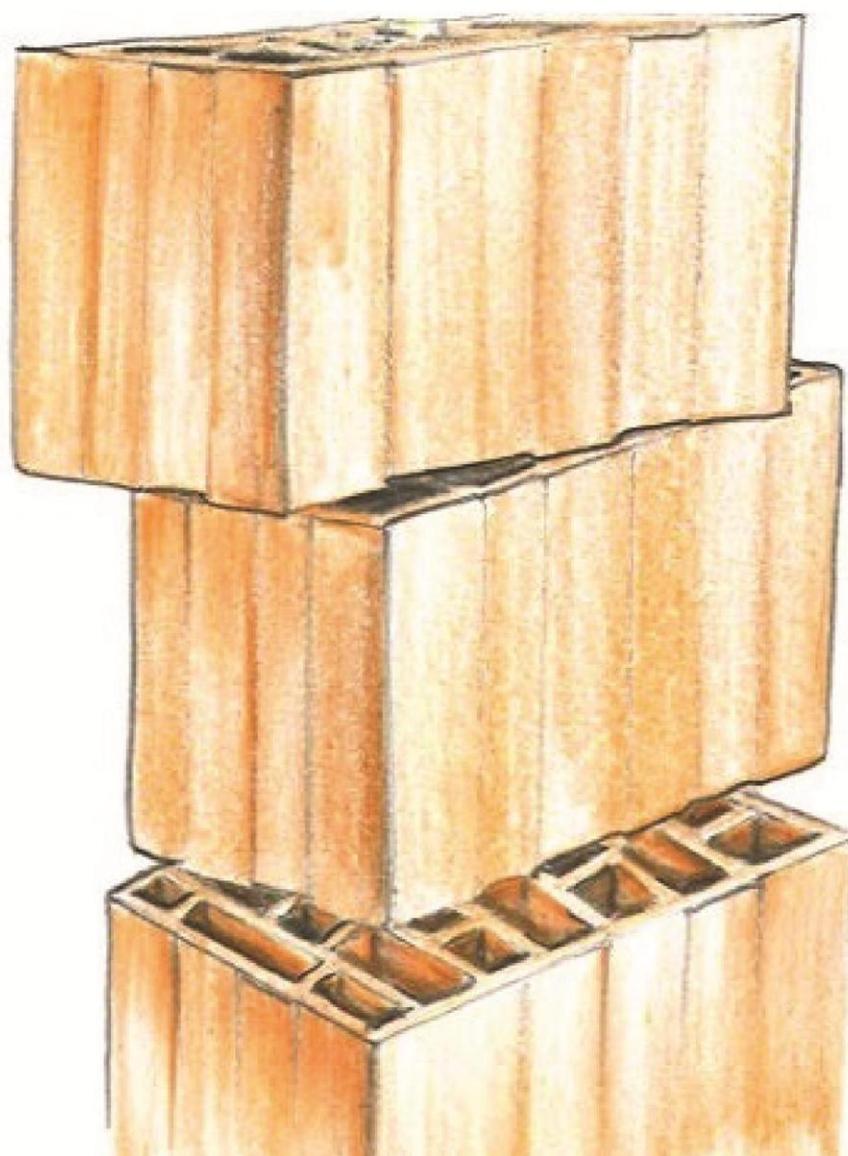


The potentials of brick manufacturers in Kosovo

March 2016



1. Introduction

Two of the biggest problems in the field of economic development faced by Kosovo are unemployment and large trade deficit. According to official statistics, unemployment in Kosovo is 35.3%, whereas among younger age groups it amounts to 61%.¹

Kosovo's trade deficit, according to the statistics from December 2014, reached over 2.2 billion euro. Exports cover 12.8% of imports at an equal level with December 2012, but at a lower level than in December 2010, when exports covered 13.7% of imports.²

High unemployment and trade deficit are based, inter alia, on the low level of domestic production. According to the Structural Business Survey 2008-2013, active manufacture businesses in Kosovo make up 9.9% (2008) to 12.9% (2013) of total active businesses in Kosovo.³

In 2014, from 9,404 new registered businesses, 978 of them or 10.3% were manufacturing enterprises.⁴

The government of Kosovo has set its priority to reduce the trade deficit, boost employment, and assist manufacturing businesses. These priorities are listed in the Government Program 2015-2018, the Medium Term Expenditure Framework (MTEF) 2016-2018, and the National Reform Program in Economics 2016.

