

RESEARCH REPORT

FINDINGS OF THE RESEARCH ON LEGISLATION RELATED TO FRUIT AND VEGETABLE PROCESSING

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The author's views, expressed in this report, do not necessarily reflect the views of PePeKo.

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1. Introduction

The Kosovo Economic Reform Program¹ states that agriculture sector plays an important role in economic development and employment. Participation of agriculture sector in GDP during 2015 is estimated to be around 12%. Currently around 26.7% of the total number of employees is estimated to be in agriculture and the agricultural products constitute around 12% of total export value. Despite investments in the agriculture sector, Kosovo is still facing negative trade deficit of agriculture products. Imports of agricultural products remain relatively high, accounting for about 10% of all imports. Out of this amount, 30% consists of food and food products. Kosovo is one of the largest importers of food per capita in Europe. Inadequate situation in primary production is directly reflected in the agro-food industry, and as a result the agro-food industry is quite fragmented. Within the processing industry, food-product processing constitutes the largest part of financial turnover (50%), whereas the processing of beverages participates with 25%. Besides processing industry, other important business activities are also the crop and animal production, hunting and related services with a turnover of 15%, production of wood, wood products and cork participates with 9% and fishing with aquaculture with 1%.

Based on a publication by GAP Institute², the Government of Kosovo has approved the list of measures of fiscal package 2.0 and has obliged the Ministry of Finance and other responsible institutions to take the necessary actions to prepare the relevant documents under their authority. Fiscal Package 2.0 contains 22 measures aimed at promoting investment in Kosovo by providing incentives for producers and sectors that have greater potential for growth. The issuance of sub-legal acts for each measure is meant to concretize the incentives and also to enable businesses to use them. Four of these measures were to be prepared in July and eight of them in September, but the political blockade even after two months since parliamentary elections has hindered the process and it does not seem that the situation will be any different in the coming month.

Given that fiscal policies can have positive effects, for example, increased investment in the agricultural sector, but at the same time negative effects, such as reduced state revenues due to tax breaks, tax cuts, or exemptions from income tax of said sector, the drafting of a sound tax policy is essential. The measures introduced in 2017³ foresaw the expansion of the list of products that are considered as raw material for customs duty exemption. Based on the requirements and needs of businesses for exemption from customs duties for products that are considered as raw material in the production process, a list of such products has been compiled, which products belong mainly to sectors such as the industry of food, beverages, metallurgy, agriculture and some other sectors.

In the meantime, the Kosovo Government has introduced a new set of measures, included in the fiscal package 2.0, which prescribes the amending and supplementing of three laws, issuing five

¹ [http://www.kryeministri-ks.net/repository/docs/KOSOVO_ECONOMIC_REFORM_PROGRAMME_\(ERP\)_2017.pdf](http://www.kryeministri-ks.net/repository/docs/KOSOVO_ECONOMIC_REFORM_PROGRAMME_(ERP)_2017.pdf)

² <http://www.institutigap.org/news/2027>

³ [http://www.kryeministri-ks.net/repository/docs/KOSOVO_ECONOMIC_REFORM_PROGRAMME_\(ERP\)_2017.pdf](http://www.kryeministri-ks.net/repository/docs/KOSOVO_ECONOMIC_REFORM_PROGRAMME_(ERP)_2017.pdf)

administrative instructions, two legislative acts (administrative instructions or regulations) and amending an existing administrative instruction, alongside some administrative procedures and government decisions.

Likewise, the law on Corporate Income Tax and Personal Income Tax will be supplemented to address, among others, the reduction of withheld tax on agricultural product collectors. Another point that affects business directly is the exemption from customs of the production lines.

Additionally, the measures foresee the issuance of an administrative instruction for amending the list of articles that may be subject to a reduced rate of 8 percent of VAT. The list shall include cultural, artistic, sports, tourist, accommodation and recreational activities as well as fish processing to provide incentives for such categories. The law on VAT was amended in 2016, which determined the rate of VAT reduced to 8% for some categories of products, such as: a) food (rice, flour, white bread, milk, eggs, etc.). Other measures of the fiscal package 2.0, which could have an impact on the food processing industry are the government decision to reduce excise duty on carbonated and non-carbonated drinks as well as for ethyl alcohol for use in medicine, and creating a list of local manufacturers that will be reviewed annually according to administrative procedures prepared by TAK, Customs, MTI and MAFRD.

