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KOSOVO DAIRY VALUE CHAIN CASE STUDY

**GUIDED CASE STUDIES IN VALUE CHAIN DEVELOPMENT FOR
CONFLICT-AFFECTED ENVIRONMENTS**

microREPORT #95



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FRONT COVER PHOTO: Donors have introduced new breeds of high-quality milking cows such as Holsteins and Brown Swiss to Kosovo.

INSIDE COVER PHOTO: Like many commercial family farms in Kosovo, Dukagjin-Deda in Peja/Pec has integrated vertically to produce feed crops for their cows.

All photos by Julie Grygiel

ACRONYMS

AMPKO	Association of Milk Processors and Producers of Kosovo
CEFTA	Central European Free Trade Agreement
DHI	Dairy Herd Improvement
EAR	European Agency for Reconstruction
EU	European Union
FAO	Food and Agriculture Organization (of the United Nations)
FRY	Federal Republic of Yugoslavia
GDP	Gross Domestic Product
GHP	Good Hygienic Practice
GMP	Good Manufacturing Practice
GTZ	German Technical Assistance Agency
HACCP	Hazard Analysis and Critical Control Point
IMF	International Monetary Fund
KADP	Kosovo Agribusiness Development Program
KAMP	Kosovo Association of Milk Producers
KASS	Kosovo Agriculture Sector Support
KBS	Kosovo Business Support
KCBS	Kosovo Cluster and Business Support
KDPA	Kosovo Dairy Processors Association
KEAP	Kosovo Emergency Agri-Input Program
KFOR	NATO-Led Kosovo Force
KLA	Kosovo Liberation Army
KTA	Kosovo Trust Agency
KVFA	Kosovo Veterinary and Food Agency
LDK	Democratic League of Kosovo
LINK	Livestock Improvement in Novo Brdo/Novo Bërdë and Kamenica/Kamenicë
COMPETES	Competitive Marketing of Milk Production Enabling Trade and Enterprise Success
MAFRD	Ministry of Agriculture, Forestry, and Rural Development
MCC	Milk Collection Center
NATO	North Atlantic Treaty Organization
NGO	Nongovernmental Organization
OSCE	Organization for Security and Cooperation in Europe
PISG	Provisional Institutions of Self-Government
SDC	Swiss Agency for Development and Cooperation
SOE	Socially-Owned Enterprise
SSOP	Sanitation Standard Operating Procedures
UHT	Ultra-High Temperature
UN	United Nations
UNMIK	United Nations Interim Administration Mission in Kosovo
USAID	United States Agency for International Development
VAT	Value-Added Tax

EXECUTIVE SUMMARY

In the 1990s, there were few functioning participants or linkages in Kosovo's dairy value chain. The command production system had broken apart and cooperatives had dissolved. Many families became self-sufficient units, producing what they could to meet consumption needs and trading any surplus to procure other goods and services. Then, the violent conflict of 1998-1999 destroyed much of the production base, damaged infrastructure, displaced people, widened ethnic divisions and eroded Kosovars' trust in each other and their government.

Since mid-1999, the international community, led by the United Nations Interim Administration Mission in Kosovo (UNMIK), has been actively involved in the reconstruction of Kosovo. In the dairy industry, donors and implementers have rebuilt and strengthened commercial production. Immediately following the conflict, they worked to restart agricultural production and economic activity. Thereafter, donors and implementers focused on moving value chain participants from informal to formal markets and from subsistence to commercial activity. Now, to improve competitiveness against imports, they are helping processors and producers upgrade their products and processes and counter constraints to growth resulting from: the 1998-1999 conflict, the persisting post-conflict environment due to the uncertainty surrounding Kosovo's final status and the transition from a command to a market economy.

The factors cited in the box at right describe the underlying conditions that weaken Kosovo's dairy value chain. To overcome the three main functional weaknesses that prevent the dairy value chain from meeting end-market demand in domestic markets, from competing effectively against imports and from targeting potential export markets, value chain participants need to do the following:

1. Processors need a greater supply of high-quality inputs to improve the quality of their products and ensure consistent high quality. Processors of value-added product lines need to upgrade equipment, facilities and processes to meet international standards.
2. Milk producers need to improve the quantity and quality of raw milk. The new milk decree provides an economic incentive for producers, but does not address their key constraints—limited availability of low-cost, high-quality feed and limited access to finance.
3. Crop producers (input suppliers), including many vertically-integrated dairy farmers, need to use better quality seeds, fertilizers and pesticides to improve both the quantity and quality of feed.

This case study of Kosovo's dairy value chain addresses two research questions:

FACTORS CONSTRAINING KOSOVO'S DAIRY VALUE CHAIN

Conflict factors:

- Limited investment due to uncertainty regarding Kosovo's final status
- Limited capital for lending (low deposits) and thus limited access to finance due to lack of trust in the banking sector
- High production costs due to damaged or poor infrastructure
- Weak value chain relationships and linkages due to a lack of trust

Transition factors:

- Low production efficiency and limited economies of scale due to small land plots and slow privatization (also land ownership issues due to the conflict)
- Investment delays due to slow privatization
- Weak value chain relationships and linkages due to poor contract enforcement by an ineffective judiciary and inadequate government legal and regulatory enforcement capacity

1. How can sector selection and value chain analysis tools be adapted to post-conflict situations and the need for quick action?
2. How can value chain analysis and the value chain framework help us identify and understand the major opportunities for sector upgrading and the constraints to market growth exacerbated by or resulting from conflict?

To answer the first question, the research team analyzed the sector selection process in Kosovo from 1999 to the present to see how donors and implementers adapted objectives, sector selection criteria and the approaches/tools used to evaluate sectors based on conflict factors in the environment. Two main findings emerged:

1. **Sector selection and value chain analysis tools require more adaptation in earlier post-conflict periods to restart economic activity quickly.** In the immediate post-conflict period, decisions need to be made quickly and resources directed toward beneficiaries as soon as possible to rebuild and create incentives for non-violence. A traditional approach to sector selection usually is not possible as time for information gathering, data for market analysis and a calm environment for selecting lead sectors or enterprises often are lacking. Sector selection criteria should instead be adapted to address conflict factors such as restoring the food supply, replenishing agricultural inputs and helping farmers, entrepreneurs and enterprises rebuild their operations and reconnect to other value chain participants.
2. **Rebuilding and competitiveness are not complementary objectives for initial programs in post-conflict environments.** The presence of conflict factors (box, preceding page) constrains the selection of sectors or enterprises based on potential competitiveness. It is difficult to judge which sectors or enterprises will survive, respond to technical assistance and be able to access resources for growth.

Based on the analysis of sector selection in Kosovo, the team identified five sector selection criteria for a post-conflict environment and evaluated Kosovo's dairy sector against these criteria to determine if it is a good choice for Kosovo.

The team then analyzed donor projects targeting the dairy industry in Kosovo from 1999 to the present to see how approaches and interventions evolved to support opportunities for upgrading and to counter constraints to growth as Kosovo moved from relief to development. Four main findings emerged:

1. **To rebuild and develop value chains in a post-conflict environment, move from the micro to the macro, starting with individual enterprises and/or functions to achieve quick results and gain traction before targeting the entire value chain.** In Kosovo, donors and implementers began working with individual farmers to make no- or low-cost changes to upgrade the production process and improve yields and quality. They then worked with larger groups and through associations to expand their reach. Once processors emerged and started to demand inputs, donors and implementers steered farmers toward commercial channels, worked with processors to upgrade their processes and products based on end-market demand and helped rebuild linkages between processors and producers. Upgrading continues in the input supply, production and processing functions of Kosovo's dairy value chain to improve the industry's competitiveness in domestic and export markets.
2. **In a post-conflict environment there are unique constraints to or breaks in value chains that require special attention to rebuild capacity and promote upgrading.** Value chain analysis allows donors and implementers to identify functions and relationships that the conflict has weakened or damaged. Once all functional and relationship gaps have been identified, donors and implementers can prioritize them and design programs or interventions to rebuild and develop value chains based on available resources.

3. **Grants programs are indispensable parts of donor projects to help value chain participants invest in the improvements they need to upgrade.** In post-conflict environments, access to finance typically is more limited than in traditional development environments. Private investment may be constrained by conflict factors, and there may be little capital for lending due to a lack of trust in formal financial institutions and thus low deposits. Projects that award grants directly to value chain participants for specific purchases, or that provide loan capital to non-banking and other financial institutions to lend to value chain participants, facilitate upgrading.
4. **When replenishing inputs, donors and implementers must be careful to ensure that valuable, high-quality inputs such as livestock contribute to production.** Understandably, donor emergency programs target more vulnerable groups when distributing inputs in a post-conflict environment to create incentives for non-violence and provide a means for immediate survival and a source of income. However, in Kosovo, a number of valuable, high-quality milking cows distributed to subsistence farmers were not cared for or bred properly, yielding little milk for on-farm consumption or sale.

The research also yielded two general findings, applicable in any environment, that have enhanced upgrading in Kosovo's dairy value chain:

1. **Economic incentives promote upgrading in value chains.** Varied incentives may be offered to value chain participants, originating from the value chain itself, the business enabling environment (government) and/or the external environment.
2. **Value chain development may be enhanced by direct work with leaders within the sector as well as with associations to spread benefits to smaller value chain participants.** Leaders typically have the willingness and ability to try new technologies and make improvements, serving as examples for others. Associations play a key role as industry advocates and as service providers and they disseminate information to wider audiences.

I. INTRODUCTION

OVERVIEW OF THE CONFLICT IN KOSOVO

Kosovo has been in the international spotlight for much of the last decade due to both the 1998-1999 conflict that ended after NATO bombed the Federal Republic of Yugoslavia (FRY) and the continuing negotiations regarding Kosovo's final status. Like the rest of the Western Balkans, Kosovo has had a multi-ethnic and multi-religious society for centuries; however, since the 1990s, formal political, economic and social institutions in Kosovo have not served ethnic groups equally. Ethnic divisions became more pronounced in the 1990s when Serbian President Milosevic proposed constitutional changes (which were ratified by a referendum) to revoke Kosovo's autonomy and expelled Albanian Kosovars from state institutions, after which they developed their own parallel systems. Ethnic repression led to violence in 1998-1999. Following the conflict, the international community took charge of reconstructing Kosovo's institutions to support a multi-ethnic society, but ethnic divisions remain. Serbian Kosovars live in guarded, self-segregated communities, largely boycott Kosovo's new institutions, and have set up their own parallel systems. In the past few years, negotiations regarding Kosovo's final status have intensified with Albanian Kosovars demanding independence and Serbia refusing to relinquish its sovereignty over Kosovo. In March 2007, former Finnish President Martti Ahtisaari presented a plan to the United Nations (UN) Security Council recommending conditional independence for Kosovo with extensive rights and security for Serbian Kosovars, but neither party is satisfied with the plan. A detailed analysis of the conflict in Kosovo comprises Section II.

RELIEF AND DEVELOPMENT ACTIVITIES IN POST-CONFLICT KOSOVO

Since mid-1999, UNMIK has overseen the reconstruction of Kosovo, directing activities under Pillars I (police and justice) and II (civil administration). The Organization for Security and Cooperation in Europe (OSCE) oversees Pillar III (democratization and institution building), and the European Union (EU) manages activities under Pillar IV (reconstruction and economic development). This case study focuses on donor economic recovery and growth programs from 1999 to the present, primarily those of the U.S. Agency for International Development (USAID) with some examples from the European Agency for Reconstruction (EAR) and the Swiss Agency for Development and Cooperation (SDC).

In summary, donor relief programs focused on rebuilding Kosovo's agricultural production base and restarting economic activity. USAID and SDC targeted primarily the private sector—specifically input supply and production and individual entrepreneurs and enterprises—while EAR directed programs at the public sector to build Kosovo's legal and regulatory framework and the institutional capacity of the new government. Chemonics implemented USAID's Kosovo Business Support (KBS) program from October 2000 to September 2004, providing broad-based business development services and training to enterprises, and starting mid-2002, specialized technical assistance to processors in select sub-sectors to improve competitiveness against imports.

Donor development programs focus largely on competitiveness. USAID continues to support the long-term development of five agricultural sectors and two non-agricultural sectors with its Kosovo Cluster and Business Support (KCBS) project, which Chemonics implements. Started October 2004 and due to end September 2008, KCBS has two components—general business support and cluster (value chain) development. Under the second component, KCBS supports the development of three value chain clusters: livestock (dairy, beef, poultry and animal feed); fruits and vegetables; and construction materials.

KOSOVO'S DAIRY SECTOR

The case study analyzes the evolution of approaches and interventions targeting the dairy sector from 1999 to the present as Kosovo moved from relief to development. Dairy is a traditional product in Kosovo and throughout the Balkans in terms of consumption and production. Due to strong end-market demand and existing and potential capabilities, and to alleviate Kosovo's large food trade imbalance, dairy became an early target for donors, first to rebuild the sector and then to improve competitiveness. Donors and implementers have worked to strengthen the functions and relationships in Kosovo's dairy value chain that were damaged by conflict, to promote upgrading and to counter constraints to growth. A detailed analysis of the dairy value chain in Kosovo is presented in Section III and of donor programs targeting the dairy sector from 1999 to the present in Section IV.

SUMMARY OF STEPS TAKEN TO PREPARE THE CASE STUDY

The team conducted desk and field research to analyze the dairy sector in post-conflict Kosovo; reviewed qualitative and quantitative information on the conflict, dairy value chain and pertinent donor programs¹; and interviewed value chain and supporting market participants, service providers and KCBS project staff, several of whom also worked on earlier donor projects. Team members also met with USAID/Kosovo and officials from relevant government agencies. Two KCBS-hosted events provided valuable insight on current value chain issues: the first, an agricultural finance seminar at which KCBS presented opportunities for, and addressed concerns related to, agricultural lending with representatives from leading financial institutions in Kosovo; and the second, a special meeting of the Kosovo Dairy Processors Association (KDPA) at which government officials formally announced their plans to implement and enforce the new milk decree.

¹Including assessments, evaluations, and reports from donors and implementers, international organizations, UNMIK, the EU, and Kosovar institutions

II. ANALYSIS OF THE CONFLICT/POST-CONFLICT ENVIRONMENT

For centuries, the Balkans has been rife with violent conflict that has disrupted political, economic and social development. Historians and political leaders have long referred to the region as the “powder keg of Europe.” Following is a summary of the conflict and post-conflict environment in Kosovo, a province in Serbia, from 1989 to the present.

Conflict resurged in the Balkans in the early 1990s after the fall of the communist Yugoslav state; the rise of nationalism throughout the region and of ultra-nationalist Slobodan Milosevic as president of Serbia; and the fragmentation of Yugoslavia into several independent states: Bosnia and Herzegovina, Croatia, FRY (Serbia and Montenegro²), Macedonia and Slovenia. The Dayton Peace Accords, signed in 1995, brought temporary peace to the region, until 1998, when an uprising by an ethnic Albanian paramilitary, the Kosovo Liberation Army (KLA), triggered a counterinsurgency that resulted in mass expulsions and murders by Serb paramilitaries and Yugoslav forces. NATO bombed FRY in the spring of 1999, forcing Serbian and Yugoslav military capitulation. Predominantly ethnic Albanian insurgents perpetuated the conflict upon their return to Kosovo, spurring the flight and self-segregation of Kosovo’s ethnic Serb minority and other minorities seen as collaborators of the Yugoslav forces. In June 1999, with Resolution 1244, the UN Security Council authorized a NATO-led force (KFOR) to protect all Kosovar communities and tasked UNMIK with reconstructing Kosovo.

An environment of conflict existed for years before the violence of 1998-1999. A post-conflict environment persists while Kosovo’s final status remains unresolved. The case study focuses primarily on the period after 1989, the year that Serbian President Milosevic proposed constitutional changes to revoke Kosovo’s autonomy. It examines the motives and means for violence, the institutions and regional/global forces that can stem or promote violence and the windows of opportunity that have led, or can lead, to violence.

A. INCENTIVES FOR VIOLENCE

ETHNIC DIVISION AND REPRESSION

Like the rest of the Western Balkans, Kosovo has had a multi-ethnic and multi-religious society for centuries. Since the 20th century, Albanians have been the majority group; currently, 92 percent of Kosovo’s population is ethnic Albanian. Serbians are the largest minority group (5.3 percent) followed by Bosniaks, Turks and Roma. Most Kosovars tend to define themselves by language rather than religion, although Milosevic used the latter to stir emotions as part of Serbia’s nationalist propaganda, and conflict parties have destroyed mosques and churches as part of the conflict.

Kosovo’s Population (2006)		
Overall	2,100,000	100%
Albanian	1,932,000	92%
Serbian	111,300	5.3%
Other	56,700	2.7%

Source: Statistical Office of Kosovo

² Montenegro declared its independence from Serbia and Montenegro on June 3, 2006, after a successful referendum in May 2006.

Both Albanians and Serbs claim a historical right to Kosovo. Albanians consider Kosovo a center of Albanian nationalism and renaissance from the 19th century and claim to descend from the Illyrians who arrived in Kosovo several centuries before the Serbs. For Serbs, Serbia's resistance to, and defeat by, the Ottomans at Kosovo Field in 1389 signified a rebirth of Serbian nationalism. Serbs consider Kosovo a center of Serbian history, tradition, religion and culture. The Ottomans ruled for almost five centuries, falling in 1878, after which Serbia and Montenegro gained control over Kosovo and neighboring Albanian territories. In 1946, Kosovo became a province of Serbia within Yugoslavia. Under the 1974 Yugoslav constitution, Kosovo was granted autonomy and federal unit status within Yugoslavia.

In 1989, Milosevic proposed constitutional changes to revoke Kosovo's autonomy, which were passed by a referendum of FRY citizens (Albanian Kosovars boycotted it), and instituted "emergency measures" to gain control over Kosovo. Suddenly, Kosovo's political rights, including a seat on the federal presidency and its own assembly, police force, national bank and relative economic independence (within a command system) disappeared. For non-Serbian Kosovars, the 1990s became "a decade of disenfranchisement and apartheid,"³ marked by ethnic division and repression.

In 1991, Albanian Kosovars were expelled from all state institutions including government, police, education and socially-owned enterprises (SOEs). Thereafter, they developed their own parallel political, economic and social systems. The newly unemployed were forced into situations of new and often under-employment. Remittances served as a significant source of income for many families. Funds from the diaspora, funneled primarily through Bujar Bukoshi's "government in exile" in Germany, supported schools, hospitals and other institutions. Ibrahim Rugova, head of the Democratic League of Kosovo (LDK), was elected "President" of Kosovo in 1992 and again in 1998. Ethnic divisions became more pronounced in the 1990s and led to the rise of Albanian and Serbian paramilitaries and, ultimately, violence between the two groups in 1998-1999.

