

A brief assessment of the dairy industry in Kosovo

March 2016



1. Introduction

Development of agriculture plays a key role in the replacement of imported products and the improvement of trade balance. Agricultural lands in Kosovo are very fragmented (on average 0.15-0.18 hectares per person), while the number of agricultural households is 129,220¹. This structure creates opportunities for the production of various types of crops, which provide new jobs, food security and improve the lives of people in rural areas where poverty is more pronounced.

Kosovo government in its government program 2015-2018 and the National Program of Economic Reforms 2015 has prioritized the development of agriculture as one of the most realistic ways of improving the trade balance and growth of employment². To this end, measures were taken to support local producers, ranging from doubling the budget for the agricultural sector, the elimination of VAT for agricultural raw materials and manufacturing machinery and planning for construction of irrigation capacities.

However, despite this effort, local manufacturers continue to face a chain of problems related to access to domestic and foreign markets. In recent years, the most significant problems were observed in the dairy industry, where the increasing share of imported dairy products has threatened the existence of many local farms.

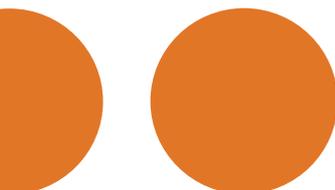
Kosovo associations of dairy producers and processors have organized various protests demanding higher government controls on imported milk products because of dumping practices - lower prices than in the country of origin - or have plant origin and are sold on the market as animal products³. According to these associations, all these irregularities cause the prices of imported products to be lower than local ones, and this threatens to close many farms that in total employ about 40 thousand people.

Therefore, given that milk is one of the most strategic sectors, which due to daily use enables hiring a large number of farmers, in this

¹ MAFRD, Green Report 2014, accessed on 21.10.2015, <http://bit.ly/1F5RAz6>
Kosovo Agency of Statistics, Number of agricultural households, accessed on 24.10.2014
<http://bit.ly/1QIUD6y>

² Program of the Government of the Republic of Kosovo, accessed on 7.3.2016,
<http://bit.ly/1LBjNFP>
National Program for Economic Reform 2015, accessed on 03.07.2016,
<http://bit.ly/1FklShc>

³ Interview with Ramadan Mema, Association of Milk Producers and Processors, interviewed on 02.07.2015.



study, GAP Institute has analyzed concrete problems of this sector and herein provides recommendations for ways of improving the current situation.

2. Milk production and the processing sector

2.1 Production

The last war in Kosovo severely damaged the dairy sector, causing thousands of farms to be burned and brought about the destruction of some 50% of livestock⁴. The drastic drop in milk production led to increasing unemployment and trade deficit in food stocks, while the options to develop this sector through investments were almost impossible due to the limited access of farmers to credit services.

First initiatives for the construction of a dairy sector were undertaken by various international organizations such as USAID and the Swiss Agency for Development and Cooperation which assisted farmers with various grants in the construction and renovation of barns, milking equipment, cooling (lacto-freezer) and other accompanying infrastructure⁵. These investments were aimed at the transition from personal and informal production to commercial or market production.

On 4 April 2007, the Government of Kosovo for the first time approved the Agriculture and Rural Development Plan (ARDP) 2007-2013, which created the first policy support for the establishment of commercial milk production⁶. Therefore, since 2010, the Ministry of Agriculture, Forestry and Rural Development (MAFRD) began distribution of direct payments of 30 euros per cow to farmers who possessed a minimum of five cows. Table 1 shows the trend of direct payments and beneficiaries over the years.