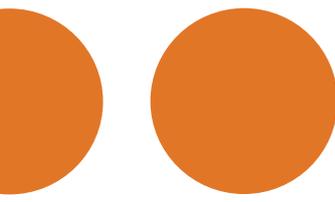
In order to increase investment in production, the government of Kosovo has also adjusted tax policies. With the amendments to the Law on Value Added Tax (VAT), which are expected to take effect in the second half of 2015, production lines are exempt from VAT. According to the MTEF 2016-2018, this move is expected to improve the liquidity of local manufacturing businesses; in the medium term it will encourage growth of private investment, domestic production and creation of new jobs; and in the long term would enable a

¹ Kosovo Agency of Statistics. Results of the Labor Force Survey 2014 in Kosovo. June 2015

² Kosovo Agency of Statistics. Survey results. Foreign Trade Statistics December 2014.

³ Kosovo Agency of Statistics. The results of the Structural Business Survey 2008-2013.

⁴ Kosovo Agency of Statistics. Statistical Repertoire of Economic Enterprises in Kosovo (TM1-2015). May 2015.



gradual increase of competitiveness of Kosovo businesses in international markets.⁵

To contribute directly to government policies for sustainable economic development, GAP Institute has issued a series of reports that analyzed specific problems faced by local producers and provided recommendations for their elimination.

This report analyzes the main problems of brick manufacturers, such as customs duties on raw materials, high price of electricity during the winter season, clay exploitation procedures, lack of human resources, and other barriers on the export and sale of products.

2. Construction sector

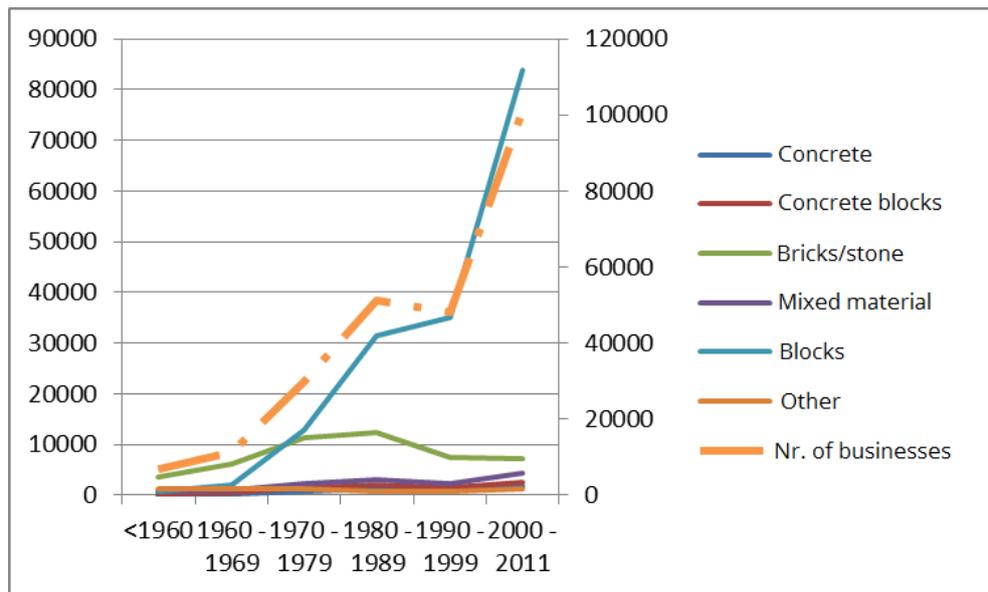
The construction sector is one of the sectors which experienced a dynamic growth in the period following the Kosovo war. The largest increase occurred mainly in the Prishtina region. In the last decade, the construction sector has grown much more than in the 1980s and 1990s combined.

According to KAS, by 2011 there were 247,949 buildings in Kosovo which contained 412,884 housing units.⁶ In the period 2000-2010, an average of 9,135 buildings were built per year, or around 100 thousand for 10 years. Compared with the past two decades, the number of new buildings has doubled over the last decade.

⁵ Ministry of Finance. Medium Term Expenditure Framework 2016-2018. Adopted by the Government of Kosovo on April 29, 2015, with decision 09/25. Source: <http://bit.ly/1KP3AS3>

⁶ Kosovo Agency of Statistics. Dwellings and Buildings - by municipalities. December 2013. Source: <http://bit.ly/1NJNiqc>

Figure 1. Number of buildings constructed over the years and construction material used