Since 1999, Albanian Kosovars have regained power as the majority population, and Serbian Kosovars have assumed a minority role. The ethnic division of Mitrovica, a city in the north of Kosovo, symbolizes the challenging post-conflict environment. There, Albanian Kosovars and Serbian Kosovars live on opposite sides of the Ibar River with little interaction between them. Approximately 40 percent of Serbian Kosovars live in the area north of the Ibar, and the remaining 60 percent live in isolated, KFOR-guarded enclaves throughout Kosovo. Although Kosovo's government, the Provisional Institutions of Self-Government (PISG)⁴, with the assistance of the international community, is building a legal and regulatory framework to support a multi-ethnic society, the communities live largely divided. Most Serbian Kosovars reject PISG, opting instead to set up parallel political, economic and social structures similar to the Albanian Kosovar system of the 1990s. Serbia supports these communities with financial, human and physical resources including courts and police, the last in contravention of Resolution 1244. Ethnic segregation, and to some extent repression, persist in post-conflict Kosovo.

³ International Crisis Group, *Starting from Scratch in Kosovo: The Honeymoon Is Over*, Europe Report № 83, December 1999.

⁴ UNMIK established PISG in May 2001 as part of a larger Constitutional Framework including a 120-seat assembly (legislature), a Prime Minister and 11 ministries (executive branch), and a judicial system.

ECONOMIC CAUSES

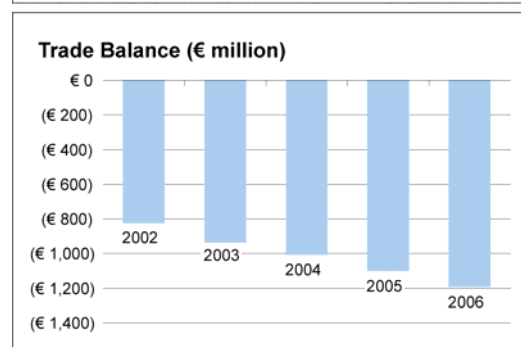
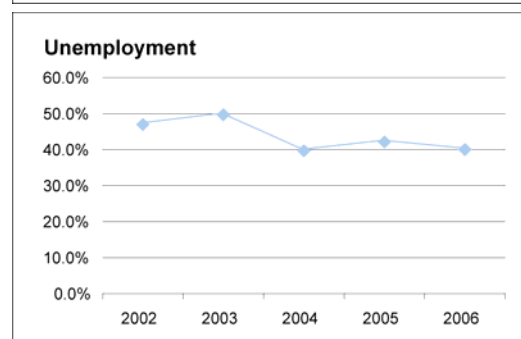
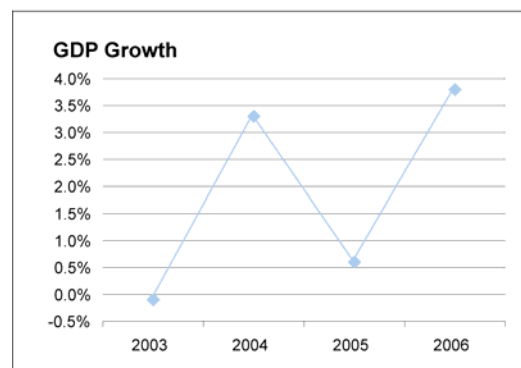
As noted previously, the livelihoods and sources of income of most Albanian Kosovars changed dramatically in the 1990s. Following their expulsion from SOEs, many professionals moved to agricultural production, but operated at a subsistence level, producing primarily for consumption and selling or trading any surplus for other goods and services. Others traded goods or offered services primarily within the gray economy. Such mass-scale, forced unemployment and the struggle to find alternate sources of employment and income demoralized many, but also inspired a strong entrepreneurial culture.

Meanwhile, commercial production fell and trade patterns changed, reducing the size and strength of the Kosovar economy. SOEs produced marginally under new management or lay vacant. Overall, there was little commercial activity, thus few items to trade. Kosovo became a net importer and reliant upon FRY for many goods and services.

Since the 1998-1999 conflict, the international community, led by the EU, has helped rebuild Kosovo's economy, but constraints remain that hamper growth. After the reconstruction boom, gross domestic product (GDP) growth fell to -0.1 percent in 2003 and has been unsteady since then.⁵ Unemployment has ranged from 40 to 50 percent. Trade and construction are the most active sectors and agriculture is starting to show potential. Meanwhile, Kosovo's trade balance continues to deteriorate. The development of commercial production is plagued by structural problems; slow privatization resulting from conflict-induced land and ownership issues; and a lack of investment. Serbian Kosovar communities receive most goods from or via Serbia and there are few transactions and contracts between Albanian Kosovar and Serbian Kosovar entities. In addition, PISG's weak legal and regulatory capacity and ineffective judiciary do not promote inter-ethnic business relations.

COMPETITION OVER NATURAL RESOURCES

Few Kosovars have benefited from Kosovo's greatest source of wealth since the 1980s, mining. Trepca, a conglomerate of 40 mines and factories in the north, has become a symbol of Kosovar identity and control of the mines has gained new importance. Albanian Kosovars managed the mines through the 1970s, but after Tito's death in the early 1980s, Belgrade reasserted control over Trepca. In exchange for the wealth from the mines, Belgrade provided Kosovo with electricity and other non-cash payments. After Albanian Kosovars were expelled from the mines, the production plants closed, only to be reopened for a short time in the mid-1990s, during which it is purported that Belgrade exported \$100 million from Trepca. Since the 1998-1999 conflict, the complex has been closed due to political sensitivities regarding ownership.



⁵ Sources: EU, data on GDP growth and unemployment; Statistical Office of Kosovo, data on the trade balance

B. CONFLICT MOBILIZATION AND EXPANSION DYNAMICS

ORGANIZATIONAL FACTORS

Since the 1990s, formal political, economic and social institutions in Kosovo have not served ethnic groups equally. After 1989, Albanian Kosovars created parallel systems following their loss of autonomy and expulsion from state institutions controlled by Belgrade. After the 1998-1999 conflict, the international community assisted in rebuilding Kosovar institutions and forming a new government that Serbian Kosovars regularly boycott. Serbian Kosovars have self-segregated in the area north of the Ibar River or in enclaves throughout Kosovo and receive support from Serbia to maintain their own political, economic and social structures.

ACCESS TO FINANCE

Kosovo's ethnic groups have access to finance from myriad sources. From Germany, Bujar Bukoshi channeled funds from the Albanian Kosovar diaspora to schools and hospitals under the parallel system, and remittances supplemented the incomes of many families. Resourceful entrepreneurs took advantage of opportunities in the gray economy. Now, Serbia sustains the parallel structures in Serbian Kosovar communities. The Albanian Kosovar diaspora, which has grown since the 1998-1999 conflict, continues to support family members and institutions in Kosovo. Organized crime and corruption also are rampant.

HUMAN RESOURCES

Kosovo has a wealth of under-utilized human resources. According to the UN Development Programme's 2004 Human Development Report for Kosovo, 52 percent of the population is under age 25. As shown in the table at right, 60 percent of youth from 15-19 and 45 percent of youth from 20-24 are unemployed. The education system in Kosovo is strained, with schools accommodating multiple shifts of students every day. Many students leave Kosovo to attend university. Skilled Kosovar professionals are attracted to higher-paying jobs with international organizations, leaving a shortage of talent for local institutions.

Unemployment (2006)	
Overall	40.0%
15-19	60.1%
20-24	45.0%
25-39	44.1%
40-54	20.1%
55-64	7.6%

Source: Statistical Office of Kosovo

C. INSTITUTIONAL CAPACITY OF STATE AND CIVIL SOCIETY ACTORS/ENTITIES TO RESPOND TO THE CONFLICT

GOVERNMENT AND PUBLIC INSTITUTIONS

It is unclear why, but Belgrade tolerated the parallel political, economic and social institutions built by Albanian Kosovars in the 1990s. Stripped of autonomy and excluded from state institutions controlled by Belgrade, Albanian Kosovars had little incentive to organize a system to maintain their marginalized status.

PISG has faced serious challenges in promoting peace and stability in post-conflict Kosovo. Working with the international community, PISG created institutions for governance at the municipal and national levels, including a police force, and it continues to develop Kosovo's legal and regulatory framework. But weaknesses remain, particularly related to enforcement capacity and the judiciary. Moreover, most Serbian Kosovars boycott PISG, including the last two general elections in October 2004 and November 2007, and refuse to take reserved ministry posts. In March 2004, unfounded allegations of Serbian Kosovars drowning Albanian Kosovar children sparked two days of rioting throughout Kosovo, leaving 19 dead, 900 injured, 4,500 displaced and more than 700 homes and 40 public buildings damaged or destroyed. The riots highlighted the powerlessness of PISG and civil society to contain

violence, and the disorganized response from KFOR and UNMIK lowered their credibility among Serbian Kosovars and other minorities. Since 2004, there have been no major outbreaks of violence, but PISG, civil society and the international community continue to be tested, especially as pressure for independence grows.

FINAL STATUS

The key unknown, which undermines the legitimacy of PISG and complicates the work of the international community, is Kosovo's final status. Albanian Kosovars demand independence, but Serbia refuses to relinquish sovereignty over Kosovo. Initially, it was expected that Kosovo's status would be resolved two to three years after the conflict, but talks continue after multiple postponements. Thus far, any plan to partition Kosovo, join it to another state, or return it to its pre-1999 status has been rejected. In March 2007, former Finnish President Martti Ahtisaari presented a plan to the UN Security Council with three main elements: 1) conditional (supervised) independence for Kosovo; 2) extensive rights⁶ and security for Serbian Kosovars and privileged relations with Serbia; and 3) multiple international presences to monitor parties for an initial period of two years.⁷ Neither Albanian Kosovars nor Serbian Kosovars are satisfied with the Ahtisaari plan. The six-country Contact Group (France, Germany, Italy, Russia, U.K. and U.S.) concluded the latest round of talks between Pristina and Belgrade on the Ahtisaari plan in early December 2007 without resolution.

“As long as Albanian fears and Serb hopes of Kosovo's eventual reincorporation into Yugoslavia are allowed to persist, efforts to develop normal relationships between the two communities, either within Kosovo or between Kosovo and Serbia, are unlikely to bear fruit.”

—International Crisis Group, *A Kosovo Roadmap (I): Addressing Final Status*, Europe Report № 124, March 2002.

D. REGIONAL AND GLOBAL FORCES AFFECTING CONFLICT DYNAMICS

Several influences promoted instability in the Balkans in the 1990s. The fall of communism in Eastern Europe led to political, economic and social upheaval across the region. Various political and economic shocks hit countries in transition leading to power vacuums, rampant corruption, unemployment and (hyper) inflation. The rise of nationalism throughout the Balkans propelled the fragmentation of Yugoslavia and sparked violence along ethnic and religious lines. Organized crime flourished and weapons were readily available, all of which heightened tensions in Kosovo.

Today, Kosovo remains the most volatile part of the Balkans. Other countries in the region have acceded, or are in the process of acceding, to the EU. To do so, they have instituted numerous changes to promote political stability and democracy, reduce corruption and crime and sustain long-term economic growth. Though Kosovo is installing similar institutions, it remains a wild card due to its unresolved final status.

The international community continues to play tug-of-war over the question of Kosovo's status. The U.S. firmly supports Kosovo's independence and the Ahtisaari plan. Most EU members also favor independence for Kosovo, but how many of them support the Ahtisaari plan is unknown. Russia supports Serbia and thus opposes parts of the plan

⁶ Specifics include 1) the creation of more and expanded Serbian Kosovar-majority municipalities that would have a right to link with each other and receive assistance from the Serbian government, 2) special protection zones and prerogatives for the Serbian Orthodox church, and 3) additional parliamentary seats and double-majority rules to prevent Serbian Kosovars from being out-voted on vital interest questions.

⁷ Martti Ahtisaari, *Report of the Special Envoy of the Secretary-General on Kosovo's Future Status*, presented to the UN Security Council by UN Secretary-General Ban Ki-moon, March 26, 2007.

and it has hinted at using its veto in the UN Security Council. This uncertainty in the international community is destabilizing the process surrounding Kosovo's final status.

E. WINDOWS OF VULNERABILITY FOR CONTINUATION OR RESURGENCE OF VIOLENCE

The last two general elections in October 2004 and November 2007 were peaceful, but most Serbian Kosovars boycotted them. Recent public demonstrations in support of independence also have been peaceful. It is possible that Kosovo will unilaterally declare independence following the recent round of failed negotiations regarding its final status, which could trigger violence within Kosovo and/or between Serbia and Kosovo.

F. CURRENT CONFLICT TRENDS/ANTICIPATED CONFLICT DYNAMICS

Conflict dynamics will continue to revolve around inter-ethnic relations in Kosovo, the current PISG political structure and the possibility of an independent Kosovo. The determination of Kosovo's final status will have major implications for potential conflict, and the international community must be poised to facilitate a peaceful outcome. Patience on all sides is growing thin and the current state of limbo cannot be maintained much longer—expectations are too high. The international community and PISG are building the structures to support and promote a modern, multi-ethnic society in Kosovo, but they need a full mandate to run it effectively. Kosovar citizens need incentives for non-violence. The rebuilding of value chains enhances livelihoods and strengthens relationships, creating incentives for non-violence.

III. VALUE CHAIN ANALYSIS OF DAIRY INDUSTRY

A. VALUE CHAIN SUMMARY

An analysis of the dairy industry in Kosovo reveals the effects of conflict on individual value chain participants, the dynamics and linkages within the chain, as well as industry growth and competitiveness.

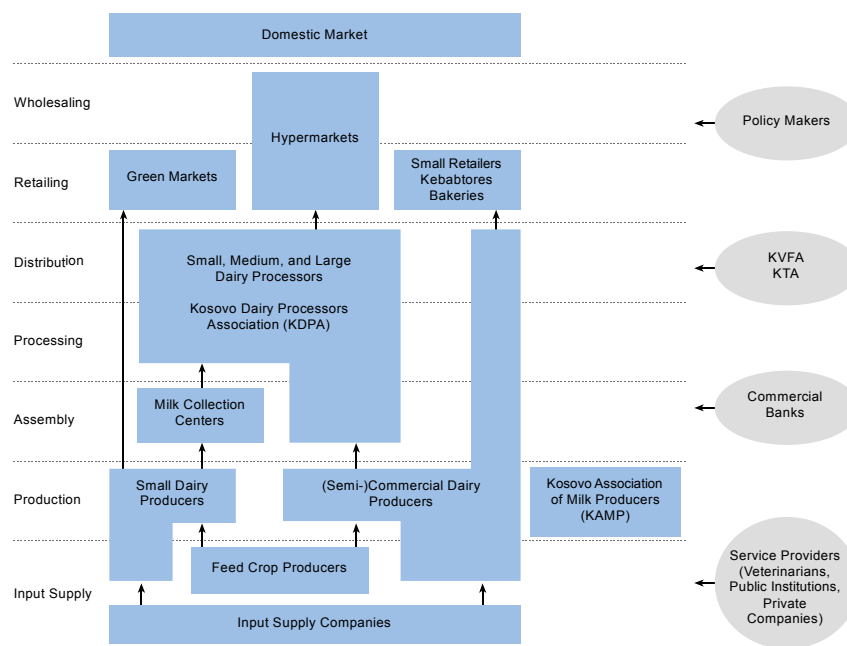
From the early 1990s through the initial post-conflict period, the command production system broke down, cooperatives dissolved, and there were few functioning participants and linkages in Kosovo's dairy value chain. Many families became self-sufficient units, producing what they could to meet consumption needs and trading any surplus to procure other goods and services. The 1998-1999 conflict destroyed much of the production base, damaged infrastructure and eroded Kosovars' trust in each other and government. Since then, buildings and roads have been rebuilt, livestock replenished, crops replanted, elections held, laws passed, processing facilities reopened and stores restocked with local products. Linkages are growing stronger.

Though all seven functions of Kosovo's dairy value chain are now operating, value chain participants need to continue upgrading and strengthening their relationships to improve competitiveness in domestic markets against imports and expand to regional markets.

B. VALUE CHAIN MAP

The diagram shows the functions and linkages within Kosovo's dairy value chain.

Figure 1. Dairy Value Chain in Kosovo



C. VALUE CHAIN STRUCTURES AND DYNAMICS

The following sections describe and analyze the structures and dynamics in Kosovo's dairy value chain, starting with end markets, demand and the business enabling environment, and examine the functions and linkages at each level. The findings outline major opportunities for upgrading and constraints to growth, as well as the intersections between value chain and conflict dynamics.

END MARKETS

Dairy is a traditional product in Kosovo in terms of consumption and production. Products sold within commercial channels fall into two groups: basic and value-added. Basic products include pasteurized milk, drinkable yogurt, unflavored set yogurt and white cheese. Value-added products include ultra-high temperature (UHT) milk, cream cheese (with peppers), yellow cheese, flavored set yogurt and flavored dairy drinks.

CURRENT AND ANTICIPATED DEMAND FOR DAIRY PRODUCTS IN KOSOVO

Demand for basic and value-added dairy products is strong. Annually, Kosovars consume 357 million liters of dairy products, approximately 170 liters⁸ per person.⁹ Imports account for 24 percent¹⁰ of total consumption and local products the remainder.

In its 2007-2013 Agriculture and Rural Development Plan, the Ministry of Agriculture, Forestry and Rural Development (MAFRD) assumes that annual domestic consumption will increase to 190 liters per person by 2013.¹¹ They do not list their rationale for the increase in demand, but, based on economic theory, we know that changes in income, personal preferences and/or the prices of substitute and complementary goods affect demand, any of which is plausible in Kosovo's growing economy. Value-added products such as yellow cheese have higher milk equivalent ratios, so an increase in demand as expressed above could reflect a shift in consumption to more value-added products.

Based on interviews with retailers, the research team concluded that consumer requirements for dairy products are quite similar, regardless of the market. Quality is the most important factor, followed by freshness and price. Package size and labeling are more important factors in urban areas where people typically have smaller families and buy more food products in formal markets. Consumers tend to be loyal, so consistency is critical in all markets along with brand recognition in formal markets. There is more room for differentiation of value-added products via formulations and flavorings plus packaging and labeling. While marketing for basic products adds little value (unless the processor is a new entrant to the market), it is vital for processors to differentiate their value-added products from those of competitors.

TYPES OF MARKETS

Eighty-five percent of the milk produced in Kosovo is consumed on the farm or goes to unregulated local markets (green markets). Fifteen percent flows through commercial channels to processors and domestic markets. Very few

⁸ Demand reflects the milk equivalent for all dairy products consumed in one year. For example, one liter of pasteurized milk requires one liter of raw milk, while one kilogram of yellow cheese requires on average seven liters of raw milk.