⁴ USAID, Kosovo dairy value chain case study, accessed on 3.7.2016, <http://1.usa.gov/1QIVhRw>

⁵ USAID, Kosovo dairy value chain case study, accessed on 3.7.2016, <http://1.usa.gov/1QIVhRw>

⁶ MAFRD, Agriculture and Rural Development Plan, accessed on 3.7.2016, <http://bit.ly/1F5TSy8>

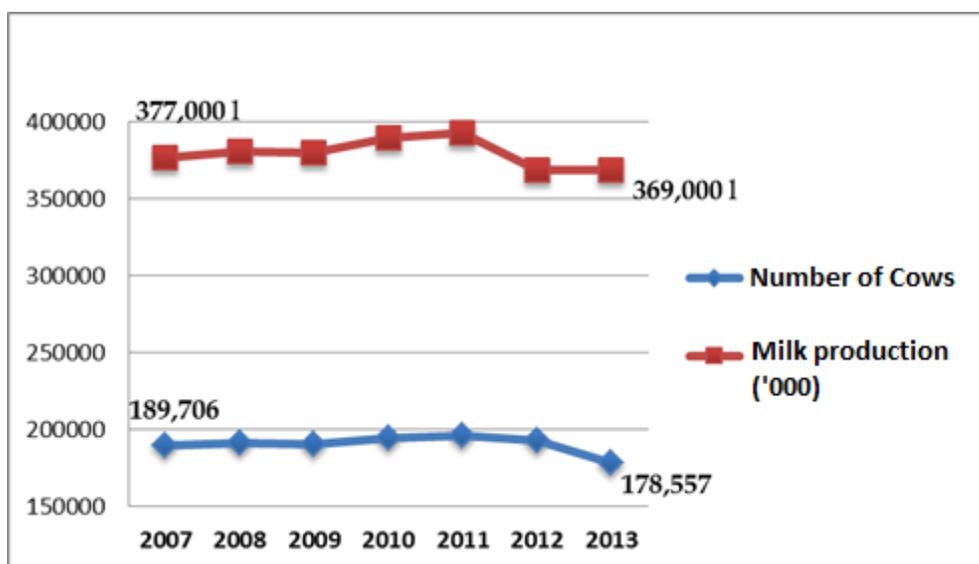
Table 1: Direct payments in years

Year		2010	2011	2012	2013	2014
Milk cows	Number of beneficiaries	4,287	4,162	5,231	5,075	5,472
	Payment per person	€30	€30	€50	€50	€50
	Total amount paid	€1,108,380	€992,340	€2,104,800	€2,105,950	€2,211,750

Source: MAFRD

These investments are aimed at increasing the number of cows and therefore local production. However, in Figure 1 we see that in 2013 the number of dairy cows and the level of production reached its lowest level since 2007. This decline is worrisome since domestic consumption of dairy products has increased, but this increase is covered by imported products.

Figure 1: Milk production in years



Source: GAP Institute, based on data from MAFRD

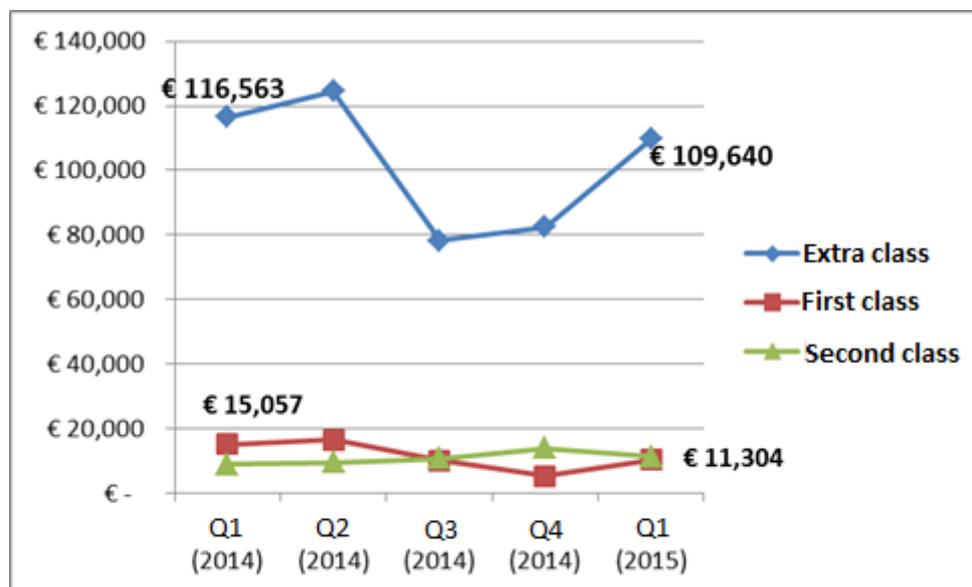
Besides direct payments for dairy cows in 2014, MAFRD also created financial incentives for farmers to produce quality milk. Thus, extra quality milk has a bonus of 0.06 euro/liter, followed by first class milk (0.04 euro/liter), second class (0.02 euro/liter) while third class milk has no bonus⁷.