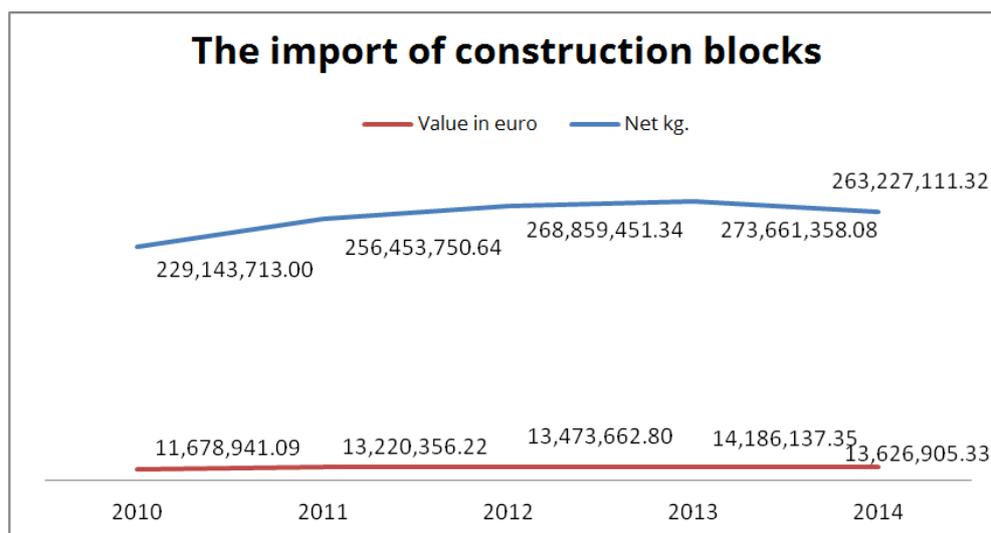
Source: GAP Institute, based on data from KAS

Regarding the construction material, Figure 1 shows that in the last decade, buildings constructed using red clay blocks have seen a significant growth of over 140% compared to other construction materials.

3. Local production versus imports

In the past five years (2010-2014), Kosovo has imported over 1.3 billion kilograms of clay-based construction materials, with a total monetary value of over 66 million euros.⁷ Figure 2 shows that in 2010-2013 imports have increased both in monetary value and quantity.

⁷ Data obtained from Kosovo Customs, at the request of GAP in March 2015. The data presented are from 690410 and 690490 tariff codes.

Figure 2. Imports of construction blocks 2010-2014

Source: GAP Institute, based on data from Customs

Based on the value, as well as on the amount in net kilograms, Kosovo imports the construction material mainly from Serbia (80%) and Albania (18%).⁸ In 2011, Kosovo constituted 33%⁹ of the export market of Serbian producers of clay-based construction material.¹⁰ Expressed in monetary value, from 64.4 million dollars (45 million euros) of export, almost 21 million dollars (15 million euros) worth of materials was exported to Kosovo.¹¹

There are eight manufacturers of clay-based construction materials which operate in Kosovo which cover about 60% of domestic demand for these materials.¹² Factories producing clay-based construction materials are mainly former socially-owned enterprises, privatized by the Privatisation Agency of Kosovo (PAK). These enterprises represent one of the few examples of successful privatization.

Table 1. Characteristics of local producers

Factory	Location	No. of employees	Product ion lines	Types of production	Amount of annual production (average)
Brickos	Crep/Crep ana, Municipality of	85	2	7 types of blocks	10-12 million blocks

⁸ See Annex 1 and 2

⁹ See Annex 3

¹⁰ Industrija glinenih proizvoda Srbije. Bilten broj 31. 2011.

¹¹ Ibid.

¹² Calculation of GAP Institute

	Ranilug/Ranillug				
"Vëllezërit Geci"	Skenderaj/Srbica	100	1	9 types of blocks	6 million
Tulltorja	Landovica, Municipality of Prizren	150-170	3	7 types of blocks	27 million blocks 3 million bricks
Niki-S*	Gjakova/Đaklova	274	2		/
Ringovi i Ri	Peja/Peć	12 regular and 41 seasonal	1	1	2 million 14 thousand
Rizam Holding	Krushë e Madhë/Velika Kruša	83	2	8 types of blocks	12.3 million
Eurobllok	Podujeva/Podujevo	50-60	1	6 types of blocks	around 5.4 million
Tulltroja Apollonia	Obiliq/Obilić	65-70	1	Thermo block, liners, hollow and manta	around 10 million

* At the time of the visit (in March 2015), the factory "Niki-S" was not working.

Almost all these factories have at least one production line and in total employ about 850 people. After privatization, some factories invested in new production lines.¹³ The construction of a new production line, which can produce an average of six to ten million blocks per year, requires an investment of nearly 5.5 million euros. However, access to finance remains one of the biggest problems. High interest rates on loans are a serious obstacle for the majority of owners to build or operate a production line.¹⁴

Based on a rough estimate, in order to replace imports in Kosovo there is room to invest on six local production lines with an average capacity of 10 million blocks per year. According to GAP Institute calculations, in case of such an investment, the number of employees in this sector will increase by about 500. It is worth noting that a new manufacturing plant in Klinë/Klina is in the process of construction and is expected to increase the local production capacity of these materials.