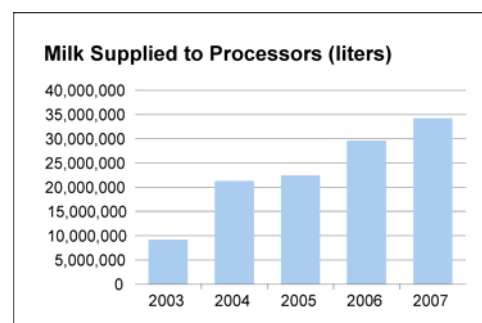
⁹ WYG International Ltd., *Marketing Support Project: Agri-food Sector Review*, April 2006 (updated in *Fourth Quarterly Report*, March 31, 2007), p. 8 and 30.

¹⁰ Peter Oldham, Elinor Bajraktari, and Andreas Wittkowsky (EU Economic Policy Office), *The Kosovo Dairy Sector: Study of Competitiveness of Imports*, November 2006.

¹¹ MAFRD (with the assistance of EAR's Agricultural Master Plan for Kosovo project), *Agriculture and Rural Development Plan, 2007-2013 (third draft)*, November 2006, p. 87.

local products reach regional or global markets. The graph shows how commercial milk production has grown since 2003.

Green markets. Traditional green markets, found in all cities and villages throughout Kosovo, are where small producers sell unpasteurized milk and on-farm-produced white cheese to a steady base of customers who trust their products. Most operate in permanent locations on a daily basis. Prices for like products are the same within a single green market.



Domestic markets. Processors claim that there is little competition with basic products, yet they are sensitive to both competitors' prices in formal markets and the quantities and prices of products sold in green markets. Most processors charge the same price for like goods, though one said he charges a higher price for his drinkable yogurt to differentiate its quality from that of competitors. Transportation costs and high turnover make imports of basic products impractical with the exception of white cheese, which is competitive against local products. For value-added products, processors compete against imports primarily from Hungary, Slovenia and Germany. In 2005, 86 million liters of dairy products were imported into Kosovo: 37 percent from Hungary, 29 percent from Slovenia and 13 percent from Germany.¹² Imports dominate in categories such as flavored yogurts, UHT milk and yellow cheese, where there is little or no local production.

Regional markets. Dairy is a traditional product in the Balkan region. Few Kosovar processors currently produce at a level sufficient to export in terms of quality and quantity. This year in particular, there is a shortage of raw milk due to region-wide drought conditions that led to lower crop yields and less feed for cows. In the past, a few Kosovar processors exported to Macedonia and Albania. Processors and MAFRD agree that Albania's dairy industry is less developed than Kosovo's and holds potential as a future export market.

BUSINESS ENABLING ENVIRONMENT

The EU advises PISG on drafting, passing, implementing and enforcing laws and policies related to economics and business. Bodies governing the dairy sector include MAFRD, which oversees policy making in the areas of agriculture, forestry and rural development and the Kosovo Veterinary and Food Agency (KVFA), which implements policies related to live animals and products of animal origin. The Kosovo Trust Agency (KTA), an independent body established by UNMIK in 2002, is authorized to privatize former SOEs including approximately 200 agricultural entities.

Following the conflict, PISG and the EU faced significant challenges in reconstructing Kosovo's economy. Not only were they charged with developing the legal and policy underpinnings for an independent market economy, but they also had to dismantle the fixtures of a command economy, all with limited resources.

MAFRD considers dairy a strategic industry and one of its development priorities for several reasons. First, a significant number of people are tied to the industry,¹³ thus one intervention may be able to impact multiple sub-sectors. Second, dairy is a valuable food source for the population, as well as a major source of income and employment for many families. Third, there is potential to substitute imports of value-added products and to export others, thus improving Kosovo's large trade imbalance.

¹² Peter Oldham, Elinor Bajraktari, and Andreas Wittkowsky (EU Economic Policy Office), *The Kosovo Dairy Sector: Study of Competitiveness of Imports*, November 2006.

¹³ Approximately 60 percent of Kosovo's population depends on agriculture and/or animal husbandry for their livelihood.

CONSTRAINTS

The team found four major constraints that limit the dairy industry's capacity to grow and meet end-market demand.

1. Lack of support mechanisms. PISG has limited resources to support the dairy industry directly. Those most in need of assistance are dairy producers and input suppliers (crop producers) that are especially vulnerable to shocks. With no regular source of revenue to invest in the sector and a small tax base, PISG relies on donor funding. The International Monetary Fund (IMF) blocked €1 million in PISG-approved milk subsidies to limit market distortion. PISG is considering a multi-year tax exemption for registered farmers to promote commercial farming and help build its future tax base. Targeted government programs and services such as fee-based rural advisory services provided by public sector agencies and/or the private sector and the strengthening of agricultural associations as service providers could support the development of the dairy sector and provide a safety net for farmers in times of need.

2. Damaged or poor infrastructure. High electricity and fuel costs reduce the competitiveness of Kosovo's dairy sector. Poor rural roads lead to longer milk hauling and collection times. A recent EU study on the dairy sector notes that collection and transport costs are more than 250 percent greater in Kosovo than in Bulgaria, Hungary, Slovenia and Turkey.¹⁴ High costs prevent producers and processors from operating efficiently and reduce their competitiveness against lower-cost, high-quality imports.

3. Slow privatization. The slow privatization of SOEs and agricultural land hampers investment, which is especially crucial at this point for Kosovo's dairy sector. One of the main functional weaknesses in the value chain is the insufficient quantity and quality of raw milk. According to producers, two constraints hinder their investment in livestock, equipment and other improvements: lack of access to finance and ownership issues. The largest dairy producer in Kosovo has decided to postpone further investment until he can buy the farm that he is leasing and he is not alone. Farmers want to ensure that they have the necessary funds to buy land or do not lose improvements they have made to immovable property they lease. Further, once farmers own their farms (land and buildings), they will have collateral for loans to finance future investment.

RESHAPING EXPECTATIONS OF GOVERNMENT

A remnant of Kosovo's previous command economy is the prevailing expectation among citizens that the government will intervene to fix all problems. The government wants to help, but is not sure where and how to intervene. For example, the government recognizes that access to finance is a major constraint for farmers, so it has proposed a credit guarantee scheme with 80 percent risk coverage, which the international donor community does not support. If publicized, what incentive would borrowers have to repay their loans? Nonpayment of government-backed loans could spread to private loans and destroy the banking sector, especially with a weak judiciary. In Kosovo's new market economy, it will take time to reshape the relationship and expectations between people and government.

Two factors complicate the privatization of agricultural land. First, cadastral records were lost, stolen or destroyed during the conflict, meaning title cannot be verified in many areas or prepared for transfer. A second complication is that many holdings are small and/or not contiguous, hampering the creation of large commercial farms for leasehold or sale. With small land plots, it is difficult to produce efficiently and achieve economies of scale; this is especially important for dairy, where feed amounts to more than 50 percent of the cost of milk production. To date, KTA has privatized about 40 percent of Kosovo's agricultural land, but the process is slow and burdened.

4. Weak legal and regulatory enforcement capacity. At present, there are limits to PISG's capacity to implement and enforce laws and regulations. In general, Kosovo is writing and passing laws in line with the EU, but they rarely

¹⁴ Peter Oldham, Elinor Bajraktari, and Andreas Wittkowsky (EU Economic Policy Office), *The Kosovo Dairy Sector: Study of Competitiveness of Imports*, November 2006.

reflect the reality on the ground. Thus, many laws are not enforced, as there is no logical step-by-step implementation plan, or the government does not have the necessary resources. Specific to dairy, it is important for MAFRD and KVFA to enforce the milk decree (discussed in detail in the next section) to level the playing field for processors and mitigate concerns regarding the security of raw milk supply.

Additionally, the courts in Kosovo are weak and ineffective. While programs are underway to strengthen the judiciary, the enforcement of laws is inconsistent or absent. Contract enforcement is vital for the development of dynamic relationships among value chain participants in all sectors—without it, economic growth cannot be sustained.

OPPORTUNITIES

MAFRD told us that they intend to declare milk a strategic product and part of Kosovo's national strategy. In its new development plan, MAFRD has set ambitious targets for the dairy sector to achieve by the end of 2013, including:

- Reduce imports to zero;
- Increase the average yield per cow from six to twelve liters per day;
- Ensure all milk produced is Grade A quality;
- Ensure all profitable dairies that survive the restructuring process are Hazard Analysis and Critical Control Point (HACCP) compliant and meet international standards.¹⁵

Upgrading is needed to reach these goals, particularly in the areas of input supply, production and processing. PISG and the EU have passed several measures that create opportunities and incentives for upgrading, but they could do more.

1. Institution of quality standards. MAFRD's most significant success to date in support of a competitive and safe dairy industry in Kosovo has been the administrative instruction regarding raw milk quality. Signed in September 2006, the decree establishes a payment correction for milk quality based on the market price, creating a price differential of 35 percent between the highest and lowest grades of milk sold through commercial channels.¹⁶ The decree provides an economic incentive for producers to improve raw milk quality and thus addresses one of the main functional weaknesses in Kosovo's dairy value chain: the insufficient quantity and quality of raw milk. All producers interviewed by the team indicated that the milk decree provides an adequate incentive for them to improve quality, but only if it is enforced and the test laboratory is objective.

The decree requires processors to send samples from each producer or milk collection center twice per month to the high-tech KVFA laboratory for testing. As an added incentive, KVFA will not charge for testing in 2007. Processors may

REBUILDING TRUST IN A POST-CONFLICT ENVIRONMENT

Following MAFRD's announcement, dairy processors voiced concerns regarding the implementation of the milk decree. They recognize the need to provide an economic incentive for farmers to improve milk quality, but many are worried about the security of milk supply; if they discount payments for low-quality milk, producers will sell to processors that do not comply with the new payment scheme or return to the green markets. In reply, the KCBS livestock cluster advisor remarked, "You need to trust each other, your colleagues, to comply with the law, and you need to trust the Ministry and KVFA to enforce the law."

¹⁵ MAFRD (with the assistance of EAR's Agricultural Master Plan for Kosovo project), *Agriculture and Rural Development Plan, 2007-2013 (third draft)*, November 2006, p. 87.

¹⁶ The milk decree lists four classes (grades) of milk based on microbiological qualities (total bacteria and somatic cell count). A premium of 15 percent is paid for extra class milk, first class milk is paid at the base rate (market price), and discounts of 5 percent and 20 percent are taken for second and third class milk respectively.

accept all classes of milk in 2007 and 2008, but as of January 1, 2009, they may not accept milk below EU standards. At a special meeting of the dairy processors association, MAFRD and KVFA announced their plan to implement and enforce the milk decree beginning November 2007. MAFRD regional officers will monitor compliance and assess penalties—fines from €1,000 to €10,000, for non-compliance.

The milk decree is the first step in instituting international quality standards and improving the safety of dairy products in Kosovo. High-quality inputs are required for high-quality outputs. As a next step, the government may consider promoting Good Manufacturing Practice (GMP) and HACCP certification (international food safety standards) among processors to improve the quality of outputs and the competitiveness of local products in domestic and export markets. GMP/HACCP certification is necessary to gain access to regional and EU markets. For example, Macedonia will require all domestic processors to be GMP/HACCP compliant by the end of 2008. Thus, to compete effectively against Macedonian products (among others) in domestic and export markets, Kosovar processors must meet the same standards. Essentially, standards function as a non-tariff barrier in developed markets and Kosovo's neighbors are joining this market. Currently, Kosovo's processors can compete in domestic markets without complying with international standards, but they have limited success against imports.

To meet certification requirements, processors need to invest in equipment and facility improvements and to upgrade their processes. So far, few processors have demonstrated the willingness and ability to make such an investment. In our interviews, none mentioned problems accessing finance; rather, they are concerned with the current shortage of raw milk. Few processors operate at full capacity; the industry average is 49 percent. Currently, there is no capacity in Kosovo to produce powdered milk during the summer season when milk tends to be abundant (except this year due to the drought) and imported powdered milk is too expensive for most processors. For smaller processors, it is not economically feasible to increase their overhead expenses when the supply of raw milk is short. Currently, only one processor in Kosovo is pursuing GMP/HACCP certification. MAFRD and dairy experts in Kosovo anticipate that few processors will be able to upgrade to meet international standards, but they do see potential in three to five of the larger processors to compete successfully against imports in domestic markets and to target export markets, particularly Albania. Several commented on the consolidation presently occurring in Bulgaria, where GMP/HACCP compliance is mandatory. They expect the same to happen in Kosovo's dairy sector in the next five to ten years as larger processors become more competitive and gain market share, forcing out smaller ones.

2. Favorable customs and tax regimes. MAFRD has removed duty and value-added tax (VAT) payments from imported agricultural inputs including grain and other animal feed ingredients, equipment and material for breeding. Drought conditions have affected the entire region this year, thus imported inputs remain expensive, even with the elimination of duty and VAT. Still, the exemptions help reduce costs for producers.

Also, incidences of milk dumping have been reduced. Dairy products such as UHT milk have been dumped in the Kosovo market at invoice prices reflecting the cost of production or less. To promote fair competition for local products, customs officials are trained to apply duty and VAT to the estimated value of imported goods, including standard production costs and a wholesale mark-up.¹⁷

¹⁷ The 2006 EU study (Oldham et al) confirmed allegations from Kosovar processors regarding dumping. The EU team collected wholesale prices from Ministries of Agriculture in select countries to compare against invoiced prices of imported products and to inform Kosovo's customs officials.

3. Trade promotion. Kosovo has one of the most liberal, uncomplicated trade regimes in Europe. Following the conflict, Kosovo became a large importer of goods from virtually all sectors; even today up to 85 percent¹⁸ of processed food products are imported including 73 percent¹⁹ of processed dairy products.

As one of eight parties to the Central European Free Trade Agreement (CEFTA), Kosovo aims to establish a free-trade zone with neighbors by December 31, 2010. Considering Kosovo's liberal trade regime and status as a net importer, current and potential Kosovar exporters stand to benefit more than importers from CEFTA. As noted previously, competitiveness in export markets in the dairy sector depends largely on the quality of local products, conformity to international standards and cost competitiveness.

CEFTA MEMBERS

Albania
Bosnia and Herzegovina
Croatia
UNMIK on behalf of Kosovo
Macedonia
Moldova
Montenegro
Serbia

CONFLICT FACTORS

The conflict and persisting post-conflict environment create unique constraints to building an enabling environment supportive to business in Kosovo. The neglect, damage and destruction from the larger conflict period hamper the privatization process and poor infrastructure leads to higher costs for producers and processors. As detailed in Section II, PISG's ability to govern effectively is limited by Kosovo's unresolved final status as well as the self-segregation and non-participation of Serbian Kosovar communities. PISG posts reserved for Serbian Kosovars remain vacant including the head of MAFRD. Parallel political, economic and social structures likely will stay in place in Serbian Kosovar communities until Kosovo's final status is resolved.

VALUE CHAIN PARTICIPANTS

As depicted in the value chain map, there are seven value chain functions in the Kosovo dairy sector: wholesaling, retailing, distribution, processing, assembly, production and input supply. There has been much rebuilding and some upgrading in Kosovo's dairy value chain from 1999 to the present. Value chain functions and linkages have been strengthened and there are no gaps or breaks in the chain, but weaknesses remain that hinder upgrading and growth. The major constraints to and opportunities for each function are presented below.

"Agriculture is a factory without a roof; it can collapse at anytime."

—Lulzim Shamolli, MAFRD Chief of Division for Agricultural Policies and Projects

WHOLESALE/RETAILING

Dairy products are sold to end consumers in four main types of venues in Kosovo: hypermarkets, small retail shops, kebabtores/bakeries and green markets. Hypermarkets, many of them wholesalers and retailers, first opened in Kosovo 3-4 years ago; now there are 15-20 throughout Kosovo including 9 in Pristina. Both foreign- and locally-owned hypermarkets carry a full selection of basic and value-added dairy products, local and imported. Many have exclusive arrangements to sell certain imported products.

Small retail shops, kebabtores and bakeries may be found in cities and villages of all sizes. Following the conflict, trade was one of the first functions to proliferate as donors, government and industry worked to rebuild the production base. Small retail shops carry a limited selection of local and imported basic and value-added dairy products. Bakeries

¹⁸ WYG International Ltd., *Marketing Support Project: Agri-food Sector Review*, April 2006 (updated in *Fourth Quarterly Report*, March 31, 2007).

¹⁹ Peter Oldham, Elinor Bajraktari, and Andreas Wittkowsky (EU Economic Policy Office), *The Kosovo Dairy Sector: Study of Competitiveness of Imports*, November 2006.

and kebabtores sell large quantities of locally produced drinkable yogurt. Retailers in Serbian Kosovar communities buy and sell goods primarily from or imported via Serbia.

Constraint. The research team concluded that larger retailers (particularly hypermarkets) and processors have the weakest relationship in Kosovo's dairy value chain. It is asymmetrical with retailers dominating the relationship due to end-market demand. Imports sell well, and profit margins typically are higher than those realized with local products. Until consumers demand more local products, retailers have little incentive to push them over imports when both are available.

Opportunity. Despite the uneven risk, hypermarkets are a good testing ground for processors to see how well they have improved product quality and competitiveness against imports. It is important for processors to strengthen relationships with larger retailers to gain access to market information and increase market share.

DISTRIBUTION

Many retailers and processors distribute through their own networks. Larger processors have multiple distribution centers throughout Kosovo and dispatch drivers daily to deliver fresh products to distribution centers and retailers. Smaller processors own refrigerated trucks and employ drivers to deliver products to retailers on a daily basis.

Constraint. Vertical integration of retailing and distribution or processing and distribution functions makes sense, but it is not cost effective for processors. Funds that could be invested in improvements to processing are diverted to distribution.

Opportunities. To reduce costs, processors that serve the same geographic regions may consider sharing storage facilities and/or trucks if they are not operating at full capacity. Alternately, larger processors could sell distribution services to smaller processors, or private distributors could target services to dairy processors.

PROCESSING

In the 1990s, there were two dairy SOEs (one was leased privately) and one other small private dairy. After the destruction of 1998-1999, it took several years for private dairy processors to recover and grow. In 2003, operations started to stabilize as the supply of raw milk increased and processors' relationships with producers and retailers developed.

Today, there are 24 dairy processors in Kosovo, 18 licensed by MAFRD²⁰ and two located in minority areas. Small processors have a capacity of up to 3,000 liters per day, and the largest processor can process up to 100,000 liters per day (but operates at 30 percent of capacity). In total, processors have a capacity of 231,000 liters per day but process only 114,000 liters per day, 49 percent of capacity.

Most processors have multiple product lines. Minimally, they produce basic products, and larger processors also make value-added products. Devolli produces UHT milk exclusively and competes successfully against imports.²¹ Drinkable yogurt is the most profitable product for many processors; the margin is small, but the volume is high. Few processors export, but look to Albania and Macedonia as potential markets for value-added products and white cheese.