Currently, Kosovo has a rate of VAT at 18%. The lowest VAT among the Balkan countries has Montenegro with 17.5%. Macedonia and Serbia have an 18% VAT similar to Kosovo, followed by Greece and Romania at 19%, and Bulgaria 20%, and finally Croatia at 23%.

2. Research Methodology

PEPEKO hired a consultant for conducting a research of the legislative framework related to food processing in Kosovo, for measuring the difficulties that the current legal documents present for the industry and identify the major areas in need of intervention. The Project Management team has met with the consultant several times and has identified the approach methodology. The common decision was to conduct a desk research of the legislative framework, as a first step, and identify the laws and sublegal documents having an impact on the food industry, as well as individual articles and points affecting directly the processors. As the second step, it was decided to interview members of the association's members for identifying the issues and problems that the current legislative framework presents for them directly. As the final step, the research dealt with the comparison of the legal environment related to food processing in the countries of the region.

The research was carried out at national level, where the interviews targeted members of the Association of Fruit and Vegetable Processors of Kosovo – PePeKo, as well as stakeholders, who were informed about the food processing industry in the country. Within the member companies, the research targeted either high-ranking managers, as well as accountants and/or financial officials, who had first hand information about the legal environment.

As a next step, the consultant, in cooperation with the management team, developed and finalized a research questionnaire, which enabled the consultant to conduct semi-structured interviews with the targeted respondents. Then, the consultant conducted the interviews in the field, out of which, the first interview served also as a test for the questionnaire. Once the interviews and the desk research were completed, the consultant analyzed the findings and drafted this report with the findings of the research.

3. Research Target

The research included the members of the Association of Fruit and Vegetable Processors in Kosovo – PePeKO, as well as the legal framework related to fruit and vegetable processing. Among the legal documents included in the research are:

List of Fiscal Package Measures 2.0

The research included Law 05/L-029 on Corporate Income Tax

Law 05/L-037 on Value Added Tax

Law No. 02/L-95 on Plant Protection

Administrative Instruction 16/2011 on assessment form and content of data to the phytocertificate for export, re export and phytocertificate on the internal movement of plants, plant productions and other facilities

Law No. 04/L-240 on Anti-Dumping and Countervailing Measures

Law No.2004/18 on Internal Trade

Law No. 04/L-048 on External Trade

Code No. 03/L-109 on Customs and Excise Code of Kosovo

4. Executive Summary

The research commissioned by the Association of Vegetable and Fruit Processors – PePeKo targeted the legislative framework related to food processing. The research aimed at identifying the main issues that hinder the work of the association's member companies, as well as the overall development of the food processing sector. Specifically, the research targeted the new fiscal package 2.0, especially the legal documents related to food processing. In order to get a better overview of the legal environment, the research interviewed several members of the association, who gave their input about the difficulties the legal framework presents in doing business in Kosovo.

One of the first issues, the interviewed processors stated, was the fact that each taxpayer making payments to non-business natural persons, farmers, agriculturist, collectors of recycle materials, forest fruits, healing plants and similar, shall be obliged to withhold tax at the rate of three percent (3%) of gross payment, at the moment of payment. This presents a problem for the processors, as the farmers do not recognize them as tax collectors and ask for the reimbursement of the full price for their product. Otherwise, they refuse to sell to the processors. Another issue related to taxes was VAT, more specifically the list of goods excluded from it. While the processors can purchase raw material at reduced VAT rate, they can import the raw material VAT free, which gives the imported goods an advantage, as they can deduct 18% of purchase price. Further, the VAT reimbursement process for companies requesting a refund is a lengthy and complicated process. The Tax Administration has worked towards streamlining the VET reimbursement procedure. However, the refund is still slow and takes a lot of time from them in order to complete the process. The processors complained that the process takes too much of their time, which they could dedicate to running a more effective business. The other problem that VAT presents for food processors is the fact that they need to pay the VAT and custom's fee in the moment at the import of goods, instead of after the goods are sold. The payment of VAT on the moment of import puts a financial burden on the processors straining their financial capacity, thus hindering their development. The payment of the VAT at the moment of the import makes it difficult for processors to stretch their financial capacity and purchase new technologies and/or invest in new production practices.