¹³ "Brickos" and "Tulltorja" factories have each added a new product line after privatization.

¹⁴ According to one of the "Geci brothers" factory owners, Mr. Nehat Geci (interview conducted on February 26 2015), an investment of about 6 million euros is needed to operationalize the second production line, which cannot be borrowed from local banks due to a high interest rate. On the other hand, "Tulltorja" factory has been lucky because they received a soft loan investment from the European Bank for Reconstruction and Development (EBRD).

Table 2 shows the decline of prices of local clay-based products in most categories.¹⁵

Table 2. Price trends in Euro of local clay-based products

	2011	2012	2013	2014	2015
Hollow 12 block 19x20x20		0.24	0.25	0.24	0.20
Euro block 20 dim 25x20x19 toothed block	0.23		0.20	0.18	0.19
Standard block dim. 25x20x19	0.29	0.31			
Masonry blocks dimension 19x19x25	0.29	0.29	0.25	0.22	0.21
Masonry blocks dimension 12x19x25 - G2			0.22	0.20	0.19 ¹⁶
Masonry blocks dimension 19x19x25 - G6			0.27	0.24	0.23
Masonry blocks dimension 12x19x25	0.27	0.25			
Eco block 19x20x25		0.22	0.22	0.21	0.17
Production of standard bricks 250x120x6.5	0.08	0.09	0.09	0.09	0.09
Thermo block 12 x 20 x 25				0.21	0.15
Thermo block 19x20x25 - 2	0.19	0.19	0.19		
Thermo block 19x20x25 - 1	0.22	0.22	0.22		
Thermo block 2 19x20x25 Fermorala				0.24	0.20

Source: Kosovo Agency of Statistics

In Table 3 we compared the prices of domestic production of some kinds of clay-based construction materials with import prices of these products from Serbia as stated by the Kosovo Customs (without VAT). Despite falling prices of domestic production, in both cases it shows that import prices are cheaper compared to domestic production, while only thermo block made domestically is cheaper.

Table 3. Prices of domestic production and imports

Import	Price per unit	Domestic production	Average price
Simple bricks II class 25x12x6.5cm	0.08	Production of standard bricks 250x120x6.5	0.09
Thermo bricks 25x19x19	0.29	Thermo block 2 19x20x25 Fermorala	0.24
Division block 250x190x120	0.18	Masonry blocks dimension 12x19x25 - G5	0.20

Source: Statistical Agency of Kosovo and Kosovo Customs

¹⁵ It is worth noting that, according to local producers, names of products used by the Kosovo Agency of Statistics are problematic and in some cases prices are incorrect.

¹⁶ According to local producers the price of this product is 0.17 cents

4. Difficulties faced by local producers

In general, local producers have managed quite well to expand in the domestic market and cover the demand for construction material.

However, they face some difficulties. Access to finance is not the only problem. Other problems faced by local producers are customs duties on raw materials, electricity prices and higher winter tariffs, procedures for clay exploitation, human resources, non-tariff barriers to export, and lack of marketing.

I. Customs duty on petroleum coke

One of the imported materials for production of construction materials is petroleum coke, known as petcoke. Petcoke is used for heating kilns for heat treatment of blocks and other materials produced from clay. According to producers, petcoke reaches a high percentage of the cost of production.

The Customs duty on this basic production element is the standard 10%. Local producers have sought to remove this duty¹⁷ in order to compete with import prices.

Petcoke constitutes 14% of the overall amount of imported petroleum products in Kosovo.¹⁸ Local producers spend about 30 thousand tons of petcoke per year.¹⁹ One kilogram of petcoke costs about 13 cents on the market and exemption from customs duty would reduce the price of the raw material by one cent per kilogram. For example, the difference between the price of local bricks and those imported from Serbia is one cent.

¹⁷ The Clay-Based Construction Materials Manufacturers Association on February 12, 2015 sent a letter to the central institutions asking for the removal of the customs duty on petcoke.

¹⁸ Kosovo Agency of Statistics. Annual balance of energy in the Republic of Kosovo in 2014. Pg. 4. Source: <http://bit.ly/1NqwCNJ>

¹⁹ Telephone interview with representatives of Lab-Oil.

II. The price of electricity

Local producers have major problems with electricity. One of the main difficulties for businesses in Kosovo for many years has been an insufficient electricity supply.

Power outages in recent years are smaller and construction material manufacturers, who spend large amounts of energy ²⁰, have agreements with KEDS and supply advantages compared to other customers. However, some factory owners have complained that despite agreements between producers and the supplier (KEDS), outages still occur.²¹

The biggest problem with electricity is the winter tariff. Electricity costs increase by around 50% when the winter tariff is applied. For example, in September a construction material manufacturing plant spends about 50 thousand euros for electricity, but in October when the winter tariff is in effect, for the same amount of production the energy bill goes to 75 thousand euros. This tariff policy set by the Energy Regulatory Office in order to increase savings in the winter season is a burden to businesses. Besides increasing the cost of production, winter rates create problems with liquidity during because sales drop during this season as a result of the interruption of construction works due to the weather.