Processors collect raw milk from individual producers and milk collection centers. Due to quality concerns, they prefer to buy from individual farmers under contract; however, with the shortage of milk this year, they are hesitant to reject any suppliers. Larger processors started paying a premium for high-quality milk prior to the implementation of

²⁰ Licensed dairies meet minimum, government-mandated requirements in their processing facilities and practices.

²¹ According to the 2006 EU study (Oldham et al), Kosovo can produce milk at a competitive price and could improve if hauling, transport, and processing costs (manufacturing overhead) were reduced.

the milk decree; presently, no processors discount payments for low-quality milk.

Some processors offer direct assistance to producers to improve the quality and quantity of raw milk. For example, Kabi trains farmers with whom it contracts on herd health, hygiene and proper milk handling practices and Bylmeti supplies lacto freezers to 13 of its larger farmers. Based on their agreement, Bylmeti does not charge the farmers to use the freezers (it is not a rental or lease agreement), but they must sell their milk to Bylmeti and maintain the freezers.

Constraints. The major weakness of the processing function is poor-quality outputs. Processors are constrained by an insufficient quantity and quality of raw milk, thus operate below full capacity. Processors need to upgrade and standardize their processing practices to improve the quality and consistency of finished products, increase production efficiency and reduce costs. Also, most processors view marketing as an expense rather than an investment. Differentiation via marketing will become more important once local products consistently meet international quality standards and the domestic market becomes more competitive.

Opportunities. Kosovar processors that comply with international standards will improve competitiveness against imports in domestic markets and gain access to export markets. Processors need to understand end-market demand for value-added products and assess their capacity and ability to invest in needed improvements to add product lines and upgrade processes to meet international standards. Also, the supply of high-quality raw milk inputs should improve if all processors follow, and the government enforces, the milk decree.

ASSEMBLY

During the conflict in 1998-1999, more than 50 percent of the livestock in Kosovo was destroyed. Early relief efforts targeted the replenishment of livestock and cows were distributed to small farmers. To facilitate the collection of milk from small producers and create an economically viable supply of raw milk for the commercial sector, donors and implementers helped establish 25 to 30 milk collection centers (MCCs) throughout Kosovo (in majority and minority areas). Most MCCs are owned and managed independently.

As an intermediary between small producers and processors, MCCs serve a necessary but temporary function. The milk they collect tends to be low quality, and poor-quality milk from one farmer lowers the quality of the composite sample. Small producers typically do not have the capacity to cool and store milk properly, which results in lower quality. As the requirements of the milk decree become more restrictive, the MCCs' composite samples likely will not meet EU standards. Small producers who improve the quality and quantity of their milk could move to semi-commercial or commercial production and sell directly to processors.

PRODUCTION

Within Yugoslavia, Kosovo was not the major dairy producer (it was Voivodina near Hungary), but it did have a good dairy industry that supported local markets. Farmers worked in cooperatives within the SOE system. Following the expulsion of Albanian Kosovars from all SOEs, many people moved to agricultural production including dairy farming. Most new farmers operated at a subsistence level, producing primarily for consumption; some sold unpasteurized milk or white cheese in green markets or door-to-door, or raw milk to the few small, private dairies.

Dairy Farms in Kosovo (2006)			
	No. of Farmers	No. of Cows	Avg. Herd Size
Subsistence (<5 cows)	78,124	97,610	1.3
Semi-commercial (5-9 cows)	4,378	26,559	6.1
Commercial (≥10 cows)	787	11,017	14
Total	83,289	135,186	1.6

Source: MAFRD

Private semi-commercial and commercial farmers (with five or more cows) did not begin to appear until 2001. According to MAFRD, there are more than 750 commercial farmers in Kosovo, 4,370 semi-commercial farmers and 78,000 subsistence farmers. The average herd size is 1.6 cows. The table on the previous page breaks down the types of farms by the number of farmers and cows and by average herd size from 2006.

Most commercial farmers sell their milk directly to processors under contract though a few have integrated vertically to process and distribute their own basic products. Small farmers sell their milk to MCCs.

Many farmers (regardless of size) produce their own feed crops (grains, corn and grass silage, hay, etc.) and buy imported concentrate and soybean meal from input suppliers. Some farmers contract with crop producers for specific grains and a few provide advances to share risk. For imported feed ingredients, farmers shop for good quality and price. Typically, they buy from the same input supplier, but not under contract.

Constraints. The shortage of high-quality raw milk is a major constraint to upgrading and sector growth. The milk decree sets the standard and creates an incentive for producers, but it does not address their most pressing needs—more cost-effective and balanced feed and access to finance. Farmers are very sensitive to shocks. The 2007 drought led to poor crop yields and inadequate feed rations for cows, thus shortage of raw milk in the market. Donors and implementers have helped improve crop yields and introduce balanced feed rations, yet costs remain high, and the productivity of cows is relatively low (the average is 5.5 liters per day for all farmers, 17 liters per day for commercial farmers). To increase the quantity and quality of raw milk, producers also need to invest in more livestock, equipment and/or structures, for which they require funds. The need is most acute for commercial farmers who already produce high-quality milk. Two farmers (and landowners) in this category have the willingness and know-how to expand, but lack needed financial resources.

Opportunities. Similar to processors, there are multiple steps farmers can take to standardize and improve production processes to realize higher yields, greater efficiency and lower costs. Many farmers are using calendars distributed by the milk producers association to monitor the (re)production cycles of their cows. The Dairy Herd Improvement (DHI) software program allows larger producers to monitor the yield, health and reproductive cycle of individual cows within their herds. The KCBS project began a pilot project with six farmers in 2006 and recently turned it over to the Kosovo Center for Livestock Breeding, which plans to enroll another 12 farmers in the program by the end of 2007. Additionally, producers may pursue GlobalGAP certification, the international standard for agricultural producers.

PROFITABLE FARMING

The largest farmer in Kosovo, Rudina in Prizren, grows rapeseed and processes it into biodiesel (top photo) to cut fuel costs, plus uses the byproduct (in bags in photo) as a substitute for some imported soybean meal, lowering feed costs.

By investing in calf hutches (bottom photo), the mortality rate of Rudina's calves has gone from 50 to 0 percent. An investment in better machinery allows Rudina to provide services to neighbors, supplementing income by €10,000 a year.



INPUT SUPPLY

Approximately one-third of the arable land in Kosovo is used for forage crops and grain. Farmers who specialize in crop production sell feed under contract (or more informally) to dairy farmers. Due to increased demand from dairy producers, crop farmers are improving the quantity and quality of feed crops. Input suppliers sell imported feed components, seeds, fertilizers and pesticides to farmers. Following the conflict, donors helped rebuild Kosovo's input supply system by linking local private dealers to regional suppliers.

Constraints. As noted in the previous section, dairy farmers demand lower-cost, higher-quality feed to improve the quality and quantity of raw milk. In general, seeds, fertilizers and pesticides are poor quality, thus yields are low. Crop farming is a highly volatile activity, and there is no insurance for crop farmers. Few have access to finance to invest in better inputs or to expand crop production.

Opportunities. Farmers are employing new technologies, such as better fertilizer, to improve crop yields and pastures. Seed multiplication is a new sector with good potential to reduce seed imports and lower costs. The KCBS project helped negotiate a reduced fee for soil tests performed by the Peja Agricultural Institute for (groups of) farmers delivering five or more samples, thus more farmers now are having their soil tested. Also, many farmers are interested in forming cooperatives to improve access to services and imported inputs.

SUPPORTING MARKETS

Related to the dairy industry, the financial services market is the most important supporting market. To invest in necessary improvements to upgrade and/or expand, most value chain participants require finance from financial institutions. Few have accumulated equity sufficient for investment or are able to access private investors.

FINANCIAL SERVICES MARKET

The financial services market in Kosovo is growing. Banking laws, the central bank and commercial banks are getting stronger, and more products are available for consumers and corporate customers. Despite growth in the sector, few Kosovars trust banks with their savings, a common mentality in post-conflict environments. In the 1990s and during the 1998-1999 conflict, money in banks was pulled to Belgrade, so non-Serbian Kosovars learned not to keep deposits in banks. Most deposits are short-term and medium- or long-term savings products such as bonds or certificates of deposit are not available. Alternatively, people invest in land and buildings and construction proliferates, often without proper permits and/or with unclear title due to missing cadastral records. Furthermore, the Kosovo Pension Savings Trust and KTA proceeds are held overseas. Overall, there is little liquidity in the market, thus bankers have limited capital to lend. At present, only land (with a clear title) and buildings (constructed legally) may be used as collateral for larger loans, while personal assets can be leveraged against small consumer loans. The KCBS project is promoting a law regarding bills of exchange and other negotiable instruments as collateral for short-term loans to make it easier for small businesses to access working capital or trade finance.

Agricultural loans account for less than two percent of all lending. Most banks are averse to agricultural lending due to a perception of high risk. At a minimum, banks require prospective borrowers to be registered, show records of their business activity and explain how loan funds will be used so loan officers may prescribe proper loan terms and collateral requirements. Misunderstandings between farmers and loan officers regarding needs and requirements complicate agricultural lending.

Leasing is a viable alternative to lending for value chain participants to procure equipment and vehicles. Presently, one local bank offers financial leasing products and more institutions are expected to introduce leasing in the first quarter of 2008. Although existing banking and company laws allow leasing, international organizations are working with local counterparts on a new leasing law, currently in draft form, to provide clarity on policies and procedures.

Constraints. Dairy and crop producers list access to finance as a major constraint. The issue is most pressing for farmers who already produce high-quality milk and/or feed and want to expand, but lack the funds to invest in additional livestock, equipment and other improvements. A banking expert in Kosovo said that loan officers do not explain lending and leasing options well to farmers. Many farmers complain that interest rates are too high (the average currently is 12 percent), and often there is a mismatch between the purpose and terms of the loan, including collateral requirements. Also, few farmers meet lenders' basic requirements of being registered and having records of their business activity. Banks need to rebuild trust with the public to encourage more deposits.

Opportunities. More banks are offering leasing as well as lending products to farmers, which help them procure needed equipment. Raiffeisen Bank made 88 loans totaling €307,500 (predominantly to the dairy sector) in the six months after it lowered its loan threshold from €5,000 to €2,000. Further, the passage of a law on bills of exchange and other negotiable instruments as collateral will allow the introduction of more short-term lending products for value chain participants. In addition, donor projects like KCBS are working with farmers to promote registration and improve record keeping.

SERVICE PROVIDERS

Veterinarians are the largest group of service providers to the dairy sector. Presently, there are 172 veterinarians registered with the Kosovo Chamber of Commerce, 74 percent of them private (the remaining 26 percent work for municipalities or KVFA). Aside from tests for certain diseases, veterinary services are not subsidized. Competition among veterinarians is increasing as more qualified practitioners are entering the market, thus they are paying more attention to service quality and pricing and to strengthening relationships with clients. A few of the larger producers and processors have a veterinarian on staff (for processors, to help their producers improve the quantity and quality of raw milk), but most producers work with local veterinarians as needed.

Biolab is the only private consulting company in Kosovo focused on food technology. Started by two Kosovar professionals who previously worked on international donor projects, Biolab works with clients throughout Kosovo, targeting primarily three sectors: dairy, fruits and vegetables. They work with donor projects and associations and offer fee-based services to farmers, MCCs and processors. As the exclusive distributor of Delaval milking equipment in Kosovo, Biolab provides installation, training and maintenance services to farmers.

Public sector entities like the Pristina Agricultural Faculty and Peja Agricultural Institute provide advice, training and services (mostly testing of soil, seeds, animal feed and food products) to farmers for a fee. Their services are not subsidized—the institutions set their own prices, the basis of which is unclear. In general, both current and potential clients consider public sector service providers slow and expensive.

Constraints. Producers and processors hesitate to pay for consulting services (remnants of a “grant” mentality) and tend to think in short-term gains rather than long-term profitability. There are few public sector service providers, especially at the municipal level. There is need and demand for rural advisory services.

Opportunities. There is room in the market for more private consulting companies—Biolab cannot keep up with demand.

Providers are developing new products and services as the needs of their clients change. For example, Biolab plans to develop products and services to help processors and producers meet international standards such as GMP/HACCP and GlobalGAP.

THE ELUSIVE 12-HOUR RETURN

Bunjamin Alili of Biolab described how prospective clients come to them with grand ideas but do not understand the investment and commitment required to achieve long-term profitability. They want easy, short-term gains: to plant in the morning, harvest in the afternoon, sell in the evening, and sleep with their profit stored safely under their pillow.

INTER-FIRM LINKAGES

Agricultural associations in Kosovo are relatively well developed. Not only do they serve as advocates for their members, but they also provide fee-based services to sustain their operations. Described below are the horizontal linkages among dairy producers and processors and a summary analysis of the vertical linkages in Kosovo's dairy value chain.

HORIZONTAL LINKAGES

Dairy producers and processors in Kosovo now have separate associations to represent their respective interests.

Kosovo Association of Milk Producers (KAMP). KAMP started with 40 members but has grown to a self-imposed limit of 200 members based on current management capacity. Governed by a board of 13 (11 Albanian Kosovars and 2 Serbian Kosovars) and managed by two professional staff, it welcomes producers of all ethnicities with farms of all sizes. Members pay annual dues of €2 per milking cow (€30 minimum) to support advocacy efforts, programming and administrative costs. Fee-based trainings are offered to all farmers (including non-members) in various locations throughout Kosovo. Donor projects work with KAMP (for example, via subcontract) to transfer new technologies to farmers throughout Kosovo. KAMP also creates and distributes informational materials and DVDs plus equipment for mastitis testing.

In addition, many crop and dairy producers have expressed interest in reviving cooperatives to improve access to services and imported inputs. Participation in cooperatives also may help producers achieve economies of scale.

Kosovo Dairy Processors Association (KDPA). KDPA has 15 members and would like to expand to include all licensed dairies in Kosovo. At a recent meeting, KDPA members decided that they all would be board members. Annual dues range from €100 to €400 based on processing capacity. Members benefit from effective advocacy such as the recent joint efforts of KDPA and KAMP to lobby government to remove duty and VAT from imported agricultural inputs.

Constraints. Trust is fragile among processors due to competition to buy raw milk. It is not efficient for all KDPA members to be on the board. Disagreements among the larger processors erode the leadership of KDPA's chairman, and without their buy-in, it is difficult to build consensus among members. Both associations need to find ways to sustain their activities without donor support. Currently, KCBS covers 40 percent of the KAMP and KDPA annual program budgets. To help contain overhead costs, many agricultural and agribusiness associations based in Pristina share a building and office equipment.

Opportunities. KAMP's programming helps farmers improve raw milk quality and quantity, and KDPA is a good vehicle to promote GMP/HACCP certification among processors. Both associations actively dialogue with the government.

VERTICAL LINKAGES

From the 1990s through the initial post-conflict period, there were few functioning vertical linkages in Kosovo's dairy value chain. In the past few years, commercial dairy production has started to expand. Vertical linkages have reappeared and are growing stronger.

Input suppliers, producers and processors. In general, relationships between members at the lower end of the value chain are the most collaborative. They regularly share information, attend group trainings and work within associations to achieve common goals, and there are more examples of trust and shared risk. Although formal contract enforcement is weak, most producers operate under contract with processors and there are few complaints of non-compliance. Due to the shortage of raw milk this year, producers command relatively more power over

processors, but do not abuse it. The milk decree creates a mechanism for processors to get a desired input, high-quality raw milk, and compensates the producer for taking extra steps to comply. In the end, both parties benefit. Processors and producers depend on each other to improve the quality and quantity of their respective outputs and to maximize profitability.

Processors. Moving to processors, relationships become more formal, and competition erodes trust. Processors do not trust each other to play fair in the competition for raw milk, which is why they all want a voice and a vote on KDPA's board. Also, they are wary of MAFRD's ability to enforce the milk decree. Similarly, processors are not willing to change their distribution systems even though it would reduce costs and improve profitability—they want to control their access to retailers/wholesalers and end markets.

Processors and retailers. Relationships between processors and retailers are marked by asymmetry. Retailers have more power since they have another source of supply with imports. This power varies depending on the size and location of the retailer. Small retailers in rural areas stock more local products so work closely with processors. Hypermarkets rely much less on processors, but this will change as the quality of local products improves. Processors tolerate late payments and greater risk due to potential future payoffs and greater market share. Long-term win-win situations exist for producer-processor as well as processor-retailer relationships.

D. VALUE CHAIN FINDINGS

In summary, weaknesses in the input supply, production and processing functions limit the ability of Kosovo's dairy value chain to increase market share and improve competitiveness. All weaknesses are linked and exacerbated by various constraints, but they can be overcome.

Processors need a greater supply of high-quality inputs to improve the quality of their products and ensure consistent high quality. Processors of value-added product lines need to upgrade equipment, facilities and processes to meet international standards.

Producers need to improve the quantity and quality of raw milk. The milk decree provides an economic incentive for producers, but does not address their key constraints: limited low-cost, high-quality feed and limited access to finance. Many farmers who can produce high-quality milk and want to expand do not have the resources to invest in additional livestock, equipment and other improvements. In some instances, producers who are not landowners are postponing investments until they can buy the land and/or buildings they lease.

Lastly, crop producers (input suppliers), including many vertically-integrated dairy farmers, need to improve the quantity and quality of feed by using better quality seeds, fertilizers and pesticides. In addition, the slow privatization of agricultural land and small land plots reduce production efficiency and limit economies of scale.

OPPORTUNITIES

- **High demand for dairy products.** In Kosovo and the Balkan region, dairy is a traditional product in terms of consumption and production, so demand is high. There is potential for processors to increase the number of value-added product lines; command a greater market share in domestic markets against imports; and expand production of basic products.

Lacto freezers cool milk quickly and keep bacterial counts low, key to producing high-quality raw milk.



- **Understanding consumer requirements.** Value chain participants understand that quality, freshness and consistency are the most important requirements of consumers.
- **Willingness and ability of value chain participants to change.** Processors and producers alike are working hard to improve the quality and quantity of their inputs and outputs. They are optimistic about the future and plan to (or would like to) invest in needed improvements.
- **Export potential.** CEFTA membership improves access to export markets. However, to compete effectively, Kosovo's dairy sector needs to improve the quality of local products, conform to international standards, reduce costs and expand production.

CONSTRAINTS

- **Infrastructure.** Damaged infrastructure increases production costs and lowers the competitiveness of local industries. An irregular supply of electricity, high fuel costs and poor rural roads hinder the dairy sector.
- **Access to finance.** There is little liquidity in the market due to a lack of medium- and long-term deposits, thus little capital for lending and most banks are averse to agricultural lending due to a perception of high risk. Producers, in particular, lack finance to invest in additional livestock, equipment and other improvements.
- **Weaknesses in the business enabling environment.** PISG and UNMIK have taken measures to create a supportive environment for business, but constraints remain: few support mechanisms for farmers; slow privatization of agricultural SOEs and land; weak legal and regulatory enforcement; and an ineffective judiciary.
- **Trust.** Among retailers and processors in particular, there is a lack of trust due to competition for scarce inputs (among processors) or power asymmetry (between retailers and processors).
- **Uncertainty regarding Kosovo's final status.** A vast majority of the international community supports independence for Kosovo, but there also are strong opponents. Uncertainty about Kosovo's future deters foreign direct investment and discourages Kosovar citizens and institutions from holding deposits in financial institutions in Kosovo.