This support structure is aimed at motivating farmers to improve the quality of milk they send to processors. However, even with respect to these policies it is noted that compared to the first quarter of 2014,

⁷ MAFRD, Agricultural Development Agency (ADA), accessed on 9.19.2015, <http://bit.ly/1iBeW5K>

in 2015 the number of beneficiaries of extra class and first class bonuses is 6% lower. Figure 2 shows a decrease from 116,563 euros in the first quarter to 109,640 euros this year.

Figure 2: Milk payments by quality



Source: MAFRD

The assessment of two cases of subsidies reveals that agricultural policies have not shown positive results with regards to increasing the quantity and quality of milk. Consequently, the current farm structure remains extremely heterogeneous, with 94.2% being family farms with 1-5 cows, while only 5.8% are commercial farms with over 5 cows⁸. This structure creates difficult conditions for achieving economies of scale and thus improve competitiveness in Kosovo and foreign markets.

2.2 Processing

Besides production, according to the Food and Veterinary Agency (FVA), there are 43 processing companies in Kosovo that collect milk from farmers and process it into products with added value such as cheese, sour cream, yogurt, ayran, sterilized milk, etc⁹. Some processors are supplied directly by farmers who produce large quantities of milk, while some others collect milk at collection centers where farmers with small capacities send milk to a collection point.

⁸ MAFRD Milk Market Analysis, accessed on 7.3.2016, <http://bit.ly/1p1Y0ld>

⁹ Food and Veterinary Agency (FVA) List of approved facilities for the processing and packaging of milk, accessed on 9.20.2015, <http://bit.ly/1OBM29J>

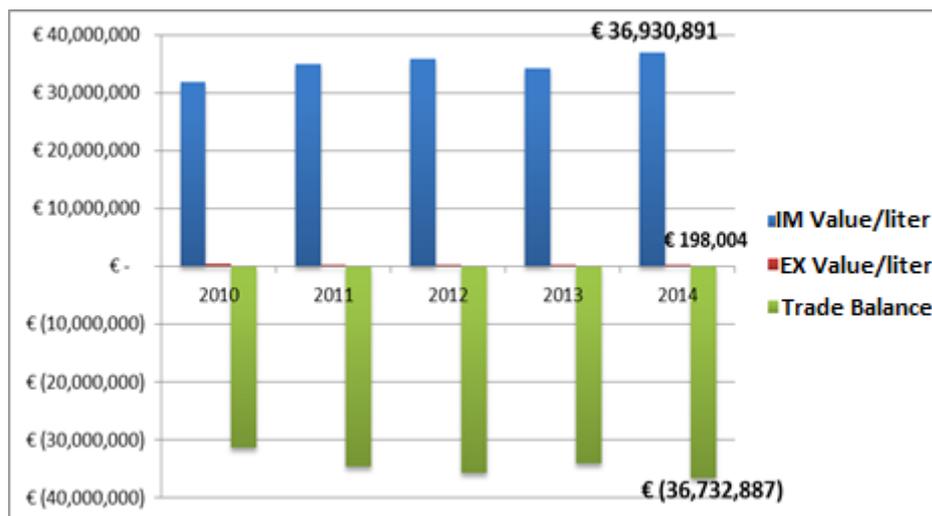
Both producers and dairy processors benefit from many international donations that have assisted in the construction and modernization of milk processing factories. However, their further development is limited due to the market which, according to processors has no statutory regulation for certain categories of products.