Besides the winter tariff, for a number of years the businesses have been requesting changes in the policy of the Energy Regulatory Office for cross-subsidization of electricity tariffs, where businesses are required to pay more than physical persons for the same amount of energy used.

Another problem with electricity are the voltage buffers or *Maxigraphs*. Since turning on the manufacturing machinery requires high amounts of energy and this can cause problems in the energy network, KEDS has installed Maxigraphs at production plants, intended to maintain voltage stability. What happens is that when the set amount of energy to be used for the entire month is exceeded, the factory is obliged to pay a higher price for electricity. This, together

²⁰ According to data on energy consumption in 2014, from 112.84 ktoe energy consumed by the energy sector, 5% of that amount is used by the construction materials industry. Source: Kosovo Agency of Statistics. Annual balance of energy in the Republic of Kosovo in 2014. Pg. 16-17.

²¹ Interview with Skender Bajrami - owner of "Niki-S" factory in Gjakova/Đakovica. Interview held on March 4 2015.

with cross-subsidies and winter tariff, further increase the cost of production.

III. Permits for the exploitation of clay

The basic element of production in this sector is clay. With the Law no. 03/L-163 on Mines and Minerals, clay is classified as a construction mineral. Minerals in Kosovo are managed by the Independent Commission for Mines and Minerals (ICMM).

Factories that use clay need to follow a number of procedures for obtaining and maintaining permits and licenses from this institution. Initially, clay exploiters are required to obtain a permit for research which costs 700 euros. The duration of this license is two years, renewable for two additional years. The maximum surface for which a license can be obtained for research is 50 ha, reduced from 250 ha in the previous Law on Mines and Minerals.²² According to producers, since clay is a surface mineral, almost all factories in Kosovo have identified sources of supply with clay. For this reason, this license is often only a legal obligation and an unnecessary additional cost for the company. It is noteworthy that the maintenance cost of this license is 500 euros per year. On the other hand, according to representatives of ICMM, this permit for research primarily protects the producer, because prior research avoids surface mining in areas which do not have sufficient resources of clay.²³

In addition to the research permit, manufacturers must obtain the exploitation permit. The cost for this license is 1,200 euros, while annual maintenance costs 800 euros. The duration of the license is 25 years, with a possible extension for a similar period.²⁴ Although the extraction of clay is conducted only four or five months a year, mainly in the period when there is less humidity, ICMM procedures require quarterly reporting. According to representatives of ICMM, quarterly reporting is done in parallel with other reports that manufacturers must file with: TAK, the Minister of Finance, etc. Also, during the months when there is no activity, manufacturers must fill only one simple form which takes no more than 10 minutes. It is

²² Law no. 03/L-163 on Mines and Minerals, article 21 Source: <http://bit.ly/1IMZv2c> and Article 16 of the Law on Amending Law No. 03/L-163 on Mines and Minerals No. 04/L-158, Source: <http://bit.ly/1J7O9Y7>

²³ Interview with Principal Resource Geologist at ICMM Mr. Xhavit Raci, 13 August 2015

²⁴ For more detailed information regarding the administrative costs, taxes and licenses see the decision 02/2014 of the ICMM. Source: <http://bit.ly/1fbCBXF>

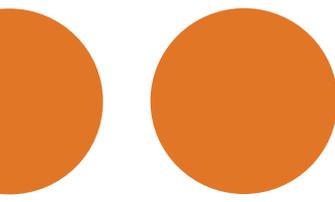
worth noting that there are countries where such reporting is less frequent, on six-month basis.²⁵

Another obstacle identified by the owners of the factories is the legal requirement by the Independent Commission for Mines and Minerals for production factories to hire geology or mining engineers to complete the necessary documentation for licensing. According to the owners, such work can be performed by technologists or chemists who are already engaged in the production process. However, the Law requires that projects are made by a geologist or mining engineer. This legal requirement, according to producers, increases the cost of production, because it requires the commitment of persons who are not required in the production process, but it also increases cases of corruption, because in most cases ICMM inspectors intercede for people they know to perform this procedure. According to the ICMM, a technologist may not perform the tasks of the geologist or a mining engineer and there have been instances when companies have been punished for it.

Another obstacle mentioned by the factory owners is the royalty payment based on tons of clay used, not per meter³, as it applies to minerals other than coal. According to the ICMM, the application of the royalty per m³ does not affect the total cost of the royalty issuance because if it would be applied the quantity and unit cost would increase. It is worth noting that the royalty costs per ton are 0.13 cents and that the Government is in the process of reviewing the royalty for this mineral so that the cost is equal to the region.

