

# Under Invoicing of Imported Broiler Meat: a Challenge to the Development of the Local Broiler Industry in Kosovo

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## Abstract

The aim of the study is to show how the under invoicing of imported fresh broiler meat affects the sales of the locally fresh produced and marketed broiler meat in Kosovo. One of the biggest Kosovo broiler producers was the subject of this study, who raised the issue about under invoicing prices for poultry meat imports, exported to Kosovo by a well-established EU certified Slovenian company. For this purpose the monthly sales data for the whole year before under invoicing prices was exposed, was compared with data for the monthly sales after the reference pricing policy for customs valuation was introduced by Kosovo government. There was a statistical significant difference between Kosovo broiler producer (named x company) monthly sales 12 months before the under invoicing prices were introduced and 12 months after the reference pricing policy was introduced. A significant increase in monthly sales after introducing the reference pricing policy for custom valuation occurred at  $t(11) = 3.947$ ,  $p = 0.002$ , with Confidence Intervals (CI) 95% - 99%, ranging from Euro 13,584.11 respectively Euro 47,827.53 per month. The results of the study showed that the under invoicing has affected the local broiler industry and had economic consequences for Kosovo.

**Keywords:** *broiler industry, under invoicing, reference pricing, custom valuation,*

## 1. Introduction

The broiler industry is one of the fastest growing industries globally and the trade of poultry meat has increased in the last years driven by increased demand. Its higher demand is related to many factors such as increased in household incomes, an increase of prices of pork and beef, higher preferences for poultry meat and lower prices compared to other protein sources of animal origin [14]. Poultry meat still remains the most preferable protein sources in the EU countries with small changes in low income consumers switching to carbohydrate products [20].

Globally the broiler industry is very competitive, and increasing global competition is of particular concern for many small broiler producers in developing countries, such as Kosovo, because their production and marketing systems are not yet fully developed and still lack efficiencies. Broiler production comes from America, Asia and Europe with highest growth rates in Asia respectively China and India [7, 15]. In 2012 the EU produced 12.4 million tons of poultry meat and meat products with 0.82 million tons imported, mostly comprised of high value poultry products from Brazil and Thailand as well as the USA, being the principal exporting

countries in the world [22]. In the developing countries such as China India and the rest of the world the broiler industry is moving rapidly towards modernization [7].

At the global level, the GATT agreement (General Agreement on Tariffs and Trade) and Uruguay Round table were instituted to reduce the barriers in the international trade [12]. There have been increasing reports of many developing countries experiencing rising food imports, with negative effects on local producers [23], Bhagwati (1964) emphasises in his paper that the 'price gap provides, a strong indication of the presence of under-invoicing of imports. The reference pricing policy for custom valuation to combat under invoicing is supported by WTO to protect nascent industries from competition from well-established industries in other countries<sup>1</sup>. The TRQ (Tariff Rate Quotas) were applied for agricultural products including poultry after transformation of GATT into World Trade Organization (WTO). Various disease outbreaks in poultry have been the cause of restriction for poultry trade among countries

<sup>1</sup>GATT, Non-Tariff Measures Affecting Trade of Developing Countries: Note by the Secretariat, MTN/3B/23 (December 31, 1974), at 24.

worldwide such as the AI (Avian Influenza) in 2004 [4]. In the EU, import tariffs protect EU broiler prices by increasing the average import prices above EU average prices, which based on an AVEC study (Association of Poultry Processors and Poultry Trade in the EU) the higher costs of Production of broilers in the EU are based on EU production and environmental standards [1]. For trade in poultry, the EU applies the same standards for third countries as for EU countries regarding animal health, processing hygiene and consumer safety [8]. Dumping prices are one of the main issues concerning less well established poultry production and processing businesses. Due to the dumping prices of bone-in meat imports, South Africa imposed an anti-dumping policy against 3 EU countries in 2013 to protect the local industry [2]. Many countries have successfully industrialized behind high tariff barriers. WTO's GATT, Article XVIII, "Governmental Assistance to Economic Development," authorizes the use of high tariffs and other restrictive trade measures by developing countries as a tool to promote the development of infant industries [10].