The next issue, the interviewed processors raised, was that the export certificate issued by the Phytosanitary Inspectorate is valid only for the specific consignment instead of for the entire bulk, produced under the same conditions and from the same materials. Furthermore, the phytosanitary certificate is valid for 15 days only. This complicates the exporting process for the processors and presents also a financial burden on the companies, as they have to pay for each certificate.

The food processing industry also faces the problem of anti-dumping measures for products, which are dumped from subsidies of the exporting country. While the law is in order, the interviewed processors stated that it needs enhanced implementation, in order to ensure a fair competition between imported and domestic products.

Another issue that the interviewed processors raised was the lack of protection of domestic products by the legal framework. For instance, the law on Internal Trade does not promote the presence of local products in the markets and selling points in the form of percentage. If a market, or other selling points, offers for sale a specific imported product, it should be obliged to have a certain percentage of the similar product from the domestic production as an alternative. The processors also complained there was also a complaint about the lengthy procedures for obtaining a license for exposing the goods outside, or in front of the selling points. At the same time, the license needs to be obtained for each selling point separately and for a validity period of only three months. The law on external trade also does not promote enough the domestic products, as the institutions do not provide enough control of the imported goods, such as the relation between the net fruit versus net weight on the packaging.

The processors stated their concern about the subsidizing program, which is low compared to the regional countries and is not managed properly, enabling subsidies based on the planted surface, instead of on the output. On the other hand, a number of Kosovo's trading partners subsidize agricultural production, which clearly puts in disadvantage Kosovo producers both in the domestic and export markets. This mismatch of the subsidy amount between Kosovo and the regional countries was the major complaint of the local processors. The higher subsidies in the region, as well as beyond, make it difficult for local products to compete in the market.

As another problem, Kosovo does not meet the Sanitary and Phytosanitary standards of the EU, which are the main reason why the country cannot export anything of animal origin to the EU. This was one of the concerns raised by the processors, as the failure of Kosovo to meet SPS standards hinders them from exporting products of animal origin, including pickled peppers in cheese. Even if a country accepts products produced in Kosovo, such as Switzerland, the export is still impossible, as the products cannot transit other countries to reach the targeted market.

The treatment of diesel and petrol used in the production process or in the logistics as a luxury product, which is subject to the state determined excise is another problem. Having to pay the excise tax during the production process, as well as during the distribution of goods, adds a certain amount to the final price of the product, which reduces the competitiveness of local products in the market. Another issue related to the excise tax in Kosovo was the fact that processing of hard alcoholic beverages, which use fruit as raw material, have high excise tax and are not subject to supporting measures introduced by the government. Although the hard liquor has a great development potential and quite a high consumption, it is discriminated through extra taxes, instead of being supported in its development.

5. Research Findings

The Law 05/L -029 on Corporate Income Tax, article 31 on withholding tax for special categories, states on its point one that each taxpayer making payments to non-business natural persons, farmers, agriculturist, collectors of recycle materials, forest fruits, healing plants and similar, shall be obliged to withhold tax at the rate of three percent (3%) of gross payment, at the moment of payment. However, this has been difficult to be implemented by the food processors in Kosovo, as there has been resistance by the farmers to allow the processors to withhold the given tax. The resistance of farmers seems to be expressed with all interviews processors. In some cases, the farmers have asked for payments in cash, which presents a problem for the processors. And as the processors did not comply with the request, they decided to sell their product in the green market. This puts the processors in a difficult position, as they usually lose a part of the suppliers. The farmers seem not to be used to paying taxes and they ask for the full price reimbursement of their product.

Law 05/L-037 on Value Added Tax, article 29 Exemption on importation gives and extensive list of exclusions from VAT, including raw materials used for the production process, stated in point 1.11. of the article. While in one hand this could be seen as supportive to the local processors, it does not promote the supply of goods from the local market. This was one of the main issues that the interviewed processors raised. They stated that if they purchased the raw material from abroad, they would be able to get reimbursement for the VAT, which gives the imported goods an advantage. If the processors imported the raw material, they are able to ask for 18% refund. However, if they bought them locally, they can ask for a 8% refund. In the case of purchasing the goods locally, the processors are subject to deducted VAT rate reimbursement, while from the imports, they can deduct the entire amount. If the processors purchase the raw material from a Collection Center, then they must add additional 8% to the price, as the Collection Centers are not VAT exempt entities. **Even the Collection Center purchase the raw material with 8% VAT, while they must sell with 18% VAT**, which adds to the final price of the raw material, and, consequently, to the price of the final product.