The penalties applied by ICMM in case of violation of obligations arising from licenses and permits present another problem. According to producers, the applicable law is suitable for regulating plots of dozens of hectares, while the reverse is the case of Kosovo, because the clay plots are very small. According to them, the law is not adapted to the circumstances of Kosovo. By law, if a user exceeds the amount of clay allowed for use under the permit, he is considered and fined as illegal exploiter. Factory owners argue that there are times when because of production it is required to exploit more clay than foreseen by the permit, therefore, in order not to halt production, the ICMM should allow them to pay the additional duties for the exploited clay at the end of the year. On the other hand, ICMM considers this policy can not be applied because it would encourage illegal exploitation. According to the ICMM, there is scope for application of the expansion of the exploitation permit, and the

²⁵ For more detailed information regarding the administrative costs, taxes and licenses see the decision 02/2014 of the ICMM. Source: <http://bit.ly/1fbCBXF>



procedure for obtaining this permit, in case all the criteria are met, lasts three months.

The Clay-Based Construction Materials Manufacturers Association has sent a letter to ICMM and the Parliamentary Committee for Economic Development, Infrastructure, Trade and Industry, in order to change the Law on Mines and Minerals or simplify procedures through bylaws, but so far nothing has changed in this regard.²⁶

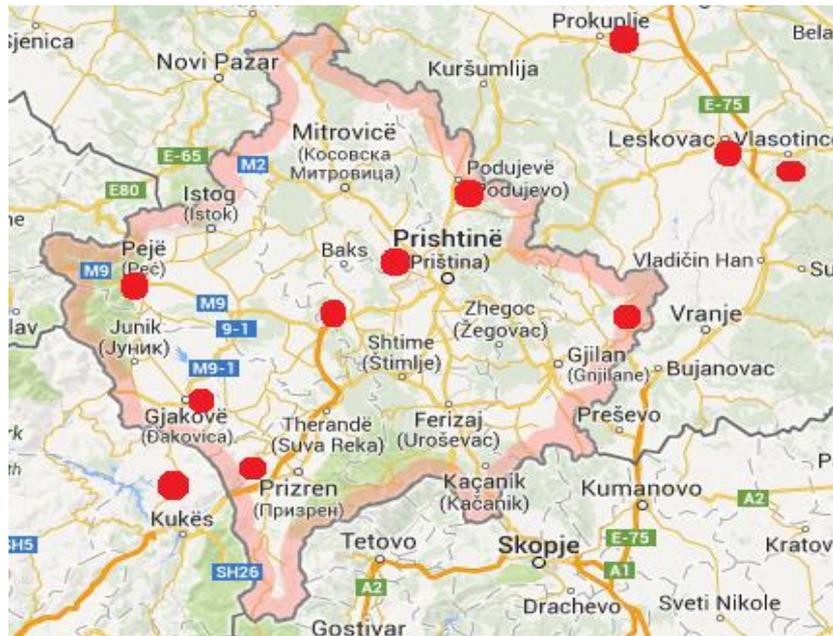
IV. Export challenges

Still, manufacturers face unequal competition. While manufacturers from other countries, especially Serbia and Albania export without hindrance to Kosovo, Kosovar producers face numerous non-tariff barriers to export to countries of the region.

Because of the cost of transport, transport of products at distances greater than 100 kilometers significantly reduces the profit margin and makes it almost impossible to remain competitive. For this reason these manufacturers aim to find markets closer to their place of production. For some of the manufacturers who are near the borders, it would be more profitable to sell in the region, rather than inside the territory of Kosovo. For example, for BRICKOS producer in the village Crep/Crepana of Ranilug/Ranillug, which is located near the border crossing Dheu i Bardhë/Bela Zemlja, it would be more advantageous in terms of distance of transport to sell in the region of Bujanovac, than for example in the municipality of Ferizaj/Uroševac.

²⁶ Interview with the President of the Association Mustafa Borovci. Interview held on March 4 2015.

Map 1: Location of producers of clay-based building materials in Kosovo and the region



V. Human resources and marketing

Manufacturers of construction materials have problems finding workers who have more advanced technical knowledge, such as mechanical engineers, electrical technicians or professional welders. Some of these positions are covered by hiring engineers from abroad, mainly from Serbia, for certain periods of time.

Another problem in this sector remains insufficient marketing. Manufacturers of clay-based building materials have not invested enough in marketing, whether individually or supported by the Chamber of Commerce or other organizations.