For this reason, in 2015 the associations of milk producers and processors organized several protests where they demanded a ban on import of products of plant origin and the opening of an investigation on some products that may have been dumped or subsidized for export¹⁰.

3. Import vs. local production

During a five-year period (2010-2014), Kosovo has imported about 194 million liters of dairy products with a value of approximately 174 million euros. Figure 3 shows that during 2010-2014 imports increased constantly, whereas in the period 2013-2014 the growth trend accelerated and increased by 8% the value of imports.

Figure 3: The trade balance of the value of dairy products in Kosovo



Source: Kosovo Customs, processed by GAP Institute

In 2014, the value of imports of dairy products totaled nearly 37 million euros, while exports were worth a total of 200 thousand euros. This imbalance between import and export has deepened the trade deficit to more than 36 million euros, which is also the highest point recorded since 2010. Imports of dairy products to Kosovo comes from Slovenia (37%), Hungary (17%), Bosnia and Herzegovina

¹⁰ Interview with Zef Deda, MTI, interviewed on 18.09.2015.

(12%), Germany (11%), Serbia (9%), Macedonia (8%), and other countries (5%)¹¹.

According to the data from the Kosovo Customs, imports of dairy products from Serbia went from 327 thousand kilograms in 2013 to 3.8 million kilograms in 2014. Expressed in monetary value, the import of dairy products from Serbia cost Kosovo 2.75 million euros in 2014¹².

This import increase comes despite the fact that Kosovo has a great potential in terms of milk production and processing in order to cover domestic demand. In 2013 alone, Kosovo farmers produced nearly 369 million liters of milk. However, of the total production, only about 49% was placed in the formal market by dairy processors, while the rest was used as feed, for own consumption, or sold by farmers in informal markets¹³. All this production covered domestic consumption to around 84%, while the rest was imported.

In interviews with some of the major milk processors, we see that this sector does not use even 50% of the installed capacity because there isn't sufficient demand in the market for domestic products. Table 2 shows the ratio between production and capacity of four milk-processing companies¹⁴.

Table 2: Milk production, production capacity and capacity utilization of the five largest local processors

Company	No. of employees	Daily production /liter	Daily capacity/liter	Capacity utilization	Types of Products
Bylmeti	53	15,000	37,500	40%	6
Sharri ¹⁵	28	13,500	/	/	7
Kabi	32	12,500	25,000	50%	5
Vita	186	25,000	50,000	50%	15

Source: GAP Institute

From this chart we see that in terms of processing, Kosovo could double production if demand in the market for local products would increase. Also, employment is multiplied with the increasing capacity utilization, economies of scale are improved, and better opportunities for export to international markets are offered.

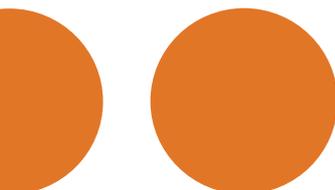
¹¹ Kosovo Customs data for 2014

¹² Kosovo Customs data for 2014

¹³ MAFRD, Green Report 2014, accessed on 07.03.2016, <http://bit.ly/1F5RAz6>

¹⁴ Interview with the owners of milk processing companies (Bylmeti, Sharri, Kabi, Vita), interviewed on 21.07. 2015 and 22.07.2015.

¹⁵ Dairy company Sharri-Prizren



However, these opportunities are currently not being utilized because, according to the associations of milk producers and processors, domestic prices are not competitive with the prices of imported products that enter the market illegally by way of dumping, subsidies or by being of plant origin and sold as animal products.

In a survey conducted by IQ Consulting, it appears the main reason why Kosovar consumers buy imported products is the cheaper price in the market¹⁶. Therefore, following that logic, we analyze the main difficulties that hinder local producers and processors from becoming more competitive in Kosovo and foreign markets.

4. The unfair competition with foreign products

Since 2010 MAFRD allocates millions of euros in the development of the dairy sector and the sector worsened every year. Official MAFRD data show that domestic production marks the lowest point since 2007, while imports of dairy products are growing steadily¹⁷.