ANALYSIS OF INCENTIVES

The following table outlines the incentives for value chain participants to take advantage of opportunities for and to counter constraints to upgrading.

	Producers	Processors
Opportunities <ul style="list-style-type: none"> • High demand for dairy products • Understanding consumer requirements • Willingness and ability of value chain participants to change • Export potential Constraints <ul style="list-style-type: none"> • Infrastructure • Access to finance • Weaknesses in the business enabling environment • Trust • Uncertainty regarding Kosovo's final status 	<ul style="list-style-type: none"> • Based on the pricing scheme of the new milk decree, farmers have an incentive to improve the quality and quantity of milk. • Producers have an incentive to register their farms and improve record-keeping to improve access to finance. • Producers (KAMP) have an incentive to lobby financial institutions to offer better lending and leasing products. • Producers (KAMP) have an incentive to lobby KTA to speed up the privatization of agricultural land. • Producers (KAMP) have an incentive to lobby MAFRD to provide more support to farmers. 	<ul style="list-style-type: none"> • Processors have an incentive to provide training and equipment to farmers to increase the supply of high-quality milk. • Processors have an incentive to contract with producers to secure their milk supply. • Due to strong end-market demand, processors have an incentive to improve product quality and add more value-added product lines. • Processors have an incentive to comply with international standards to target export markets. • Processors have an incentive to strengthen relationships with retailers to increase access to market information and market share. • Processors have an incentive to push MAFRD and KVFA to enforce the milk decree.

RELATIONSHIP BETWEEN VALUE CHAIN AND CONFLICT DYNAMICS

The conflict affected the dairy industry in myriad ways. In addition to reduced and dispersed livestock, destroyed crops, displaced people and devastated infrastructure, the dairy industry in Kosovo faced several unique constraints following the conflict. First, following the expulsion of Albanian Kosovars from all SOEs, many professionals were forced into situations of new (and often under-) employment. Many people moved to agricultural production including dairy farming, but mostly at a subsistence level. Kosovo's commercial dairy sector, albeit small, hardly functioned for most of the 1990s when horizontal and vertical linkages under the command production system were broken. Second, many cadastral records were lost, stolen or destroyed, significantly hampering the privatization process and the consolidation of agricultural land into larger, more efficient units. Third, the development of a business enabling environment was put on hold. There were no laws or regulations regarding milk quality or international standards to shape the development of a competitive local commercial sector.

Today, there is some cooperation within the dairy industry among conflict parties, but it is limited and based largely on proximity. The best example is the producers' association KAMP, which has both Albanian and Serbian (minority) Kosovar members and board members. Also, milk collection centers accept milk from producers of all ethnic groups. Commercial dairy farms and processors tend to be located in groups near larger cities throughout Kosovo. Milk needs to be handled carefully and quickly, thus it is not economically feasible for Serbian Kosovar producers located around Kosovo to ship their milk only to the two processing facilities managed by Serbian Kosovars. Geography plays a role in the dairy industry and to some extent mitigates conflict dynamics, particularly between producers and processors.

IV. STATEMENT AND ANALYSIS OF CASE STUDY RESEARCH QUESTIONS

A. STATEMENT OF RESEARCH QUESTIONS

The research team used the dairy value chain in Kosovo to address two questions:

1. How can sector selection and value chain analysis tools be adapted to post-conflict situations and the need for quick action?
2. How can value chain analysis and the value chain framework help us identify and understand the major opportunities for upgrading and the constraints to market growth exacerbated by or resulting from conflict?

The need for quick action is most important early in the post-conflict period when the food supply may be insecure, the production base weak and physical assets damaged or destroyed (the “relief” period). At this point, rebuilding and quick impact take precedence over competitiveness concerns in sector selection, especially as adequate information on market conditions and overall value chain strengths and weaknesses likely is lacking. The first finding in connection with Question #1 is that sector selection and value chain analysis tools require more adaptation in earlier post-conflict periods, taking conflict factors into consideration, to restart economic activity quickly.

A second and related finding is that rebuilding and competitiveness are not complementary objectives for relief programming. “Competitiveness” implies a leading presence or obvious comparative advantage in a sector, which may be objectively assessed in a traditional development context, but which conflict factors make difficult or impossible to judge. The need for quick action to restart agricultural production and economic activity, restoring livelihoods and creating incentives for non-violence, propels rebuilding to the forefront as an objective for relief programming.

In addition, based on the analysis of the sector selection process in Kosovo, the team offers five sector selection criteria for a post-conflict environment and evaluate Kosovo’s dairy sector against these to determine if it is a good choice for Kosovo (see *Sector Selection Criteria for Post-conflict Environments*, below).

Question #2 requires an examination of how the value chain framework can help direct donor assistance to support opportunities for upgrading and counter constraints to growth to improve competitiveness in domestic and export markets following conflict. The research team found that:

1. To rebuild and develop a value chain in a post-conflict environment, it is best to go from the micro to the macro—start with individual enterprises and/or functions to achieve quick results and gain traction before targeting the entire value chain.
2. In a post-conflict environment, there are unique constraints to, or breaks in, value chains that require special attention to rebuild capacity and promote upgrading.
3. Grants programs under donor projects are indispensable in post-conflict environments to help value chain participants invest in necessary improvements to upgrade.
4. When replenishing inputs, donors and implementers need to be careful that valuable, high-quality inputs such as livestock contribute to production.

The analysis also yields two general findings that have enhanced upgrading in Kosovo's dairy value chain and are applicable in any environment:

1. Economic incentives originating from the value chain itself, the business enabling environment (government) and/or the external environment promote upgrading.
2. Value chain development may be enhanced by direct work with leaders in the sector as well as with associations to spread benefits to smaller value chain participants.

B. ANALYSIS OF RESEARCH QUESTIONS

There is a large international presence in Kosovo, including UNMIK, KFOR and numerous multilateral and bilateral agencies and nongovernmental organizations (NGOs). This study focuses on programming by USAID with some examples from EAR and SDC. EAR directs programs primarily at the government level to build PISG's institutional capacity and Kosovo's legal and regulatory framework. While vital to the development of an enabling environment supportive to business, their work falls outside the scope of the analysis, as it is specific to only one element of the value chain framework. In contrast, USAID directs programs at both the public and private sectors that cover all elements of the value chain. Similarly, SDC targets various dairy value chain participants with its programs.

SECTOR SELECTION

A post-conflict environment introduces several complications to the sector selection process. Depending on the intensity, duration, and destruction of the conflict, there may be few value chains or parts of value chains to assess. Resources may have been shifted during the conflict from the most profitable industries, which often are targeted at the onset of violence, to less productive industries to enable survival. In the case of Kosovo, the economy is changing from a command to market orientation. The sectors supported by the state may not be the same as those emerging in a free market, especially after a decade-long conflict. Also, political or social sensitivities in a post-conflict environment may restrict certain sectors from consideration, such as mining in Kosovo.

In designing economic recovery and growth programs, donors set overall objectives that shape sector selection criteria. In addition, donors and implementers create or choose approaches and tools to evaluate sectors according to selection criteria. Conflict factors in the environment shape the choice of objectives, selection criteria and approaches/tools; adaptation often is required to yield development targets that are fungible in a post-conflict setting. The analysis of sector selection explores how donors and implementers adapted objectives, selection criteria and approaches/tools used to evaluate sectors as Kosovo moved from relief to development.

The following sub-sections analyze the sector selection process employed by donors and implementers in three distinct periods of programming in post-conflict Kosovo—relief, bridge and development. After defining each period, the study identifies the conflict factors present at that time then reviews the objectives of donor economic recovery and growth programs and how donors and implementers chose sector selection criteria. Finally, the study analyzes how sector selection approaches and tools were adapted to program objectives and selection criteria to yield feasible and timely choices.

RELIEF PROGRAMS

As defined by the team, the relief period stretches from mid-1999 to the end of 2002. Following humanitarian assistance efforts, donors and implementers worked to repair infrastructure and housing; restart agricultural production and other economic activity; and build governance structures and a legal and regulatory framework for Kosovo.

Conflict factors. Donors considered numerous factors when designing relief programs to restart economic activity in post-conflict Kosovo. First, the food supply was insecure. Very few crops had been planted during the 1998-1999 conflict, livestock numbers were low, and the input supply system was broken. Second, the production base was weak. The SOE system had fallen apart during the 1990s, physical assets had deteriorated, and many people had been forced to take new jobs. Entrepreneurs who emerged during the 1990s worked primarily in informal markets. Third, most physical, banking and communications infrastructures were damaged or inadequate. Lastly, there were no formal governance structures and no legal and regulatory framework in Kosovo. Taken together, these conflict factors complicated the sector selection, program design and implementation processes.

Objectives. Donors considered Kosovo’s conflict factors when setting objectives for their economic recovery and growth programs. In general, the objectives focus on two central themes: rebuilding and competitiveness. USAID economic growth programming from 2001-2003 fell under Strategic Objective (SO) 1.3 “Establishment of an Economic Policy and Institutional Framework that Facilitates the Recovery and Expansion of the Private Sector-Led Economy.” A 1999 assessment of agribusiness in Kosovo lists the following objectives for USAID’s program:

- Increase agribusiness employment and incomes
- Reverse the rural to urban migration
- Increase sector productivity
- Achieve a reasonably quick, positive impact
- Identify products where Kosovo agriculture could have a competitive advantage both in domestic and export markets
- Reduce substantial food trade imbalance
- Interventions are market-led and private-sector driven.²²

For USAID’s relief programs, the research team observed that rebuilding and quick impact took precedence over long-term competitiveness goals. Similarly, the relevant focal area of EAR’s relief programming was called “economic reconstruction, regeneration and reform.” The specific objectives of their rural economy program included recapturing domestic and regional markets for basic and value-added products and increasing on- and off-farm productivity, profitability, employment and incomes.²³

Sector selection criteria. The 1999 agribusiness assessment for USAID outlines the assessment team’s prioritized sector selection criteria, shown in the table below.²⁴

“A” Priority Criteria	“B” Priority Criteria
<ul style="list-style-type: none"> • Realistic potential production value per hectare • Size of local market available • Amount of labor required in production and processing • Competitive advantage that can be achieved • Export potential 	<ul style="list-style-type: none"> • Experience base available • Effectiveness of land utilization • Irrigation requirement • Inputs cost

Interestingly, two of the five “A” priority sector selection criteria relate to competitiveness, whereas USAID’s priority objective was rebuilding.

²² Booz Allen Hamilton Inc., and Cargill Technical Services Inc., *Kosovo Agribusiness Sector Assessment*, November 1999, p. 5.

²³ European Agency for Reconstruction, *Kosovo 2001, Action Programme Parts 1 and 2*, November and December 2000.

²⁴ Booz Allen Hamilton Inc., and Cargill Technical Services Inc., *Kosovo Agribusiness Sector Assessment*, November 1999, p. 36-37.

For initial programs in post-conflict environments, the research team found that rebuilding and competitiveness are not complementary objectives. Competitiveness implies the presence of lead sectors or enterprises with an advantage over other regional or global competitors. The process to select lead sectors or enterprises in a traditional development environment can be challenging and time consuming and may not be feasible in a post-conflict environment, considering conflict factors and the need for quick action. Conflict factors make it difficult to determine which sectors or enterprises will survive, respond to technical assistance and be able to access resources to change and grow. For example, many Albanian Kosovars turned to agriculture for employment after being forced from their SOE positions in the early 1990s. After the conflict, it was unclear whether these new farmers would stay in agriculture/agribusiness or move to other sectors. Further, in a post-conflict situation where there may be winners and losers, the identification and selection of lead sectors or enterprises could be contentious and exacerbate conflict dynamics. Political or social sensitivities can restrict certain sectors from consideration—mining (of coal and lead in particular) was one of the most profitable industries in Kosovo before the conflict and a large source of export revenue. However, it now is too politically charged due to the location of the larger mines in or near minority areas. The presence of conflict factors and the need for quick action complicate and limit the selection of sectors or enterprises based on potential competitiveness. Thus, the mismatch of competitiveness criteria and rebuilding objectives can lead to the selection of inappropriate sectors. Early competitiveness targets could be wrong or untimely and drain resources from rebuilding efforts.

Adaptation of approaches/tools. Sector selection approaches and tools require more adaptation in earlier post-conflict periods to restart economic activity quickly. Decisions must be made in a short amount of time and resources directed toward beneficiaries as soon as possible to rebuild and create incentives for non-violence. Typical approaches to evaluating sectors include reviewing primary and secondary sources of qualitative and quantitative information and interviewing donors, NGOs, government officials and private sector representatives. However, these approaches take time and it could be difficult to get current, accurate information and/or to identify or reach people. A key element of value chain or sector analysis is end-market demand and depending on the scope, duration, destruction of the conflict, domestic and regional market information may be limited or distorted. During relief periods, donors and implementers should adapt sector selection approaches and tools based on pressing needs (often the conflict factors) in the post-conflict environment and the availability of information and time.

In Kosovo, the 1999 assessment team contracted by USAID conducted an evaluation of sectors and reported on its sector selection process, but recommended that USAID not target specific sectors with its relief programs. The main reason for this was a lack of time, information and resources to evaluate sectors.²⁵ Rather, they recommended a program of seven linked components to replenish agricultural inputs, conduct formal sector assessments and economic analyses, assist with privatization and create a one-stop-shop agribusiness development center to offer technical, managerial and financial assistance to target clients, primarily individual entrepreneurs.²⁶ The process of selecting individual enterprises was considered less time-consuming and risky immediately post-conflict than that for selecting sectors. This conclusion is logical considering the uncertainties surrounding sector selection and the need for quick action. By starting small and achieving quick results with farmers, entrepreneurs and enterprises, donors and implementers are better able to gauge capabilities and available resources and gather more information on market conditions and overall value chain strengths and weaknesses. As results from rebuilding efforts help to mitigate conflict factors, they then can shift to a macro view of the situation and target specific sectors.

²⁵ Booz Allen & Hamilton Inc., *Kosovo Agribusiness Sector Assessment*, November 1999, p. 57.

²⁶ Booz Allen & Hamilton Inc., *Kosovo Agribusiness Sector Assessment*, November 1999, p. 3.

BRIDGE PROGRAMS

Based on USAID's program structure, the team defines the period from 2002 to 2004 as the "bridge" period. In mid-2002, USAID began developing a new phase of programming to replace its relief portfolio, which ended in the last quarter of 2002.

Conflict factors. By the end of the relief period, conflict factors had changed considerably. The food supply was no longer insecure. Agricultural production had resumed with inputs from a national system of private dealers. Producers were selling fresh products in green markets and had begun supplying emerging private processors. Infrastructure had been repaired though some weaknesses remained, particularly in rural areas; banks had reopened and started offering services to consumers; and a local government had been established after peaceful elections. During the bridge period, a lack of investment and limited access to finance (due to Kosovo's unresolved final status) became important conflict factors and conditions arising from Kosovo's transition from a command to market economy played a greater role. These transition factors included the slow privatization of SOEs and agricultural land, the need to reorient processors to end-market demand and the rebuilding of linkages between value chain participants (by choice rather than as mandated by the state).

Objectives. In mid-2002, USAID commissioned another assessment of agriculture and agribusiness in Kosovo. At that point, USAID was developing programs under a larger Kosovo Agriculture Sector Support (KASS) program to bridge the gap until they finalized their new strategy. Under KASS, USAID's three areas of focus were: 1) agribusiness development; 2) support to farmers; and 3) comparative advantage in selected agricultural sub-sectors.²⁷ Under KASS, competitiveness started to gain importance over rebuilding as an objective.

Sector selection criteria. As competitiveness gained importance as an objective, sector selection criteria changed. Under KASS, the potential to increase domestic demand for locally produced products, import substitution and export potential topped the list of selection criteria,²⁸ thus bridge programs were sector or product-specific. In its 2002 program for Kosovo, EAR listed agriculture and food processing as "pillars of a recovering rural economy"²⁹ and Part II of its 2001 program mentioned the development of "longer-term comparative advantage in key sub-sectors and products,"³⁰ but did not detail criteria or approaches/tools for evaluating and selecting sectors or products.

Adaptation of approaches/tools. Sector selection and value chain analysis tools required less adaptation during the bridge period in Kosovo. Donors and implementers had the resources to assess end-market demand and identify weak value chain functions and relationships as well as opportunities to upgrade and constraints to growth. With this information, they could determine growth potential in domestic and export markets. As detailed previously, donors and implementers used various information sources to evaluate sectors against selected criteria. Ideally, sector selection is a participatory process that involves potential stakeholders and beneficiaries. Although information on the 2002 assessment for USAID is limited, the research team presumes that the local private sector was involved minimally and/or end markets were not researched carefully, particularly those for the dairy sector, as selected products did not match producer or processor capabilities or reflect domestic market demand trends. Processors were having difficulty meeting consumers' quality requirements with current products, so it did not make sense to add new, value-added product lines, for which requirements were more stringent and competition from imports strong. Through its umbrella grant program, USAID decided to intensify its support to producers in five agricultural sectors.

²⁷ USAID, Modification 07 to KBS Contract, July 2002.

²⁸ USAID, Modification 07 to KBS Contract, July 2002.

²⁹ European Agency for Reconstruction, *Kosovo 2002 – Focal Area: Economic Reconstruction, Regeneration and Reform*.

³⁰ European Agency for Reconstruction, *Kosovo 2001, Action Programme Part 2*, December 2000.

DEVELOPMENT PROGRAMS

Beginning in late 2004, donors operating programs in Kosovo shifted their focus from relief to development and modified program objectives, approaches and sector selection criteria to reflect the evolving conflict factors.

Conflict factors. By 2004, Kosovo began to resemble a traditional transitional environment, albeit with remnants from conflict such as damaged assets and infrastructure. In March and October 2004, however, Kosovars and the international community were reminded of the volatility in Kosovo with the occurrence of riots and boycotted (though peaceful) elections. From 2004 to today, the most pressing conflict factors are Kosovo's unresolved final status, which limits investment and access to finance; the damaged/inadequate infrastructure; and a lack of trust among people and between people and institutions. In addition, transition factors such as slow privatization and weak legal and regulatory enforcement capacity continue to hinder growth.