While the factory for production of blocks and tiles from Leskovac, Serbia has its website even in Albanian, some domestic businesses have no website or other advertising platforms.²⁷

²⁷ <http://www.mladost.co.rs/alb/reference.html>

5. Conclusions and recommendations

There are eight clay-based construction materials manufacturers in Kosovo, which cover about 60% of domestic demand for these materials. The problem, when discussing the increase of production capacities of these enterprises, remains the high cost of investment loans from commercial banks. Regarding the pricing competition with imported products, especially those from Serbia, the application of import tax on raw materials on local producers remains a problem. Besides import tax, the costs of production of these producers grow significantly during winter due to winter electricity tariffs. The cost of electricity also increases due to activation of the "Maxigraph," which causes an additional increase of production cost.

Clay-based construction material producers also face numerous bureaucratic procedures. Manufacturers must be equipped with a variety of permits for exploitation, file quarterly reports with the ICMM and by law are also subject to numerous restrictions on staff and opportunities for exploitation of clay. Apart from ICMM bureaucracy, producers also face non-tariff barriers in export, lack of qualified staff, and lack of capacity for marketing.

Despite the aforementioned problems, the findings show that producers from the construction material sector has potential for growth. This is based on the growing trend of new buildings and the potential for domestic production to further replace imports in construction materials. Another growth opportunity of this sector is represented by exports to areas around the borders of Kosovo.

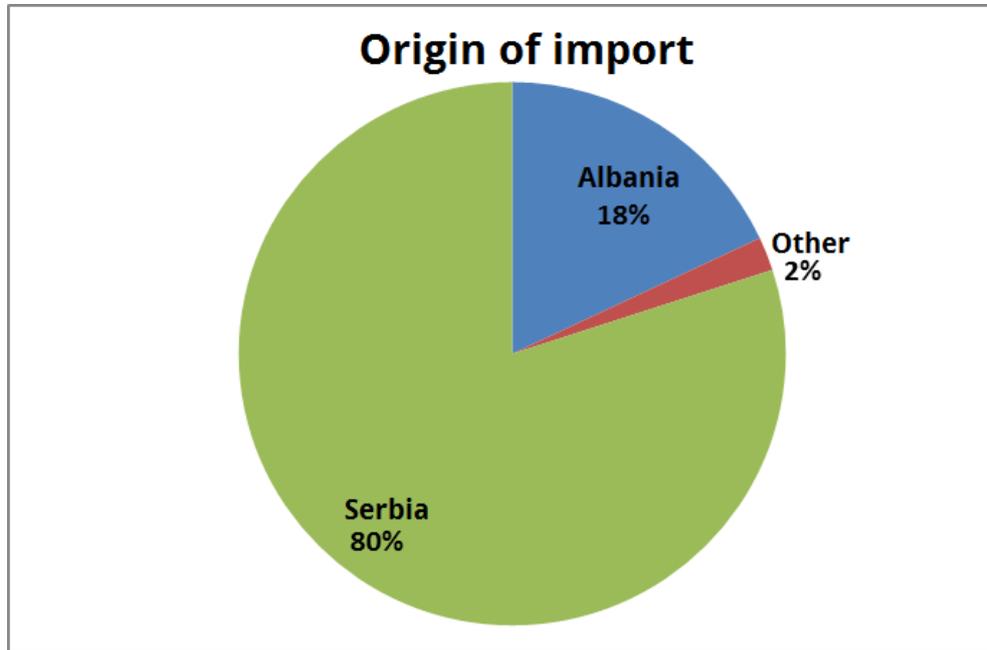
In order to increase production, employment and substitute imports in the clay-based construction materials sector, GAP Institute recommends:

- In addition to improving the business environment, the Kosovo government together with donors should look at possibilities of establishing credit lines for production activities, which will affect the reduction of interest rates. A good opportunity for this is access to the Credit Guarantee Fund.

- Kosovo government should make an assessment of the costs and benefits associated with the removal of import tax for petcoke for construction material manufacturers. Exemption from taxation of this commodity will improve competitiveness in this sector;
- The Energy Regulatory Office should revise the winter tariff policy and reduce energy costs as a result of the activation of the "Maxigraph" for the manufacturing sector;
- The Independent Commission for Mines and Minerals should consider the possibilities for reducing the number of reports by the producers, as this reduces costs for manufacturers;
- The Commission for Economic Development, Infrastructure, Trade and Industry together with the ICMM should amend the Law on Mines and Minerals in order to shorten the period for issuing the permit for expansion and also decrease the number of reports to the ICMM by producers, from quarterly to semi-annual;
- The Ministry of Education, Science and Technology in cooperation with the Ministry of Labor and Social Welfare should assess industrial needs for certain professions and develop policies and strategies to acquire as soon as possible the missing specialists, which would help economic development of the country. In addition, in order to increase the quality of graduates, the Ministry, together with universities and vocational schools, should review curriculum programs so that they relate to the practical needs and the skills required by the market;
- In order for Kosovar products to be competitive domestically and in the region, the Ministry of Trade and Industry should apply measures of reciprocity with neighboring states, whether tariff or non-tariff ;
- Local producers should invest more in marketing and enhancing the image of quality of their products.