Improving the competitiveness of local producers requires proper functioning of some value chains consisting of producers, processors and retailers to final consumers. Until now, support for the dairy sector has been limited to manufacturing and processing, and the market control is overlooked.

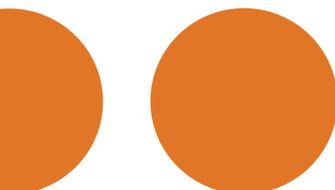
In this analysis we see that problems in the dairy sector arise from non-policy coordination between ministries, like the MTI and MAFRD. As a result, dairy producers and processors are not competing against some importers due to the uncontrolled market, inadequate agricultural policies, low efficiency, limited access in finance, and insufficient marketing and diversification.

4.1. Lack of control of imported products

One of the main reasons why some imported dairy products are found on the market with lower prices than the domestic ones is a lack of proper control of imports.

¹⁶ IQ Consulting, Import Substitution Study for the Dairy Market in Kosovo,

¹⁷ The official data of MAFRD and Kosovo Customs shown in Figure 1, 2, 3.



As a result, some foreign manufacturers exploit the situation and enter the market with dumped (price below the cost of production) or subsidized products that harm domestic production and are in violation of the free market competition practices.

Dairy producers and processors, as they perceive the Kosovo Competition Authority as almost nonexistent, presented their doubts this year to the MTI that some products may be dumped. MTI under the Law on Anti-Dumping and Countermeasures initiated a probe which revealed that some companies in our market have marketed milk products without a profit margin¹⁸.

The companies stated that sales were made during the summer sales and they were not dumped¹⁹. However, MTI suspects that these companies have spent the time allowed for sales and did not place the "Sale" sign as required by the Law on Consumer Protection²⁰. Exceeding the time limit for such sales is considered a form of dumping.

In addition, products are found in our market that are labeled as dairy products, while they are liquids of plant origin with ingredients such as palm oil and other vegetable oils. These products are sold on the same shelf with dairy products, which is considered manipulation under Article 53 of the Law on Consumer Protection²¹. Such violations were identified in 2014 when five companies were suspended for rigging product declarations²².

Such actions of exporters aim at entering the market at prices below the cost of production and through this they aim to discourage local production. These practices are contrary to the laws on free trade in Kosovo.

¹⁸ Interview with Zef Dedaj, MTI, interviewed on 18.09.2015, MTI based on Article 17 of the Law on anti-dumping and countermeasures, has initiated a probe, accessed on 01.10.2015, <http://bit.ly/1GsscPd>

¹⁹ Interview with Zef Dedaj, MTI, interviewed on 18.09.2015.

²⁰ Law no. 04/L-121 on Consumer Protection, Article 19, accessed on 21.09.2015, <http://bit.ly/1V5cJ3o>

²¹ Law no. 04/L-121 on Consumer Protection, accessed on 07.03.2016, <http://bit.ly/219tmJ5>

²² RTK, Subsidy Program, Dairy industry in Kosovo, 16.01.2015, accessed on 05.08.2015, <http://bit.ly/1LHwNPa>

4.2. Inadequate agricultural policies

In the short run, the current scheme of MAFRD subsidies increases the income of farmers, but in the long run impedes the development of dairy sector because it supports and sustains even those farmers who are not productive.

The aim of subsidies is to provide incentives for the reform of the sector which, in the case of Kosovo means (i) a change in the structure of farms and transition from own production (inefficient) to commercial production, (ii) increase in production, and (iii) improving quality. Meanwhile, the current subsidy scheme is not effective in meeting any of these purposes.

The payment of 70 euros per cow did not encourage farmers to invest in improving the race or the manner of feeding a cow which would increase the yield of milk because the mere possession of five or more cows guarantees a subsidy. For this reason, today we have 60% of the cattle of "mixed" breed with low productivity, and 35% of "high" breed with high yield. These policies do not offer motivational mechanisms for breeding improvements which raise efficiency and domestic production.

