agri-businesses also complain that they lack knowledge of business planning and loan management. The EBRD/Pestova company example of VC financing could and should be repeated at least in three other VCs (berries, medicinal and aromatic plants and top fruits) to serve as good examples for other potential clients. This could be done by IFC or other FIs active in Kosovo, whose support should include a full package of advice from the planning stage through exports to Europe or other countries. The application process should be reduced to 6 to 12 months and FIs and banks should assess the capacities of potential participants in more effective ways. Positive examples are usually copied and repeated very effectively in Kosovo.

Use of Big Data and Digital Information.

Use of agricultural big data and digital information can dramatically increase productivity. Services in the region are able to provide NDVI data, for example, every five days, with 97 percent accuracy in the estimation of planted crop (for cereals, fodder and industrial crops) by using satellite images, merged with

[19] A joint venture with BNP Paribas of France. See http://www.teb-kos.com/.

digital cadastral data, weather information, pesticide application records and other field production data, gross margin records and many other features. This data can be provided in real time, is accessible in a user-friendly format and is already used by banks and farmers in the region. Banks and MFIs must retain staff who understand and make use of these new digital technologies in agriculture.

Greater Focus on Profitable Sectors and Investments.

A list of most promising sectors (to include processed food) for agri-financing based on trusted sources as well as expert assessment should be complied. The main criteria during selection of the subsectors are: current market size, current share and trends in production and export, expected demand and price trends in the future, sensitivity analysis, production suitable for SMEs, expected profit margin in the forthcoming period, etc.

Cereals has the largest demand by volume. Majority of Kosovo's farmers are involved in cereals production. Cereals prices have been constantly decreasing over the last six years and this has made cereal production, already a very unprofitable crop, even worse. This situation is reducing profit margins of those farmers, but increasing demand for credit, since it is not possible to finance production from profits.

TYPE OF INVESTMENT: work needs to be done to determine the best type of investments for this SME agricultural sector, but will include improved field equipment, planting and crop protection technologies, etc.

Berries have good trends, expected demand and already well-established examples. These are grown by small scale farmers and larger companies as aggregators. Demand is for working capital (each exporter over 500mt requires approximately €1 million in working capital). Estimation are that sector stabilization will require between €40-50 million for raspberries and €30 million for other berries-primarily blueberry and strawberry.

TYPE OF INVESTMENT: planting material, Irrigation systems, handling facilities with packaging and sorting lines, greenhouses, anti-hail system, cold storage, etc.

Animal husbandry and dairy: large in size, good links with the market and expected investment into processing. Producers and processors involved in these sub-sectors are looking for opportunities to stabilize and improve linkages with the market. Some of them are seeking opportunities to invest in small food processing units or have regular contracts with the main stakeholders in the market-processors or collection centers.

TYPE OF INVESTMENT: new stable facilities, animals, milking system, small processing units, lacto freezers.

Stone fruits-production and processing due to the import substitutions and export possibilities and good conditions for growing stone fruits (plums, cherries, sour cherries) in many areas. Some areas can target late production with good prices and high demand. There is a relatively low market risk due to the many marketing possibilities-selling fresh, frozen, dried (increasing demand in recent years) or processed in different ways (juice, syrups and alcohol).

TYPE OF FINANCING: Cold storage for pre-cooling products, equipment for harvest and post-harvest, setting up new orchards, irrigation equipment, small processing equipment, anti-frost and anti-hail net, etc.

Pepper production is in line with Kosovo production environment. Pepper demand is increasing and due to the high labor requirements, western countries are withdrawing from the production, and prices are increasing. This is a product where economy of scale does not exist at the production level and can be profitable provided production revolves around an aggregator.

TYPE OF INVESTMENT: greenhouses, irrigation equipment and infrastructure, specific mechanization systems, pre- cooling facilities, packaging lines.

Meat processing due to the high demand (consumers prefer local meat products) and requirement for investments for aligning with food safety standards. Aligning with EU will require adopting food safety standards particularly in the meat sector. This will open export opportunities, but also will improve food safety in products for the domestic market. The concept of flexibility in veterinary food safety systems, widely spread among EU countries, will start to be implemented in Kosovo and will create demand for investment with some already registered facilities and start-ups.