Another issues raised about the VAT is the complicated reimbursement procedure and time consumption it takes. Although the Tax Administration has worked towards implementation of reforms, which aimed at streamlining the VET reimbursement procedure, the interviewed processors stated that the refund is still slow and takes a lot of time from them in order to complete the process. They complained that the process takes too much of their time, which they could dedicate to running a more effective business. In a statement given by the Ministry of Finance it said that the Kosovo Tax Administration is working hard to streamline the VAT reimbursement process. However, this process has not been completed yet.

The other problem that VAT presents for food processors is the fact that they need to pay the VAT and custom's fee in the moment at the import of goods, instead of after the goods are sold. Article 64 of the Law on VAT identifies as Tax Authorities the Tax Administration of Kosovo, which has the exclusive responsibility to administer VAT, as well as the Customs of Kosovo, which shall, on behalf of

TAK, assess, levy and collect VAT on imports, exports and other Customs arrangements, and undertake as well any other function relating to the administration of VAT, as may be required. The payment of VAT on the moment of import puts a financial burden on the processors straining their financial capacity, thus hindering their development. The payment of the VAT at the moment of the import makes it difficult for processors to stretch their financial capacity and purchase new technologies and/or invest in new production practices.

Law No. 02/L-95 on Plant Protection in its article 34.1 states that plant export is permitted if: (a) plant consignments are of Kosovo origin, while the country whereby these will be exported requires phyto-certificates. Prior to issuing phyto-certificates, the phytosanitary inspector undertakes inspection checks, in order to ensure the satisfaction of the phytosanitary requirements of the country where the consignments are to be exported. The interviewed processors stated that the export certificate issued by the Phytosanitary Inspectorate is valid only for the specific consignment instead of for the entire bulk, produced under the same conditions and from the same materials. Furthermore, the phytosanitary certificate is valid only 15 days. This complicates the exporting process for the processors and presents also a financial burden on the companies, as they have to pay for each certificate. To make the situation even worse, the companies never receive the results of the analysis. In case of lack of analysis, the responsibility of spoiled goods, which still has not expired, falls on the distributor or on the seller. According to processors, there is a mismatch of phytosanitary requirements between Kosovo and the other countries, for instance Serbia. Kosovo inspectorate sometimes asks for certificates that Serbia does not issue.

Law No. 04/L-240 on Anti-Dumping and Countervailing Measures in its Article 2 states that the scope of this law applies to the anti-dumping and countervailing measures, which is dumped or benefits from subsidies of the government or a public authority of the exporting country or the country of origin provided that the imports of the product cause or threaten to cause material injury to the domestic industry of the Republic of Kosovo. While the law is in order, the interviewed processors stated that it needs enhanced implementation, in order to ensure a fair competition between imported and domestic products. However, further field research is needed in order to identify the list of subsidized products with a solid certainty.

Another issue that the interviewed processors raised was the lack of protection of domestic products by the legal framework. For instance, the law No.2004/18 on Internal Trade does not promote the presence of local products in the markets and selling points in the form of percentage. If a market, or other selling points, offers for sale a specific imported product, it should be obliged to have a certain percentage of the similar product from the domestic production as an alternative. For instance if a supermarket offers several types of pickled peppers, at least a certain percentage, regulated by law, should consist of locally produced goods. The processors have another problem with the local supermarkets, who charge the producers certain fees for offering them front space in the shelves. Therefore, they require at least around 30% of the space to be reserved for domestic products, preferably in the front shelves, as well as to receive free registration of the barcode. This would enable the local processors to compete with the imported products.

There was also a complaint about the lengthy procedures for obtaining a license for exposing the goods outside, or in front of the selling points. At the same time, the license needs to be obtained for each selling point separately and for a validity period of only three months. The processors, who at the same time have their own selling points, recommend to have the licenses issued for all their selling points in a single document and their validity to be extended to a year. This way, they would not have to go through the administrative hassle for obtaining them every three months and they would not have to pay the license fee for each shop separately and every three months.

Law No. 04/L-048 on External Trade was another part of the legislative framework that does not provide the necessary promotion of domestic product, according to the interviewed processors. They stated that the Kosovo institutions do not exercise enough control during the import of goods. For instance the relation between the statement of net fruit versus net weight on the packaging is confusing for the consumer, as the net weight includes also the water or other type of liquid in which the fruit is conserved, but cannot be consumed.