Table 3: Breed structure of dairy cows and milk production in 2013

Source: MAFRD

Breeds	Share %	No. of cattle	Milk production / ton	Milk production / liter
Busha	5	9,167	5,134	5,133,520
Mixed breed	60	114,388	167,756	167,756,100
High breed	35	64,169	195,715	195,715,450
Total	100	187,724	368,605	368,605,070

Also, as shown in Figure 1 and 2, support schemes are failing to show a positive result either in production or increase of milk quality. Subsidies in the form of social assistance raise farmers' incomes in the short term, but hinder the development of the sector in the long term.

MAFRD is unable to identify farmers who have large production potential and support them in the development and modernization of their activity. All developed countries have helped farmers to specialize in their production in order to be more competitive with other producers.

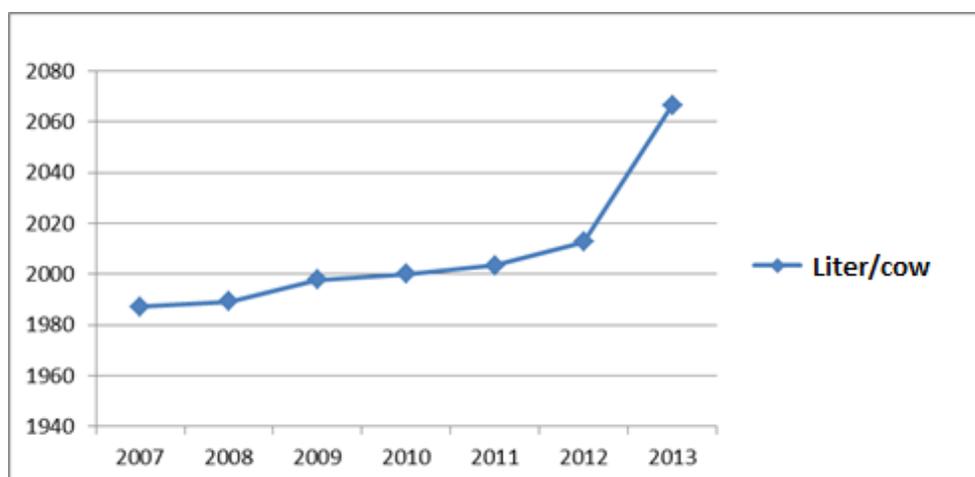
On the other hand, farmers who fail to develop in this sector should find their comparative advantages in other sectors.

4.3. Low efficiency

Production and processing of local milk is characterized by low efficiency and this leads to higher market prices than the products of the region.

Although in 2013 farmers managed to significantly improve the productivity and performance of dairy cows in comparison with countries in the region, their efficiency still remains low. Figure 4 shows the production in liters per milk cow during 2007-2013.

Figure 4: Annual milk production in liters per dairy cow



Source: MAFRD, processed by GAP Institute

Currently, the average milk production per cow is 5.7 liters per day, while in Serbia and EU countries it is around 8.2 liters and 17 liters respectively²³. Therefore, despite increased productivity, local farmers still have room to raise efficiency through improved methods of feeding cows and breed improvement.