Objectives. As Kosovo moved from the bridge to development period, donors reordered the priority of their economic growth objectives. In its 2004-2008 strategy, USAID updated SO 1.3 to "Accelerated Growth of the Private Sector" with Intermediate Results 1.3.1 "Increased Competitiveness of the Agriculture Sector" and 1.3.2 "Improved Capacity of Private Enterprises." Based on the responsiveness of targeted sectors and/or enterprises to technical assistance under relief and bridge projects, USAID launched development programs to promote the competitiveness of specific sectors. Likewise, EAR changed its focus from rebuilding to development in its 2005 program as reflected in the new focal area title "economic and social development" and corresponding objective "to promote sustainable economic development for all of Kosovo's communities."³¹ A 2005 evaluation of EAR's economic development program presents four themes, one of which addresses the need for donor objectives to evolve when transitioning from relief to development programming by moving from: 1) general support to focused support of competitiveness and innovation, 2) enterprise development toward sector or overall economic development, and 3) "aid" to "partnership."³²

Sector selection criteria. In a recent meeting, USAID/Kosovo indicated that its primary sector selection criteria for development programs, based on an objective of competitiveness, are growth potential and import substitution, both of which match the criteria of the agriculture/agribusiness evaluation USAID commissioned in 2004.

Adaptation of approaches/tools. Sector selection and value chain analysis tools require little, if any, adaptation for development programs in post-conflict environments. By that point, donors and implementers have monitored the development of sectors targeted in previous programs and can access information on new sectors with relative ease. To develop its 2004-2008 strategy, USAID collected feedback from donors, government and industry to inform both its strategy and the sector selection process. USAID also commissioned an evaluation of its agriculture/agribusiness portfolio to measure the effectiveness of past approaches in developing selected sectors and to determine what sectors to support in the next round of programming. The competitiveness objective prompted USAID to select sectors based on two main criteria: growth potential and import substitution. Other objectives for economic development programs, such as maximizing socio-economic impact or improving the livelihoods of specific populations (such as certain geographic regions or demographic groups), would likely yield different selection criteria and lead to the selection of a different mix of sectors. To promote long-term development and competitiveness, USAID decided to continue supporting five agricultural sectors including dairy and two non-agricultural sectors.

SECTOR-SELECTION CRITERIA FOR POST-CONFLICT ENVIRONMENTS

The research yielded five qualitative sector selection criteria for a post-conflict environment, which the research team used to evaluate Kosovo's dairy sector:

³¹ European Agency for Reconstruction, *Kosovo Annual Programme 2005*.

³² European Agency for Reconstruction, *Thematic/Cross-centre: Economic Development – Small and Medium-size Enterprises*, January 2005.

1. **Sector selection should be driven by the domestic market and consumer demand**, with emphasis placed on sectors for which there is high demand and short supply, or where supply consists primarily of imports. Throughout the Balkans, dairy is a traditional product in terms of consumption and production, thus there is high demand for both basic and value-added products. In Kosovo today, 73 percent of processed dairy products are imported—in earlier periods, the percentage was higher.
2. **The private sector should have an interest and willingness to rebuild and potentially expand the sector.** In Kosovo, the number of new, private dairies and dairy farmers expanding to supply semi-commercial or commercial channels demonstrates a strong level of private-sector interest in developing and expanding the sector.
3. **Efforts should build on existing capacity and skills rather than new sectors.** The production base should be functioning to some extent or operational prior to the conflict. In Kosovo, although subsistence-level production predominated in the 1990s, the production base is functioning and there was commercial dairy production under the command system.
4. **Investment in the sector should regenerate employment;** labor-intensive industries are good targets. Approximately 60 percent of Kosovo’s population depends on agriculture and/or animal husbandry for their livelihoods and dairy is labor-intensive.
5. **Selected sectors should lead to greater self-reliance and reduce imports.** In the 1990s, Kosovo became a net importer of food products. As noted above, imports amount to 24 percent of all dairy products (fresh and processed) and 73 percent of processed products. There is great potential for import substitution.

When examining Kosovo’s dairy value chain in light of these criteria, the team reached the same conclusion as earlier assessment teams and donors—dairy is a good choice for development in Kosovo. The table below presents a summary evaluation of Kosovo’s dairy sector against these selection criteria.

Sector Selection Criteria	Kosovo’s Dairy Sector
<ul style="list-style-type: none"> High demand and short supply or supply consists primarily of imports 	<ul style="list-style-type: none"> Dairy is a traditional product in Kosovo and the region High demand for both basic and value-added products Following the conflict, most processed dairy products were imported
<ul style="list-style-type: none"> Interest and willingness of private sector to rebuild and potentially expand the sector 	<ul style="list-style-type: none"> Private sector interest demonstrated by the number of new private dairies plus semi-commercial and commercial dairy farmers
<ul style="list-style-type: none"> Production base functioning to some extent or operational prior to conflict 	<ul style="list-style-type: none"> Production base neglected during the conflict, but operational under the previous command system
<ul style="list-style-type: none"> Labor-intensive industry (potential to regenerate employment) 	<ul style="list-style-type: none"> Approximately 60 percent of Kosovars depend on agriculture and/or animal husbandry for their livelihood Dairy is labor-intensive
<ul style="list-style-type: none"> Import substitution 	<ul style="list-style-type: none"> Imports comprise 73 percent of processed dairy products Potential for import substitution is great

MOVING FROM RELIEF TO DEVELOPMENT

As conflict factors weaken or disappear and a post-conflict environment evolves from relief to development, the sector selection process becomes less complicated. Access to qualitative and quantitative information improves, and it is easier to identify lead sectors or enterprises. Donors’ experience helps them see what gaps or breaks in value chains can be repaired or facilitated most effectively with limited resources. The fact that resources become more limited as donors move from relief to development programming adds weight to the sector selection process. Resources need to

be directed to good and timely choices via interventions that enhance the ability of the selected sectors to meet end-market demand and contribute to overall economic recovery and growth.

In turning to look at the donor projects targeting the development of Kosovo's dairy sector from 1999 to the present, the study analyzes how the value chain framework was used in project design and implementation, particularly, to promote upgrading.

THE VALUE CHAIN FRAMEWORK AND UPGRADING

Donors selected dairy among other sectors as development targets based on strong end-market demand, existing capabilities and growth potential. In addition, they wanted to alleviate Kosovo's dependence on imported food products. However, to improve competitiveness against imports in domestic markets and potentially target export markets, upgrading is necessary.

After the conflict, Kosovo's production base lay in shambles—infrastructure, buildings, equipment, livestock and people were dispersed, damaged, or destroyed. Most dairy farmers had one or two cows and there were three marginally producing dairies. Where and how to start rebuilding? The value chain analysis (Section III) reveals that dairy producers and processors in Kosovo have been upgrading to improve the quality and quantity of their respective outputs to meet demand, but how did they get to that point? To answer these questions, the research team looked at donor projects targeting the dairy industry in Kosovo from 1999 to the present to understand how approaches and interventions evolved to support opportunities for upgrading and counter constraints to growth as Kosovo moved from relief to development.

The following sub-sections survey several donor relief, bridge and development programs targeting Kosovo's dairy sector and analyze project design, implementation and results from each period to identify strengths and weaknesses in programming. The study details the work of donors and implementers during the bridge and development periods to promote upgrading and to strengthen vertical linkages, first in the production and processing functions and later throughout Kosovo's dairy value chain. At the end of each sub-section, findings related to the value chain framework and upgrading in post-conflict environments are summarized.

RELIEF PROGRAMS

The table on the next page presents key information on a sample of donor projects targeting the dairy sector from 1999 to 2002.

Project design. The research team identified four predominate approaches used by relief projects targeting economic recovery or agribusiness in general, or dairy in particular, in post-conflict Kosovo. The earliest emergency projects involved replenishment of inputs, primarily livestock, equipment, seeds, fertilizers and pesticides. Imported inputs were distributed directly by donors, NGOs and/or local private dealers. Second, several relief programs targeted dairy value chain participants at the lower end of the chain. USAID's KADP and LINK programs focused on input supply and production and horizontal linkages of these two groups to rebuild capacity, improve the quality and efficiency of production and promote cooperation. Third, USAID's KBS program employed a general business development approach, offering consulting services and training to individual enterprises. Fourth, the EU and other donors focused on building Kosovo's legal and regulatory framework and government

FLYING COWS

When asked about the dairy industry in the early post-conflict period, most interviewees pointed to the sky and told the story about the flying cows from Switzerland. In 2000, more than 5,500 high-quality milking cows and 45 breeding bulls were air-lifted to Kosovo from Switzerland, Austria, and Germany by SDC, the Food and Agriculture Organization (FAO) of the UN, and the World Bank. NGOs helped select recipient families with experience in livestock production and access to at least one hectare of pasture. Each family received one cow.

capacity. None of the relief projects used a comprehensive value chain approach. USAID/Kosovo explained that they were uncertain what sectors or enterprises would survive and respond to technical assistance, hence the general approach in the first years following the conflict.

Sample of Donor Programs during the Relief Period (1999-2002)

Project Name	Value Chain Participant(s)	Objectives/Main Activities	Results
<u>USAID</u> Kosovo Emergency Agri-Input Program (KEAP), Oct 1999 – May 2000	<ul style="list-style-type: none"> Input suppliers Producers (feed crops) Associations (horizontal linkages) 	<ul style="list-style-type: none"> Identify and organize entrepreneurs to supply and market inputs for spring 2000 planting season Disseminate market information and initiate market linkages with regional input suppliers Assess policy priorities to develop market-based input supply system 	<ul style="list-style-type: none"> Laid groundwork for development of national input supply system Delivered \$40 million in seeds, fertilizers and pesticides—75 percent through private dealers Increased incomes and created jobs within input supply system Established three associations and an umbrella alliance
Kosovo Agribusiness Development Program (KADP), Jun 2000 – Jan 2003	<ul style="list-style-type: none"> Input suppliers Producers (feed crops) Associations (horizontal linkages) 	<ul style="list-style-type: none"> Organize associations to deliver technical assistance and serve as agents of change Create private extension services Facilitate access to credit Provide policy analysis and promote reform related to agribusiness development 	<ul style="list-style-type: none"> Developed capacity of associations to transfer technology via field trials, demonstrations and training Formed Association of Milk Processors and Producers of Kosovo (AMPKO) Improved average yields for corn (25 percent) and wheat (29 percent)
Livestock Improvement in Novo Brdo/Novo Bërdë and Kamenica/Kame nicë (LINK), 1999 – 2002	<ul style="list-style-type: none"> Producers Assemblers 	<ul style="list-style-type: none"> Introduce new dairy production technologies to farmers using extension methodology Improve quantity and quality of raw milk sold to commercial channels 	<ul style="list-style-type: none"> Set up 170 demonstration farmers in two municipalities, reaching 3,330 participant farmers Improved milk yields by 1,500 liters per year per cow Increased sales of raw milk to processors by 50 percent from participating farmers
Kosovo Business Support (KBS) Program, Oct 2000 – Sep 2004	No direct dairy value chain targets until mid-2002	<ul style="list-style-type: none"> Provide broad-based business development services and training to enterprises in 1) accounting, 2) strategic plans, 3) marketing, 4) access to finance, and 5) trade and investment linkages 	<ul style="list-style-type: none"> Provided consulting to more than 900 enterprises and training to more than 1,500 enterprises Facilitated creation of 1,600 new jobs in client enterprises Enabled clients to generate €7.5 million in business transactions and obtain more than €12 million in bank financing Supported development of five new associations
<u>EAR</u> Multiple programs, 1999–2002	<ul style="list-style-type: none"> Input suppliers 		<ul style="list-style-type: none"> Supplied high-quality seeds and fertilizers through private-sector dealers and cooperatives Rehabilitated irrigation infrastructure
<u>SDC</u> 1999–2002	<ul style="list-style-type: none"> Producers (crop and dairy) 		<ul style="list-style-type: none"> Distributed seeds to 15,000 families and 1,750 cows to approximately 1,000 families

Implementation. The general approach of most relief programs called for flexible implementation based on what was possible to accomplish. KEAP worked with NGOs and local private dealers to distribute imported inputs to

farmers. Working through NGOs expedited initial efforts while the private-sector focus led to the development of a national input supply system. KADP and LINK designed activities based on the resources available to input suppliers and producers, focusing on simple, low-cost changes to boost production, improve quality and provide inputs to the infant commercial sector. KADP's use of associations to deliver technical assistance was effective in the short-term and helped rebuild linkages necessary for long-term sector development. KBS developed a package of services to address gaps in general business management knowledge for clients from various sectors and at different stages of development. Flexible step-by-step implementation allowed donors and implementers to make strides in rebuilding Kosovo's agriculture and production base.

Results. Donors and implementers achieved quick impact and met rebuilding objectives by targeting existing capacities in the private sector. As seen in the table, implementers reported tangible quantitative and qualitative results, such as the delivery of inputs to farmers, higher yields, increased incomes, increased sales to commercial channels and the creation of jobs. Results were small to start but incremental as donors took gradual steps to see what would work and with whom, before committing significant resources to specific sectors of the economy. Donors also worked with the public sector on key constraints to economic recovery and growth such as infrastructure, energy, privatization, customs/tax regimes and other fiscal policies and monetary policies, but results came slowly as the new government gained its footing.

STRENGTHS

- **Economic activity restarted.** Donors and implementers successfully restarted agricultural production and other economic activity to restore the food supply and regenerate incomes and employment for many Kosovars.
- **Effective targeting.** Private sector participants (farmers, entrepreneurs and enterprises) responded well to technical assistance and training activities. Donors and implementers achieved greater and quicker impact with interventions targeting existing capacities rather than start-ups. A 2005 evaluation of EAR's economic development program in the Balkans noted that the USAID and GTZ approach of targeting existing enterprises in Kosovo was more relevant than EAR's social-oriented approach of targeting start-ups.³³
- **Efficient delivery of relevant technical assistance.** Associations and demonstration farmers were effective vehicles for introducing new technologies to farmers. Without outside intervention, few farmers would have been exposed to new and/or better production practices. Further, donors and implementers focused on no- or low-cost changes to make technologies accessible to those with limited access to capital.
- **Flexible project design and implementation.** Donors and implementers adjusted programs to meet on-the-ground realities in post-conflict Kosovo.

WEAKNESSES

- **Few inputs to commercial farmers.** Donors distributed inputs primarily to subsistence farmers to provide a source of food and/or income immediately following the conflict. In combination, FAO and SDC supplied more than 5,500 high-quality milking cows to Kosovo. It is said that little milk from these cows entered commercial channels. Rather, recipient families consumed it or sold it in green markets and those who could not care for the animals sold them, sometimes for meat. In such cases, valuable inputs did not contribute to the growth of commercial agriculture in Kosovo.

³³ European Agency for Reconstruction, *Thematic/Cross-centre: Economic Development – Small and Medium-size Enterprises*, January 2005.

- **Poor coordination.** Donor efforts were not always well coordinated, resulting in duplication of or a failure to facilitate collaboration among projects.
- **Quantity over quality.** General program approaches often favored quantity over quality, a focus on reaching numerous beneficiaries with basic services and/or training, rather than providing customized services to enterprises to help them meet demand.

Summary findings from relief programs. Through relief programs, donors and implementers started to rebuild the input supply and production functions of Kosovo's dairy value chain. They targeted individual farmers, entrepreneurs and enterprises with existing capabilities first to restore the supply of fresh milk products on farms and in green markets and then to increase yields to provide inputs for commercial production. Associations facilitated the transfer of new technologies and the dissemination of information to wider audiences, as well as strengthened relationships between farmers. By the end of the relief period, donors and implementers had rebuilt the input supply and production functions of Kosovo's dairy value chain to a level sufficient to start supporting the few private processors that had emerged. The next sub-section shows how USAID shifted its focus to commercial production and began to promote upgrading and improve linkages in Kosovo's dairy value chain with its bridge programs.

BRIDGE PROGRAMS

The table on the next page presents an overview of USAID's 2003-2004 bridge programs.

Project design. With its bridge programs, USAID started to promote vertical linkages between, and upgrading in, the production and processing functions of Kosovo's dairy value chain. Based on the results of its relief programs and the 2002 assessment, USAID intensified and expanded its LINK and KBS programs to target specific sectors and products. Similar to LINK, LINK COMPETES focused on increasing the quantity and quality of raw milk via the introduction of new production technologies, but with broader geographical coverage and emphasis on commercial over subsistence production. In parallel, KBS started working with select dairy processors to produce two value-added products to compete against imports.³⁴

Implementation. The sequencing of interventions under LINK COMPETES and KBS promoted product and process upgrading. LINK COMPETES used its extension methodology to introduce new technologies to farmers and improve the quantity and quality of raw milk. Furthermore, to link smaller farmers to processors and remedy a gap in the dairy value chain in post-conflict Kosovo, five additional milk collection centers (MCCs) were established. The project also helped improve the management skills of producers and MCC managers by introducing both simple record-keeping systems, a key to accessing finance, and forward supply contracts to formalize transactions between producers and a processor in Prizren. For KBS, agribusiness development and competitiveness was a new activity that required the hiring of new project staff and a shift in methodology. Along with its package of general business development services, KBS provided specific technical assistance and training to processors to help them upgrade their product offerings and compete with imports.

Results. With its bridge programs, USAID began to strengthen functions and linkages in Kosovo's dairy value chain. Producers who adopted new technologies saw both yields and quality improve. Those who signed forward contracts secured a more stable market for their milk. Moreover, processors started testing raw milk and offering incentive payments to producers for high-quality milk, a necessary input for their new value-added products. Gradually, relationships between processors and producers started to become more collaborative. Also, LINK COMPETES made some progress in promoting farming as a business, connecting more farmers to commercial channels via MCCs and introducing basic management practices such as record-keeping. KBS had mixed results with its product-specific

³⁴ In total, following contract modification 07, KBS began supporting the processing of eight agricultural products.

approach. While KBS was successful in exposing processors to new value-added products and international standards, processors did not have the equipment, financial resources, or access to high-quality inputs sufficient to sustain new product lines after KBS ended. They could not match consumer requirements related to product quality consistently and at a competitive price, thus it was difficult to compete against imports. The two projects did not collaborate as closely as desired, yet interventions led to some upgrading among participating producers and processors and strengthened linkages between the two groups.