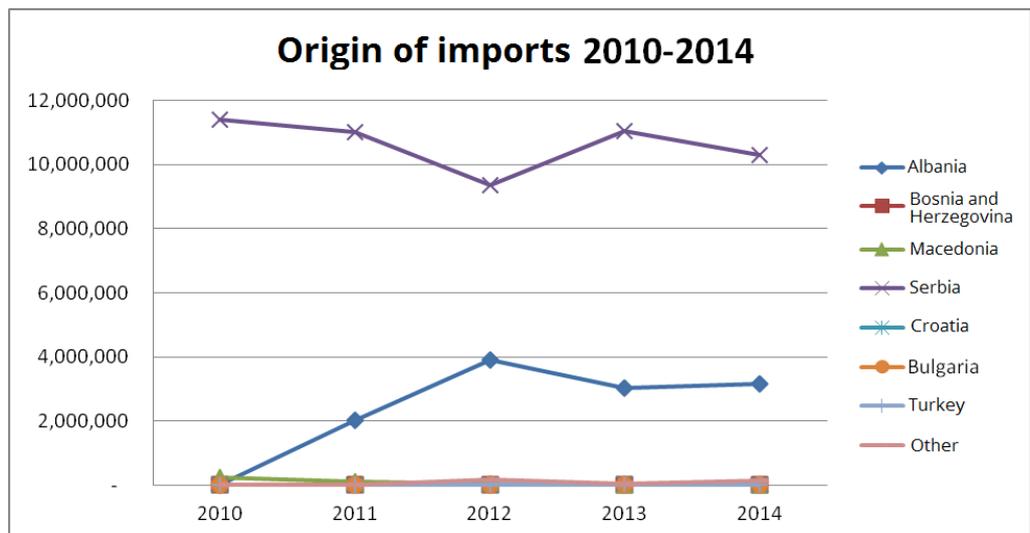
6. Annexes

Annex 1 Countries from which Kosovo imports most bricks and building blocks



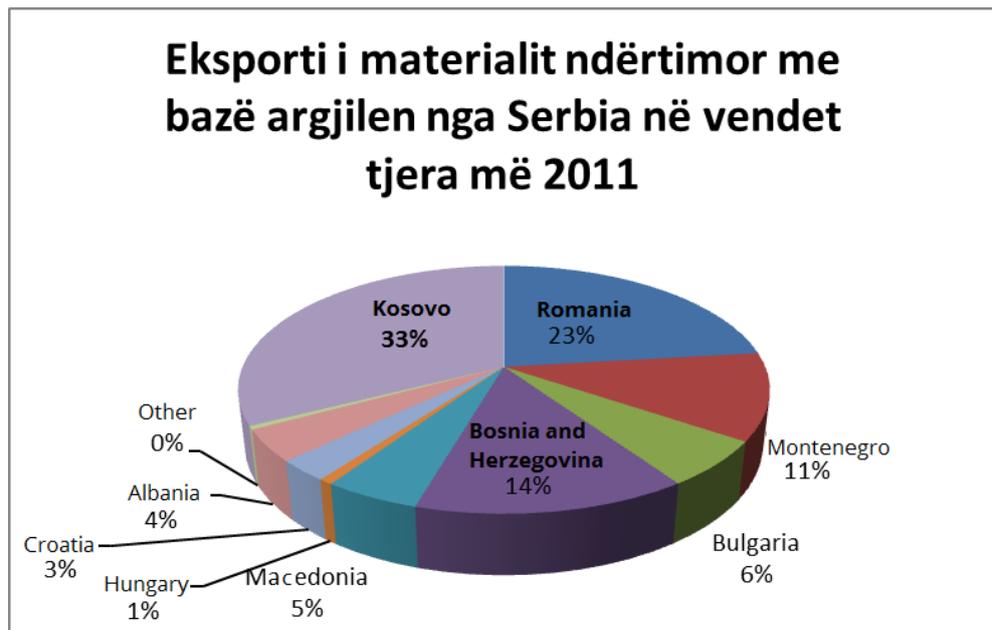
Source: Kosovo Customs

Annex 2 Building blocks imports by country 2010-2014



Source: Kosovo Customs

Annex 3 Export of Serbian producers



Source: Industrija glinenih proizvoda Srbije.



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 Kosovans for researching, developing and implementing projects with the aim of advancing Kosovan 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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