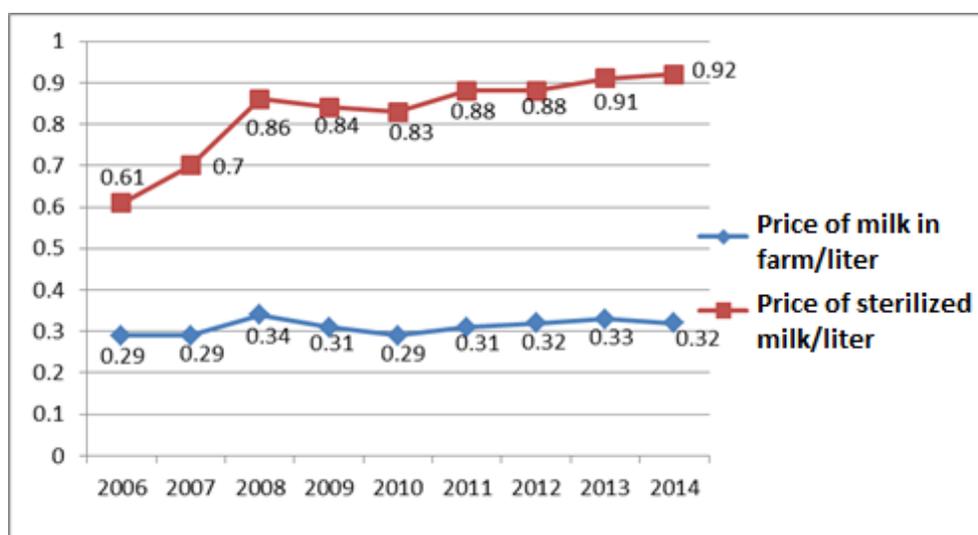
Even dairy processors operate at low efficiency; they do not use even 50% of their capacity, while they pay same overheads.

Also, processors face high transport costs since, apart from local processor Vita, others have not installed ultra-high temperature (UHT) packaging technology, which enables storage of milk for a

²³ Perspectives of the Serbian dairy sector in the process of integration into global markets, accessed on 18.09.2015, <http://bit.ly/1FWNPa7>

longer period of time²⁴. As a result, local processors are forced to transport milk to the market on a daily basis. This is reflected in the difference between the price paid to farmers, which is competitive in the region, and the price charged by processors, which is very high and with a growth trend.

Figure 5: Milk prices over a span of several years



Source: MAFRD

5. Limited access to finance

Compared with other sectors, agriculture is the sector which faces the biggest problems in access to loans. The total share of the agricultural sector in crediting is less than 3.6%, which is an obstacle to the development of this sector²⁵.

In order to increase lending to agriculture, on September 26 2012 MAFRD, in collaboration with USAID and six commercial banks in Kosovo²⁶ established the Development Credit Authority (DCA), which has a fund that guarantees 50% of commercial banks' loans.

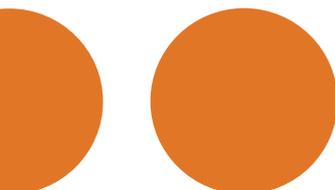
This project is scheduled to run until 2020 and aims to reduce interest rates to 10%. Three years after the establishment of this fund, the interest rates for agriculture fell by only 3-5%, while non-performing loans were only five of 193 loans issued²⁷.

²⁴ Interview with the owners of milk processing companies (Bylmeti, Sharri, Kabi, Vita), interviewed on 21, 22.07.2015.

²⁵ CBK Financial Stability Report 2015, accessed on 07.03.2016, <http://bit.ly/1N9N5RL>

²⁶ Raiffeisen Bank, TEB, ProCredit Bank, BKT, NLB and Banka Ekonomike

²⁷ GAP Institute, the Kosovo loan guarantee Fund, accessed on 07.03.2016 <http://bit.ly/1j1UJpz>



As of late, MTI has drafted a bill on the establishment of another fund to guarantee loans, which aims to increase farmers' access to credit. However, discussion with dairy producers and processors reveal that the sector continues to face numerous difficulties, both in terms of qualifying for a loan and the high interest rates, and this hinders the development of agribusinesses.

6. Insufficient diversification and marketing

Another obstacle to the sector is the fact that local processors are not proactive towards market demands. In most cases, they offer only a limited number of products and are not creative and innovative in providing product diversification. For example, Kosovo processors still do not produce products such as fruit yogurt, high quality yellow cheese, cheese with different spices which are consumed in Kosovo. Due to a lack of professional staff in Kosovo they are not produced, but instead imported.

Also, processors of dairy products have not invested enough in marketing, be it individually or supported by the government or other organizations. Currently there is no targeting of cities or businesses that consume substantial quantities of milk and use imported products. Marketing in this sector is often considered as an expense and not an investment.