The interviewed processors stated their concern about the subsidizing program. Since its introduction in 2012, the budget for subsidizing agricultural products has increased slightly and the list of subsidized products has been extended significantly. However, it is still low compared to the regional countries. Furthermore, the subsidies are paid based on the planted surface, instead of on the output. Only milk is subsidized by output, which started in 2014. The Study Report Agriculture Finance in Kosovo⁴ states that as Kosovo is party to CEFTA, the widening trade deficit with CEFTA countries and the EU suggests that the trade agreements increase domestic consumption of imported goods, which benefit from more efficient supply chains and, in some cases, subsidies from originating countries. A number of Kosovo's trading partners subsidize agricultural production, especially in animal products and cereals, which clearly disadvantage Kosovo producers both in the domestic and export markets. This mismatch of the subsidy amount between Kosovo and the regional countries was the major complaint of the local processors. The higher subsidies in the region, as well as beyond, make it difficult for local products to compete in the market. At the same time, the processors raised the issue of providing subsidies based on the planted surface, instead of on the output. This often makes that the subsidies do not go where they are needed, namely to those who are dedicated to agriculture and strive to reach higher production of crops. They stated that the subsidizing program should be reviewed and compared to the regional countries. For instance, Macedonia subsidizes agriculture products based on the outputs, which, according to them, makes the program more effective and give the farmers a competitive advantage towards Kosovo's fruit and vegetable growers.

Kosovo enjoys non-reciprocal, customs-free access to the EU market as stipulated by the EU Autonomous Trade Preference (ATP) Regime. For a small range of goods, such as wine and beef, quantitative restrictions remain in force. Although the EU is offering vast market opportunities, Kosovo is presently only taking limited advantage of this arrangement. There is simply a lack of products, which would conform to EU standards and requirements and could therefore successfully

⁴ http://www.efse.lu/uploads/tx_news/Agricultural_Finance_in_Kosovo.pdf

compete in the EU market. Moreover, Kosovo does not meet the Sanitary and Phytosanitary standards, which are the main reason why the country cannot export anything of animal origin to the EU. This was one of the concerns raised by the processors, as the failure of Kosovo to meet SPS standards hinders them from exporting products of animal origin, including pickled peppers in cheese. Even if a country accepts products produced in Kosovo, such as Switzerland, the export is still impossible, as the products cannot transit other countries.

The other issue raised by the processors was the treatment of diesel and petrol used in the production process or in the logistics as a luxury product, which is subject to the state determined excise. Code No. 03/L-109 on Customs and Excise Code of Kosovo, in its Annex C on organizations not paying the excise tax excludes diplomatic missions, UNMIK, KFOR, and even nongovernmental organizations with a public benefit status from the excise tax. However, the food processing industry is not included in this category. Having to pay the excise tax during the production process, as well as during the distribution of goods, adds a certain amount to the final price of the product, which reduces the competitiveness of local products in the market.

Another issue related to the excise tax in Kosovo was the fact that processing of beverages with alcoholic content, such as beer and wine is regulated. However, the hard alcoholic beverages, which use fruit as raw material have high excise tax and are not subject to supporting measures introduced by the government. Although the hard liquor has a great development potential and quite a high consumption, it is discriminated through extra taxes, instead of being supported in its development.

6. Recommendations

The recommendations of the respondents are summarized in the list below:

- Advocate for activities to raise the awareness of farmers for paying the 3% tax on their gross income, which is supposed to be withheld by the buyer.
- Advocate for making the VAT reimbursement process automatic.
- Advocate for payment of VAT and customs fees after the sale of the product.
- Advocate for regulating the validity of the phytosanitary certificate and its issuance for the entire production, instead of for each individual consignment.
- Target the Law on Internal Trade and regulate the presence of domestic products in supermarkets and other selling points.
- Advocate for increased control of imported goods, such as origin, expiry date, weight, etc.
- Advocate for regulating the subsidizing program based on output.
- Advocate for amending the code on excise and customs, for excluding diesel and petrol from excise tax when used by in the production process and distribution of goods.
- Target laws and sublegal documents that are planned to undergo the revision process during 2018 and 2019 as part of the Fiscal Package 2.0