Sample of Donor Programs during the Bridge Period (2003-2004)

Project Name	Value Chain Participant(s)	Objectives/Main Activities	Results
LINK's Competitive Marketing of Milk Production Enabling Trade and Enterprise Success (LINK COMPETES), Jan 2003–Oct 2004	<ul style="list-style-type: none"> Producers Assemblers 	<ul style="list-style-type: none"> Increase commercial dairy production, income and employment Transfer new dairy production technologies to farmers 	<ul style="list-style-type: none"> Reached 410 participant farmers in seven municipalities with training and advisory services via 41 “progressive” farmers Increased average milk yields by 21 percent and improved milk quality by 20 percent Established five MCCs, connecting 100 small farmers to processors Improved business management practices of farmers and MCCs Facilitated use of forward contracts between producers and one processor
Kosovo Business Support (KBS) Program, Oct 2000–Sep 2004 Agribusiness Development and Competitiveness activity, Jul 2002–Sep 2004	<ul style="list-style-type: none"> Processors Associations (horizontal linkages) 	<u>Of dairy competitiveness program:</u> <ul style="list-style-type: none"> Provide functional expertise to select enterprises within specific sub-sectors (for dairy, processed milk and yogurt) Develop and implement strategies to achieve competitive advantage in sub-sectors to support export generation or import substitution Supply KBS “package” of business development services and training to select sub-sectors 	<u>From dairy competitiveness program:</u> <ul style="list-style-type: none"> Initiated quality-based payment system with processors to incentivize farmers to improve raw milk quality Introduced new value-added products to dairy processors Promoted international standards (HACCP and SSOP) to improve quality and safety of finished products

STRENGTHS

- **Process upgrading.** Targeted technical assistance and training enabled producers to upgrade and begin meeting processors’ demand for high-quality raw milk. In step, processors started upgrading their processes to meet end-market demand with an enhanced awareness of international standards.
- **Vertical linkages.** The introduction of forward contracts and incentive payments for high-quality milk strengthened relationships between producers and processors. More small producers sold milk to commercial channels through the new MCCs.

- **Quality over quantity.** KBS tailored interventions to assist select processors to upgrade their product lines and processes to meet end-market demand. LINK COMPETES focused efforts on farmers who were willing to improve production capacity, efficiency and quality and to sell to commercial channels.

WEAKNESSES

- **Product upgrading.** Processors were not ready to start producing value-added products and compete directly with imports. They did not have access to required inputs or sufficient resources to invest in equipment and processes needed to meet international standards.
- **Poor coordination.** USAID intended for LINK COMPETES and KBS to work together and coordinate efforts, but reported that the projects rarely collaborated to tackle specific problems between participating processors and producers.
- **Access to finance.** Both producers and processors had difficulty accessing funds for needed investments, which made technical assistance and training activities less effective if the projects did not focus on no- or low-cost changes or include a grant or cost-sharing component to help beneficiaries procure needed supplies or equipment.

Summary findings from bridge programs. With its bridge programs, USAID and project implementers actively supported upgrading in and helped improve linkages between the production and processing functions of Kosovo’s dairy value chain. They worked with larger groups and through associations to expand the reach of technical assistance and training to help producers improve productivity and raw milk quality. More MCCs were established to facilitate the assembly of inputs, linking small producers to processors. Processors were reoriented toward end markets and started to upgrade their processes and products to improve quality, expand production and increase market share. The introduction of economic incentives by a few processors motivated producers to improve raw milk quality. By the end of the bridge period, commercial dairy production in Kosovo started growing. With development programs, donors and implementers intensified efforts to develop the sector and improve competitiveness.

DEVELOPMENT PROGRAMS

The next table presents some of the donor projects targeting dairy from late 2004 to the present.

Project design. Donor development programs are designed to promote competitiveness of selected sectors in domestic and potential export markets. Under KCBS, USAID continues to support the development of five agricultural sectors—dairy, meat, poultry, fruit and vegetables—and two non-agricultural sectors—construction and wood processing. According to USAID/Kosovo, they decided to employ a value chain approach with KCBS in part to alleviate coordination problems of earlier programs when different projects targeted different value chain functions. Based on recommendations from the 2004 evaluation, USAID designed KCBS around a “cluster” approach, whereby “self-selected” groups of cluster (value chain) members set initiatives and assign tasks to develop the cluster (value chain), and the implementer facilitates the planning process and provides support and expertise (technical assistance, training and grants) as required to implement cluster initiatives.³⁵ This approach is a bold move from general business development services to beneficiary-designed services to meet end-market demand in domestic and potential export markets.

Implementation. KCBS attempted to implement the cluster approach as designed by USAID, but it did not work due to conflict and transition factors. With few exceptions, relationships between value chain functions and among members of the same group were immature. There was (and is) a lack of trust between and inside these groups and

³⁵ This description comes from the Statement of Work in the KCBS task order contract, p. 12-13.

without some measure of trust, the cluster approach cannot work. Also, value chain members did not have the vision, experience or know-how to develop initiatives for the entire cluster. Their orientation toward, and understanding of, end-market demand and the demand of other value chain members was (and remains) relatively new and immature. They need additional time to adapt. Thus, KCBS took the lead and surveyed value chain participants to identify leaders with which staff could work directly to define demand, identify opportunities and constraints and design interventions to rebuild, strengthen and add value along the entire chain. Similar efforts with associations spread benefits to smaller value chain participants. Through a combination of technical assistance, training and grants KCBS helps improve the competitiveness of local products against imports and the potential of selected sectors to target export markets.

Sample of Donor Programs during the Development Period (2004 to the present)

Project Name	Value Chain Participant(s)	Objectives/Main Activities	Results
USAID Kosovo Cluster and Business Support (KCBS) Implemented by Chemonics International under contract, Sep 2004–Sep 2008	<ul style="list-style-type: none"> • Input suppliers • Producers • Assemblers • Processors • Retailers • Associations (horizontal linkages) 	<u>Overall:</u> <ul style="list-style-type: none"> • Stimulate economic growth and improve employment opportunities • Improve general business operating environment and advocacy • Strengthen business consultancy services and training providers • Use a systems, or value chain, approach to assist identified sub-sectors address constraints along chain from production through processing to end consumer <u>Specific to dairy program:</u> <ul style="list-style-type: none"> • Increase capacity of processors to supply basic and value-added products to meet domestic demand and reduce imports • Increase milk yields and flow of raw milk to commercial channels • Ensure producers and processors comply with international standards regarding raw milk inputs and finished products 	<u>Of dairy program through Sep 07:</u> <ul style="list-style-type: none"> • Helped draft and implement milk decree • Increased farmers' production efficiency and profitability by improving production practices, reproductive efficiency, milk quality and feed formulations • Increased dairies' processing efficiency and profitability by improving processing practices, product standardization, quality control and marketing • Strengthened capacity of producers and processors to access credit • Helped improve retailers' attitudes toward quality of local products • Created separate associations for producers and processors and supported both service delivery to members and institutional development
EAR Food Safety Control, Jul 2005–Jun 2007	<ul style="list-style-type: none"> • Producers • Processors 		<ul style="list-style-type: none"> • Supplied high-tech equipment for KVFA laboratory for milk testing
Agricultural Marketing Support, Nov 2005–Oct 2007	<ul style="list-style-type: none"> • Producers • Processors 		<ul style="list-style-type: none"> • Provided technical assistance and training to one processor and its producers to implement GMP and GHP quality standards
SDC Swiss Dairy Processing and Marketing Promotion Project, Oct 2002–Sep 2006	<ul style="list-style-type: none"> • Processors 		<ul style="list-style-type: none"> • Improved quality control and management in dairies • Helped processors develop new products and increase sales • Promoted milk decree

Results. Donor development programs have had some success in promoting upgrading and countering constraints to growth in selected sectors. KCBS has worked with all elements of the dairy value chain, while EAR and SDC have focused on processors. Key quantitative indicators for KCBS are listed in the box below. By working with leaders among input suppliers, producers and processors as well as with associations of these groups to disseminate information and deliver services, KCBS has helped improve the quantity and quality of raw milk inputs and finished milk products and cut production costs, which has led to greater efficiency and profitability in the sector. The new milk decree, supported by USAID, EAR and SDC projects, provides an economic incentive for producers to upgrade their production processes and the use of standard contracts to secure milk supply for processors, a pressing concern due to the current shortage of raw milk. EAR played a key role in setting up and equipping the KVFA laboratory for milk testing. If the milk decree is properly implemented and enforced, the quality of dairy inputs and outputs will improve. Relationships between retailers and processors are improving though power asymmetries remain, resulting in relatively higher risk for processors. To remedy this, KCBS plans to focus on marketing during the final project year to help processors communicate more effectively with retailers and end markets.

Key KCBS Indicators, 2004-2007		
	Dairy Sector	Overall Project
Increased sales	€36 million	€84.5 million
Jobs (FTE)	624	4199
Investment	€3.9 million	€30.9 million
Financing	€1.8 million	€11.2 million

STRENGTHS

- **Process upgrading.** Targeted technical assistance, training and grants help input suppliers, producers and processors improve production capacity and product quality to meet consumer requirements.
- **Vertical linkages.** Standard contracts and incentive payments for high-quality milk build trust between producers and processors. Improved marketing should help re-balance power between retailers and processors.
- **Horizontal linkages.** By creating separate associations for milk producers and processors, KCBS enhances cooperation; advocacy for each group's respective interests; and the delivery of information and services specific to each group.
- **Grants for procurement.** KCBS awards small grants to beneficiaries who meet specific requirements to help them procure needed supplies and equipment to upgrade, thus improving the effectiveness of technical assistance and training activities.
- **Public-private dialogue.** KCBS regularly brings together public and private sector representatives to plan, discuss concerns and solve problems. These linkages are especially important considering the temporary nature of donor assistance.

WEAKNESSES

- **Undeveloped local market for business services.** Few local business service providers and government extension services have the capacity and resources to offer technical assistance and training in place of donor programs. On the demand side, it is clear that producers need services and pay for some provided by both associations (many subsidized by donor projects) and public- and private-sector service providers, but the full extent of demand without the presence of distorting forces is unclear.
- **Late shift to demand.** To be competitive against imports, Kosovar processors must comply with international standards such as GMP and HACCP. Earlier promotion of GMP/HACCP certification might

have stimulated processors to improve product quality from the onset and pull harder for producers to improve raw milk quality.

- **Slow start to association development.** KCBS originally tried to create a U.S.-type management company for the associations, but it did not work due to limited local capacity (professionals with required financial, administrative and management skills did not have industry know-how and/or strong relationships with industry leaders) and delayed capacity-building efforts for association staff and leaders.

Summary findings from development programs. With development programs, donors and implementers have supported upgrading along Kosovo's entire dairy value chain. The milk decree institutes economic incentives for producers to improve raw milk quality and grants help all value chain participants fund needed improvements to upgrade. To meet end-market demand and improve competitiveness in domestic and export markets, upgrading must continue in the input supply, production and processing functions of Kosovo's dairy value chain.

VALUE CHAIN APPROACH: OPPORTUNITIES FOR AND CONSTRAINTS TO UPGRADING

As detailed in the preceding sub-sections, donor programs have led to upgrading in Kosovo's dairy sector, starting with rebuilding efforts with individual farmers, entrepreneurs and enterprises to more intensive work with one or two value chain functions and then to a full value chain approach. Understanding end-market demand and the linkages within the value chain are critical to upgrading. End-market demand translates to different inputs and outputs for each value chain function and reveals opportunities for upgrading. An analysis of linkages shows who is pulling, pushing or not getting the right—or any—messages due to weaknesses, gaps or breaks in the chain. Once upgrading opportunities, internal value chain weaknesses and external constraints are identified, donors and implementers can structure and sequence interventions to promote upgrading along the chain and improve competitiveness in domestic and export markets.

V. CONCLUSIONS AND RECOMMENDATIONS

A. SECTOR SELECTION

As conflict factors weaken or disappear and a post-conflict environment evolves from relief to development programming, the sector selection process becomes less complicated. Access to qualitative and quantitative information improves and it is easier to identify lead sectors or enterprises. Based on experience, donors can see what gaps or breaks in value chains may be repaired or facilitated most effectively with limited resources. The following are conclusions and lessons learned related to sector selection.

ADAPTING SECTOR SELECTION AND VALUE CHAIN ANALYSIS TOOLS

Sector selection and value chain analysis tools require more adaptation in earlier post-conflict periods to restart economic activity quickly. Decisions need to be made in a short amount of time and resources directed toward beneficiaries as soon as possible to rebuild and create incentives for non-violence. Typical approaches take time and it may be difficult to get current, accurate information and/or to identify or reach people due to conflict factors. Also, a key element of value chain/sector analysis is end-market demand. Depending on the scope, duration and destruction of the conflict, domestic and regional market information might be limited or distorted. During relief periods, donors and implementers need to adapt sector selection approaches and tools based on factors in the post-conflict environment as well as the availability of information and time.

SETTING COMPLEMENTARY OBJECTIVES

For initial programs in post-conflict environments, the research team found that rebuilding and competitiveness are not complementary objectives. Competitiveness implies the presence of lead sectors or enterprises that have an advantage over other regional or global competitors. The process to select lead sectors or enterprises in a traditional development environment can be challenging and time-consuming, and it may not be feasible in a post-conflict environment, due to conflict factors and a need for quick action. Conflict factors make it difficult to determine which sectors or enterprises will survive, respond to technical assistance and be able to access resources to change and grow. Further, in a post-conflict situation where there may be winners and losers, the identification and selection of lead sectors or enterprises could be contentious and exacerbate conflict dynamics. Political or social sensitivities may restrict certain sectors from consideration. The presence of conflict factors and the need for quick action complicate and limit the selection of sectors or enterprises based on potential competitiveness. Early competitiveness targets could be wrong or untimely and drain resources from rebuilding efforts.

CHOOSING SECTOR SELECTION CRITERIA

The team's in-depth analysis of the research provided a list of qualitative sector selection criteria for a post-conflict environment. First, sector selection should be driven by the domestic market and consumer demand and emphasize sectors for which there is high demand and short supply or supply consists primarily of imports. Second, the private sector should have an interest and willingness in rebuilding and potentially expanding the sector. Third, efforts should build on existing capacity and skills rather than new sectors—the production base should be functioning to some extent or operational prior to the conflict. Fourth, investment in the sector should regenerate employment—labor-intensive industries are good targets. Fifth, selected sectors should lead to greater self-reliance and reduce imports.

B. THE VALUE CHAIN FRAMEWORK AND UPGRADING

Ongoing analysis of the dairy value chain led to the rebuilding and strengthening of individual value chain functions and of horizontal and vertical linkages. This supported (and continues to support) upgrading to meet end-market demand, improved competitiveness and sustained growth of Kosovo's dairy sector. Below are the conclusions and lessons learned related to the value chain framework and upgrading.

WORKING FROM THE MICRO TO THE MACRO

In Kosovo, donors and implementers began working with value chain participants to upgrade shortly after agricultural production and economic activity resumed. They worked first with individual farmers to make no- or low-cost changes to upgrade the production process and improve yields and quality. They then worked with larger groups and through associations to expand their reach. Once processors emerged and started to demand inputs, donors and implementers steered farmers toward commercial channels, again helping them to upgrade processes to improve productivity and quality and to rebuild linkages with processors. In parallel, they worked with processors to orient them to end markets and, based on demand in those markets, they helped processors upgrade processes and products to improve quality, expand production and increase market share. Currently, upgrading continues in the input supply, production and processing functions of Kosovo's dairy value chain to improve industry competitiveness in domestic and export markets. By working from the micro to the macro as Kosovo moved from relief to development, donors and implementers supported upgrading and sustained growth in the dairy sector.

IDENTIFYING AND PRIORITIZING FUNCTIONAL AND RELATIONSHIP GAPS

In a post-conflict environment, there are unique constraints to or breaks in value chains that require special attention to rebuild capacity and promote upgrading. For instance, the input supply, production, and processing functions of Kosovo's dairy value chain deteriorated significantly during the 1990s under the failing SOE system, and the 1998-1999 conflict led to further damage and destruction to the sector and overall. As a result, crop farmers had limited or no access to seeds, fertilizers, and pesticides, thus little feed for cows. Dairy farmers had few cows, thus a small quantity of raw milk for consumption and processing. Further, due to bad roads and the distance between farmers and processors, hauling took a long time and was not economically feasible, thus there was a need to bolster the assembly function. Private processors were few and had a limited capacity, thus they were unable to meet end-market demand. Furthermore, relationships suffer considerably during conflict. By looking at the whole value chain, donors and implementers may determine what linkages are the most pressing and/or easiest to repair. Under the SOE system, all functions were linked, but the government controlled decisions and regulated relationships. As part of the transition to a market economy, all relationships need to be re-oriented toward end markets, decision-making decentralized, and open, two-way communication encouraged along the entire value chain. Once all functional and relationship gaps have been identified, donors and implementers may prioritize them and design programs/interventions to rebuild and develop value chains based on available resources.

MATCHING TECHNICAL ASSISTANCE AND TRAINING WITH GRANTS PROGRAMS

In post-conflict environments, access to finance typically is more limited than in traditional development environments. Private investment may be constrained by conflict factors and there likely is little capital for lending due to a lack of trust in formal financial institutions and thus low deposits. Such was (is) the case in Kosovo. Thus, grants programs were (are) an indispensable part of donor projects to help value chain participants invest in necessary improvements to upgrade. Some programs, such as KCBS, included direct grants for specific procurements, while others provided loan capital to non-banking and other financial institutions to lend to value chain participants. All producers and processors interviewed by the research team commented that technical assistance and training activities

were more beneficial when matched with grants programs so they could access funds to implement new technologies, processes and/or practices.

DIRECTING VALUABLE INPUTS TO THE COMMERCIAL SECTOR

Understandably, donor emergency programs target the most vulnerable groups in a post-conflict environment to create incentives for non-violence and provide a means for immediate survival and a source of income. Such was the case with the replenishment of livestock in Kosovo. However, had donors supplied inputs in waves, subsequent efforts (for instance, during bridge programs) could have targeted the commercial sector and increased the herds of farmers that had begun selling milk in formal markets. There was a natural redistribution process within the livestock markets, but a number of valuable, high-quality milking cows were not cared for or bred properly, yielding little milk for on-farm consumption or sale.

CREATING ECONOMIC INCENTIVES

Economic incentives promote upgrading in value chains. Varied incentives may be offered to value chain participants, originating from the value chain itself, the business enabling environment (government) and/or the external environment. In Kosovo, strong end-market demand in domestic and regional markets stimulates processors to improve the quantity and quality of finished products. However, despite their efforts, without a regular source of high-quality inputs, they cannot produce high-quality outputs. To help processors pull for high-quality raw milk, donors and implementers worked with MAFRD to pass and implement the milk decree, which provides an economic incentive for farmers to improve quality and ultimately leads to improved efficiency and lower production costs for both producers and processors. If the milk decree is enforced, upgrading should occur in the production and processing functions of the dairy value chain and improve the competitiveness of local products.

WORKING WITH ASSOCIATIONS

Value chain development may be enhanced by direct work with leaders within the sector as well as with associations to spread benefits to smaller value chain participants. Leaders typically have the willingness and ability to try new technologies, make improvements and serve as examples for others. Associations play a key role as industry advocates and as service providers and they disseminate information to wider audiences.

One of the experts interviewed by the team suggested that donors and implementers provide direct support to both value chain leaders and associations during the initial phase of a project to make sure that everyone in the chain receives the same information. As associations develop, projects may direct more work through them to help them gain experience and credibility as reliable sources of information and as service providers.