TYPE OF INVESTMENT: equipment for slaughtering and meat processing, standards adoption, cold rooms and processed meats product ripening chambers, etc.

Medicinal and aromatic plants have some existing infrastructure and export experience in collection and great potential in cultivation. Approximately 20 thousand people are engaged in the sector. The majority of them are in collection and production for the 9 registered exporters. Demand for medicinal and aromatic plant products in Europe is increasing, which can be met by production increase in Kosovo. This will require investment throughout the VC.

TYPE OF INVESTMENT: dryers, packaging and sorting lines, laboratories, specific production machinery, collection points and vehicles.

Large, private agribusinesses are interested in expanding food processing. Entities with an interest in growing and meeting market requirements are mainly cold storage facilities, collection centers, bigger dairies and farms involved in fruit production. Some of these have reached critical levels of development, but have not completed their process chain. These companies usually want to invest in fixed assets (equipment and construction), with a lesser interest in marketing, food safety and human resource development. This is becoming an obstacle to the companies to become more cost-effective and competitive in the market.

TYPE OF INVESTMENT: added value storage and equipment, packaging and sorting lines, laboratories, specific processing machinery, marketing, etc.

8. Annexes

Annex 1: Priority Investments, by Subsector

SUB-SECTOR	MAIN CHARACTERISTICS	INVESTMENT NEEDED
MEAT	- Characterized by small number of large processing plants - Lack of uniform quality of raw materials and livestock, with predominance of imported frozen and half frozen meat - Meat sector legislation needs to be approximated to EU standards - Very small number of cattle breeding farms - No practice of long term contract between processors and farmers	- Equipment for processing industry to align with EU and national standards - Increase in local production - On farm object for primary production – farm for bull fattening fulfilling requirements - Investment in marketing and promotion - Investment in human resources, especially in middle management
FRUIT AND VEGETABLES	- Sector still in development, trying to position itself in the market - Good potential for import substitution - Limited processing capacity versus installed capacity - Lack of raw material (production) in quantity for processing and high price of purchase can reduce the competitiveness - Limited classification of fruits and vegetables by quality - Limited developed human resources - Kosovo berries are mostly exported to EU	- Grading, sorting, calibrating equipment - Cold storage - Processing facilities - Seedlings - Irrigation infrastructure - Marketing and promotion - Contract farming - Diversification
DAIRY/MILK	- 43 dairies, 41 with active registration with the KFVA - 10 bigger dairies produce over 1 million liters annually; 31 produce fewer than 1 million liters annually - Installed capacity for 604,050 liters per day - Over 1,500 direct employees in processing and around 3,500 in collection and distribution - Number of dairy farmers: 8,200 - The biggest investments are made in dairy/milk - A large number of small, privately-owned dairies, oriented more towards small-scale farmers, are specializing mostly in traditional dairy products (e.g., locally branded cheese) - Low and inconsistent quality of raw milk - High unmet demand for raw milk (limited quantities of raw milk available), resulting in inconsistent quality and quantity of processed products - High competition from imported dairy products - Limited investments in attractive product packaging and marketing and promotion of goods	- Improve collection of milk from farm to dairy (cold equipment) - New farm facilities with proper dairy equipment - New product development - Import substitution - Marketing and promotion
MILLING	- Significant storage capacity, but very limited high-quality storage capacity - Futures markets and warehouse receipts system yet to be developed - Fragmentary structure of the bread-making industry	- Quality storage facility - Diversification of processing
MEDICINAL HERBS & SPICES	- Lack of organized approach and industrial production - Potential for development - Export oriented - Export value around €10 million–long term contracts - Developed system for collection and semi-processing - Potential to produce certified organic products - Lack of competition in medicinal and aromatic plant cultivation - High potential for growth: only 10 percent of wild products are collected; cultivation is increasing	- Dryers and other type of processing equipment - Organic certification - Human resources - Focus on production - Added value with further processing
WINE	- Dual structure: (i) large, recently privatized wineries and (ii) recently established, small and medium-sized privately owned wineries - Competition from imported wines - Limited local consumption - Poor quality and consistency - Poor branding and marketing - Limited availability of raw materials - Limited availability of wine-specific varieties	- Processing equipment - Marketing and promotion - Human resources - Product standardization - Develop new market channels