7. Unfavorable new fiscal package

Changes in the new fiscal package, namely the amendments to the tax on personal income, are considered as unfavorable by the Association of Milk Producers. This Law provides that each farmer who delivers milk to the milk collection points for a total annual value below 30 thousand euros is obliged to pay a profit tax of 3%²⁸. Implementation of this Law is estimated to increase the milk output gap, since it will affect the income of farmers.

Problems with this Law are also related to its implementation since processors or collection points are required to collect this tax from farmers after delivery of milk and pay it directly to the Tax Administration of Kosovo (TAK), along with the processors' other taxes.

²⁹ Law no. 03/L-061 on Personal Income Tax, Article 43, paragraph 2, sub-paragraph 2.1.1, accessed on 07.03.2016, <http://bit.ly/1Rse8JZ>

Conclusions and recommendations

This report analyzed the situation of the dairy sector, its problems and potential. The dairy sector faces major problems, as production in 2014 reached the lowest point since 2007, while imports reached the highest point.

In the short-term period, the obstacle to the development of the dairy sector is the presence of dumped and subsidized products in the market, along with consumer manipulation. In the long term, supporting policies do not address the structural problems of the dairy sector.

The report also identifies some other problems such as low efficiency of producers and processors, insufficient marketing, difficult access to finance, and high interest rates.

These problems have resulted from the failure of policy coordination between economic institutions and insufficient monitoring of the results of these policies.

Therefore, considering the great potential of the dairy sector to increase employment and improve the trade balance, GAP Institute offers some recommendations that are based directly on the main problems of this sector.

For MTI:

- After the probe, it should launch a formal investigation of officials of companies which allegedly engage in dumping and which are in violation of Article 19 of the Law on Consumer Protection (sales);
- The Evaluation Committee should recommend to the Government of Kosovo interim measures (Article 19) to ban the import of products which are suspected of being the dumped or subsidized until the investigation is completed, as prescribed by the Law on Anti-Dumping and Countermeasures;
- Increase due diligence on companies which damage local producers by violating consumer protection laws through illegal and manipulative labeling and product placement;
- Issue an administrative instruction that clearly identifies dairy products of animal and plant origin and which prescribes that

they must not be sold on the same shelf because it is contrary to the Consumer Protection Law (Article 53, Deceptive Practices);

- Mandate that inspectors examine the sale of products, implementation of the Administrative Instruction regarding the physical separation of plant and animal products, as well as implementation of the the Law on Consumer Protection;
- Inform Kosovo Customs on taxation on dairy liquids (of plant origin) and discontinue the practice of customs entry of such beverages as dairy products or impose an excise on plant products;

For MAFRD:

- Replace direct payments for dairy cows with payments for the amount of milk produced, like several regional countries. This will motivate farmers to improve feeding practices of cattle, change the breeding structure, and increase the number of cows;
- Increase the amount of direct payments that are dedicated to the quality of milk and reduce bureaucratic obstacles for beneficiaries of such payments;
- In cooperation with municipalities, provide technical and financial assistance to associations of milk producers and processors to organize information and awareness campaigns in all municipalities of Kosovo for the quality of local milk;

For MF:

- Suspend the implementation of Article 43, paragraph 2, subparagraph 2.1.1., for the 3% tax foreseen in the Law no. 03/L-061 on Personal Income Tax;

For processors:

- Examine funding opportunities to purchase ultra high temperature (UHT) packaging technology, which will reduce operating costs and the final price in the market at the same time;
- Diversify dairy products to conform to market demands;
- Target different cities and businesses that consume more imported products with various offers;
- Invest in increasing efficiency or lowering the price in order to become more competitive with imported products.



GAP Institute is a Think-Tank established in 2007 in Kosovo. The main goal of GAP is to attract professionals to create an environment of professional development and research, which is encountered in similar institutions in western countries. This also provides the opportunity to Kosovars for researching, developing and implementing projects with the aim of advancing Kosovar society. This Institute's priority is to mobilize professionals in addressing economic, political and social challenges of the country. The main goals of GAP are to fill the gaps between the Governments and the citizens, and also fill the gaps between problems and solutions.

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