APPENDICES

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ANNEX I: SCOPE OF WORK

I. CURRENT OR RECENT PROJECT DESCRIPTION FOR RESEARCH

Chemonics has been implementing KCBS, a \$19.6 million task order issued under the SEGIR Privatization II IQC, since 2004. It is due to end in 2008. The project has two components: general business support and value chain market development. Under the second component, KCBS supports the development of three value chain clusters—livestock (dairy, beef, poultry and animal feed), fruits and vegetables and construction materials. KCBS monitors and measures increased sales, jobs, investment and financing resulting directly from project interventions.

II. DESCRIPTION OF TARGETED OR POTENTIAL SUBSECTOR (DAIRY)

The researchers selected the dairy industry as the focus for the proposed KCBS case study based on results achieved with interventions among various value chain participants. The core of the dairy industry in Kosovo is composed of twelve larger processors, 750 commercial farmers and numerous small (subsistence) farmers. Local demand of consumers for milk products and of processors for raw milk is strong. A law recently passed, with KCBS help, on raw milk grades and standards marks a key improvement in the business enabling environment. Linkages among and between retailers, processors, producers, input suppliers and service providers are being rebuilt and strengthened. The offerings of input suppliers and service providers have grown as their clients demand more sophisticated products and services.

III. SUMMARY ANALYSIS OF THE CONFLICT

In the late 1990s, an Albanian uprising in Kosovo triggered a Serbian counterinsurgency, resulting in mass expulsions and murders by Serb paramilitaries and Yugoslav forces. NATO bombed Serbia in the spring of 1999, forcing Serbian military capitulation. Predominantly ethnic Albanian insurgents perpetuated the conflict upon their return to Kosovo, spurring the flight and self-segregation of the province's ethnic Serb minority and other minorities perceived as having collaborated with Yugoslav forces. The United Nations (UN) Security Council authorized a NATO-led force to protect all Kosovar communities and tasked the UN Administration Mission in Kosovo (UNMIK) to reconstruct the province.

The conflict and its lawless aftermath, however, shattered communal ties and commerce and caused many of Kosovo's more educated residents to leave. Kosovo was left without its managerial class and its tradition of social multi-ethnicity. Remittances from the Kosovar diaspora quickly became the base of the new economy, fuelling illegal commercial activities and uneven growth rates, but doing little to create sustainable livelihoods.

The conflict affected the dairy industry in myriad ways. In addition to reduced and dispersed livestock, destroyed crops, displaced people and devastated infrastructure, the dairy industry in Kosovo faced two unique constraints following the conflict. First, many cadastral records were lost or destroyed, significantly hampering the consolidation of land into larger, more efficient units. Second, there were no laws regarding milk quality and no milk product standards compatible with world-class standards.

IV. CASE STUDY HYPOTHESES

Chemonics proposed to use KCBS to test two research questions taken from the RFA:

Research question #5: How can sector selection and value chain analysis tools be adapted to post-conflict situations and the need for quick action?

During conflicts, a country's most profitable industries are often targeted and debilitated or largely destroyed. While it is important to rebuild these industries as soon as possible after a conflict ends, such efforts require tremendous resources—physical, human, technical and financial—and coordination among donors, governments and industry. In sectors such as agriculture the production, distribution, retail and trade channels are broken. However, rebuilding efforts are more organic and require relatively fewer resources and less coordination. Results appear quickly and impact more people. By selecting industries or sectors in which relatively few resources can be employed to yield quick results and broad impact, donors and governments can accelerate economic recovery and growth in post-conflict environments.

Research question #6: How can value chain analysis and the value chain framework help us identify and understand the major opportunities for upgrading and the driving constraints to market growth exacerbated by or resulting from conflict?

In post-conflict situations, domestic industries compete against new market entrants. Local value chains are broken, yet demand for basic goods in particular stays strong, so retailers and consumers turn to alternate goods. Imports grow, whether originating from relief or commercial efforts. As empty shelves are filled with imports and local consumers develop a taste for goods that often differ in quality or price from those produced locally, it becomes more difficult for local industries to compete with imports. To improve the competitiveness of local goods against imports, upgrading often is necessary. By defining demand and analyzing local value chains, donors, governments and industry can identify opportunities for upgrading and effectively combat constraints to economic recovery and growth in post-conflict environments.

FACTORS IN THE SELECTION OF THE DAIRY INDUSTRY AS A DEVELOPMENT TARGET IN KOSOVO:

- Prior to the conflict, agriculture comprised one-third of Kosovo's GDP; dairy was a large part, still functioning, and had potential for high impact.
- More than 60 percent of Kosovo's population depend on agriculture for their livelihoods.
- Kosovo's domestic industry should supply basic needs (fluid milk) rather than imports. The import substitution market has great potential.

Methodology. The KCBS project started in October 2004, five years after the Kosovo conflict. On the relief-to-development continuum, KCBS is classified as a development project. A critical aspect of this case study was the analysis of previous projects targeting the dairy industry (Kosovo Business Support, Kosovo Agribusiness Development Program and Competitive Marketing of Milk Production Project under Small Farmer Support) and a comparison of the ways approaches and interventions evolved as the opportunities and constraints to economic recovery and growth in post-conflict Kosovo emerged from 1999 to the present. By looking at a chronology of projects that directed resources toward quick action and upgrading of the dairy industry, it is possible to identify a broad sample of lessons learned in value chain market development in post-conflict environments. Specifically, the case study focuses on four general areas to identify best practices along the relief-to-development continuum—industry selection, project design, project implementation and conclusion and recommendations.

Industry selection. This examines the value chain analysis tools used by donors, governments and industry that led to the selection of the dairy industry as an early development target in Kosovo. After reviewing reports and assessments of the agriculture/agribusiness sectors and the dairy industry, the team met with donor, government, industry representatives and implementers to discuss how and why the dairy industry was selected as an early development target in Kosovo. The team looked at value chain analysis tools used to select target industries and answer questions such as:

1. Was the dairy industry an appropriate and timely selection considering available resources, opportunities and constraints throughout the value chain, in the market and the desire for quick results and high impact?

2. Were projects sequenced to maximize value chain market development and impact in terms of quantity and quality?
3. Did targets within the dairy value chain change as Kosovo moved along the relief-to-development continuum?

Project design. The research team reviewed bid, proposal, contract and other project documents for KCBS and relevant predecessor projects to analyze the approaches developed by donors and implementers to enhance the economic recovery and growth of the dairy value chain in Kosovo. They then interviewed donor, government and industry representatives and project implementers to discuss how technical approaches were developed, paying close attention to direct or indirect use of the value chain framework. They also studied value chain analysis tools used to design project approaches and set project objectives in order to answer questions such as:

KCBS' APPROACH TO THE DEVELOPMENT OF THE DAIRY INDUSTRY:

- Identified “champion” processors and helped them to define demand, understand strengths and weaknesses of local products, and identify opportunities to improve the competitiveness of local products against imports.
- Worked with more commercially oriented farmers to improve quality and increase production of raw milk.
- Designed and implemented interventions including technical assistance, training, and a performance-based Strategic Activities Fund to rebuild, strengthen, and add value along the dairy value chain.
- Helped draft and promote passage of a law on raw milk grades and standards.

1. Did project approaches adequately reflect industry strengths and weaknesses and market opportunities (especially for upgrading) and constraints?
2. Were approaches market-driven and did they include careful analysis of the entire value chain?
3. Did project approaches change as Kosovo moved from relief to development?
4. Did project approaches promote quick results and high impact?
5. Were projects designed with achievable and measurable economic growth objectives?

Project implementation. The team reviewed the successes and challenges of project implementation and considered the interactions between relief and development processes and interventions to assemble a list of lessons learned and best practices. In addition to reviewing reports, assessments and evaluations of KCBS and relevant predecessor projects, they met with donor, government and industry representatives, implementers and project clients and counterparts. The team examined value chain analysis tools used to design, sequence and implement project interventions and answer questions such as:

1. What are/were the project's greatest successes and challenges?
2. Were project interventions targeted to meet project objectives?
3. Were project interventions sequenced to maximize value chain market development and impact in terms of quantity and quality?

Conclusion and recommendations. The final section of the case study determines how well the hypotheses have been substantiated; develops actionable recommendations regarding lessons learned and best practices in value chain market development in post-conflict environments; and suggests areas for additional research.

KCBS PROJECT IMPLEMENTATION – WHAT WORKED WELL:

- Careful design, sequencing, and implementation of interventions to add value along the dairy value chain
- Highly-qualified, well-trained project staff
- Productive relationships with clients and counterparts
- Development of retailers
- Effective use of media to disseminate information
- Involvement of associations to disseminate information to a wider audience, especially smaller farmers
- On-farm demonstration work

WHAT DID NOT WORK OR COULD HAVE BEEN DONE MORE EFFICIENTLY:

- Measurement of indirect results from project interventions, particularly support services
- Increased involvement of local business service providers to build local capacity that can be sustained after KCBS ends
- Targeting larger groups with demonstration work and information
- Poor participation of government extension services in municipalities, etc.

ANNEX 2: FIELD ITINERARY

Sunday, September 23, 2007

Arrival in Pristina

Monday, September 24, 2007

Interviews with:

- Albert Wanous, KCBS Senior Livestock Cluster Advisor
- Arben Musliu, KCBS Milk Production Specialist

Tuesday, September 25, 2007

Interviews with:

- Zijadin Gojnovci, KCBS Dairy-Beef Specialist
- Kustrim Shaipi, Vice President, and Berat Abdiu, Market Research & IT Expert, Ubo Consulting

Preparation for field visits to dairy processors

Wednesday, September 26, 2007

Agricultural Lending Seminar, hosted by KCBS

Kosovo Dairy Processors Association (KDPA) meeting

Thursday, September 27, 2007

Field visits to two dairy processors—Kabi and Bylmeti

Friday, September 28, 2007

Interviews with:

- Todd Kirkbride, KCBS Senior Competitiveness Advisor
- Milazim Makolli, KCBS Feed Grain Specialist

Research

Monday, October 1, 2007

Interview with:

- Albert Wanous, KCBS Senior Livestock Cluster Advisor

Preparation for field visits to dairy processor

Research

Tuesday, October 2, 2007

Field visit to one dairy processor—Devolli

Preparation for field visits to dairy producers

Wednesday, October 3, 2007

Field visits to three dairy producers—Rudina, Dukagjin-Deda, and Ismail Demiraj

Thursday, October 4, 2007

Interviews with:

- Martin Wood, KCBS Chief of Party
- Mentor Thaqi, KCBS Agricultural Associations Specialist
- Skender Rama, KCBS Strategic Activities Fund Manager

Friday, October 5, 2007

Interviews with:

- Lulzim Shamolli, Chief of Division for Agricultural Policies and Projects, MAFRD
- Bunjamin Alili and Nazmi Zeqiri, Biolab
- Veton Hajdini, Head of Agriculture and Forestry Unit, and Muharrem Arifi, Senior Agriculture and Forestry Privatization Officer, KTA

Monday, October 8, 2007

Workday

Tuesday, October 9, 2007

Interviews with:

- Flora Arifi, Development Program Specialist (Economic Growth Office), and Jennifer Tikka, Private Enterprise Office (Economic Growth Office), USAID/Kosovo
- Michael Gold, Managing Director, Crimson Capital
- Kustrim Shaipi, Vice President, Ubo Consulting

Wednesday, October 10, 2007

Departure from Pristina

ANNEX 3: LIST OF INTERVIEWEES

Donors

Flora Arifi, Development Program Specialist (Economic Growth Office), USAID/Kosovo

Jennifer Tikka, Private Enterprise Office (Economic Growth Office), USAID/Kosovo

Implementers

Martin Wood, KCBS Chief of Party

Albert Wanous, KCBS Senior Livestock Cluster Advisor

Arben Musliu, KCBS Milk Production Specialist

Zijadin Gojnovci, KCBS Dairy-Beef Specialist (previously worked on KBS)

Milazim Makolli, KCBS Feed Grain Specialist (previously worked with IFDC and on KBS)

Todd Kirkbride, KCBS Senior Competitiveness Advisor

Mentor Thaqi, KCBS Agricultural Associations Specialist (previously worked with IFDC)

Skender Rama, KCBS Strategic Activities Fund Manager (previously worked with Save the Children on Small Farmer Support program)

Bekim Mermen, EAR Marketing Support Project

Dairy Value Chain Members

Retailers—ETC (Nerxhivane Kadriu), Metro Market (Bedri Rexhepi), and Byrektore Bosna (Zeçir Uka)

Processors—ABI, Sharri, Kabi, Bylmeti, and Devolli

Producers—Rudina, Dukagjin-Deda, and Ismail Demiraj

Public Institutions

Lulzim Shamolli, Chief of Division for Agricultural Policies and Projects, MAFRD

Veton Hajdini, Head of Agriculture and Forestry Unit, KTA

Muharrem Arifi, Senior Agriculture and Forestry Privatization Officer, KTA

Private Companies

Bunjamin Alili and Nazmi Zeqiri, Biolab

Michael Gold, Managing Director, Crimson Capital

Kustrim Shaipi, Vice President, and Berat Abdiu, Market Research & IT Expert, Ubo Consulting

ANNEX 4: PROFILES OF VALUE CHAIN PARTICIPANTS

PRODUCERS

The research team visited three producers, all members of KAMP, of varying size in different areas of Kosovo.

RUDINA

Rudina, located in Prizren, is the largest dairy producer in Kosovo and has integrated vertically to process and distribute pasteurized milk, drinkable yogurt, and white cheese to 62 local retailers. Previously, he sold his milk to ABI but stopped after losses due to missed collections by the processor. Unemployed after the 1998-1999 conflict, Rudina decided to start farming based on the encouragement of a GTZ consultant; his grandfather and father had farmed as part of a cooperative under the previous command system. He began in July 2001 with 66 cows (his own investment) and three employees on 70 hectares of leased land. Currently, 16 permanent employees (plus an additional ten seasonal employees) help him with his herd of 166 cows and heifers, which produce on average 1800 liters of milk per day, as well as with his feed crops and processing facility. Rudina participates in the DHI pilot and uses many of the new technologies (such as calf hutches) introduced by donor project consultants. Once he is able to buy the land and buildings of the farm he leases, he plans to invest in livestock, equipment, and facility improvements to expand and modernize his production and processing operations.

DUKAGJIN-DEDA

Dukagjin-Deda, located in Peja/Peć, is a 45-hectare commercial family farm with 40 cows. They sell on average 570 liters of high-quality milk per day to Devolli, for which they receive a ten percent premium. Dukagjin-Deda started farming in 2002 with 25 cows and five hectares of land. His father helped build a barn and they took out a €50,000 loan to buy livestock and equipment. The first year, they sold on-farm-produced white cheese in green markets and to local retailers. Thereafter, they switched to selling unpasteurized milk in two-liter bottles door-to-door. Demand for their high-quality milk grew from 20 liters to 500 liters per day. Once Devolli opened, Dukagjin-Deda started selling to them under contract. During the interview, they listed many improvements that enable them to produce high-quality milk—most important are fast cooling of milk and cleanliness of facilities, equipment and livestock. Anecdotally, they also mentioned that they are careful with lighting and play the radio to keep their cows happy. Dukagjin-Deda finds farming to be a profitable activity, but needs help accessing finance to upgrade production processes and expand the herd.

ISMAIL DEMIRAJ

Ismail Demiraj and his family manage a 20-hectare farm with 14 cows in Istog/Istok. Since investing in a lacto freezer six months ago, they have sold on average 220 liters of high-quality milk per day at a ten percent premium to Devolli. Prior to this investment, they sold their milk to a milk collection center. Mr. Demiraj has a B.S. in livestock management and worked as an animal nutritionist for an SOE under the previous command system. Unable to support his family with his low salary, he decided to start farming in 2002. He also teaches to supplement his income. Mr. Demiraj would like to expand his herd to 40 cows, but needs to invest in additional equipment and facility improvements to accommodate a larger herd. Due to recent losses (three cows), he cannot take more credit now.

PROCESSORS

The team visited three of the larger processors, each of which demonstrated different opportunities and constraints in processing dairy products in Kosovo today.

KABI

Kabi was started in Gjilan/Gnjilane by two Swiss investors (brothers) in 1999; the processing facility, which is managed by two Kosovars who previously worked at a dairy in Switzerland, opened in March 2000. According to Kabi's managers, their operations began to stabilize and grow in 2003 as consumers started to associate their brand with good quality. Initially, they collected 700-800 liters of milk per day to produce five products with ten employees. Currently, they have 24 employees and produce 16 products from up to 10,000 liters of milk per day (their capacity is 10,000 liters per day but outside the summer season, they operate at 70 percent of capacity), which they collect from 15 individual farmers and 20 MCCs. Kabi is building a new dairy, financed by 70 percent equity (investment by the Swiss owners) and 30 percent credit, which they plan to open in early 2008. In the new dairy, which will have double the capacity of the current facility, they plan to increase their production of white cheese, add lines for yellow cheese and yogurt with a longer shelf life, and potentially start producing UHT milk, all dependent upon the availability of raw milk. Also, they might install a homogenizer, the first in a dairy in Kosovo.

BYLME TI

Bylmeti, located in Fushë Kosovë/Kosovo Polje, is one of the more progressive dairy processors in Kosovo. Started as a family business in 1990, they processed up to 200 liters per day in the 1990s but now have 40 employees and produce 33 products in seven groups from up to 10,000 liters of milk per day collected from 120 individual farmers and multiple MCCs. Bylmeti has taken out a €250,000 loan to finance the procurement of equipment and other facility improvements to meet GMP and HACCP certification requirements. These improvements also extend to the milk collection process. As noted in the value chain analysis, Bylmeti supplies lacto freezers to 13 of its largest farmers, so they can cool milk quickly, keep bacterial counts low, and yield high-quality inputs. They are one of the few processors that currently exports (cream cheese with peppers to Albania), though they reported that the current shortage of raw milk severely limits exporting. Bylmeti has a three-part strategy to increase market share and improve competitiveness in domestic and export markets. First, they plan to continue providing training and equipment to farmers and pay a high price for raw milk to secure a supply of high-quality inputs. Second, they intend to complete the HACCP certification process and provide high-quality finished products in line with international standards. Third, Bylmeti would like to diversify production and add more value-added product lines, in part to subsidize basic products until they can reduce costs, expand production and increase efficiency.

DEVOLLI

Devolli is a large processor in Peja/Peć with multiple product lines including Princ coffee, Tango fruit juice, and Vita UHT milk, among others. In the realm of dairy, they started processing UHT milk in 2003 and are the exclusive local producer of UHT milk in Kosovo. Devolli collects milk from more than 500 individual farmers and multiple MCCs but produces at only 30 percent of current capacity. Previously, they exported to Albania and Macedonia, but stopped this year due to the shortage of raw milk. Devolli works with local and international marketing agencies to promote its products and has developed campaigns for specific target markets (for example, they promote milk with a higher fat percentage to athletes). Like all processors in Kosovo, Devolli is concerned about the short supply of raw milk and is considering vertical integration to start a dairy farm. Also, they are looking at options to target the market for UHT milk in Albania.

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