In the countries of former Yugoslavia including Kosovo, the broiler industry has started to move towards modernization but the demand for poultry meat is still covered by frozen meat products imported from abroad and mostly from Slovenia and Brazil [11]. After the breakup of Yugoslavia, most of the state owned companies were privatized or neglected and at the same time the market was fragmented and presently most of the former Yugoslav countries are trying to produce broiler meat to substitute the imports from abroad [6]; except Slovenia which has adopted modern technological broiler production, organized through specialized enterprises and processing poultry meat plants which have increased production of various poultry meat products [13]. These are competing with the local broiler industries in former Yugoslavian countries.

In Kosovo, the broiler industry was utterly destroyed. Before 1990, 12 to 15 million broilers were annually produced and processed in Kosovo, which were consumed and marketed in the republics of the former Yugoslavia. Despite the added benefit of the short production period from hatched egg to slaughter age, the broiler industry is not well developed and considering the data from Kosovo AgStrat –animal product study; it meets only 3% of the consumer demand for poultry meat in Kosovo [21]. Meanwhile,

the market is saturated with frozen birds imported from Slovenia, Brazil and the USA. Just after the war of 1999, agriculture including poultry production had to be restarted almost from the scratch. Nearly half of the livestock population had been lost and farmers had no capacity to restock their livestock. The support from international donors and humanitarian organization was remarkable in the revival of the agricultural sector. Food self-sufficiency has never been attained in Kosovo in the past. There has always been the need for imports to meet domestic demand to compensate for the supply shortfalls. The Kosovo poultry meat industry has not a long history and is competing with largest global and well established broiler producers. The market for chicken meat in Kosovo is primarily comprised of two by-products, fresh/chilled birds and frozen meat. The local x company is targeting only the fresh/chilled poultry meat local market. Low-cost poultry meat imports from Brazil and the U.S., along with low consumer purchasing power, represent some of the biggest obstacles for the growth of the poultry meat sector in Kosovo.

Currently there are two local companies producing and marketing locally produced fresh poultry meat in Kosovo. The Company (x) on which this study is based, is by far the largest fresh poultry meat producer in Kosovo and it is located in east-Kosovo and was established in 2008. The main activities of this company include production of eggs, animal feed, and replacement pullets as well as broiler production. Its market share is estimated at 25 to 35% for fresh eggs and 2% in the poultry meat market. There are many obstacles for local broiler industry to grow such as low purchasing power of Kosovo consumers, and stiff competition from frozen broiler meat imports. One additional challenge to grow that the broiler producer (x) faced was unfair trade applied for fresh poultry meat by a Slovenian company (y). In this research we are trying to assess the data coming from the observation of monthly sales fluctuations of the largest Kosovo broiler processing company (x) over a 12 months period after under invoicing was exposed from a Slovenian company (y) which was exporting to Kosovo fresh whole carcass and after neutralizing measures by state authorities were introduced to neutralize under invoicing. The null hypothesis is the reference pricing for custom valuation has no effect on the monthly sales of x company.

For imports of poultry meat, Kosovo applies the same EU policy such as animal health standards at the country of origin, being an approved establishment, enforcement of necessary health controls, residue control, *Salmonella* control program. Non-tariff barriers respectively TBT (Technical Barriers to Trade) are not applied for imports of chicken and chicken products as well as no import quotas are applied in Kosovo for broiler meat as Kosovo has signed the Central Economic Free Trade Agreement (CEFTA 2006) as a pre-accession stage prior to EU membership. The Slovenian broiler company (y) was present in the Kosovo market before the Kosovo broiler company (x) started the broiler production and processing operation. Once the local broiler producing company entered the market, the Slovenian company started to use under invoice pricing for customs valuation which suppressed fresh poultry meat sales prices in local market. The local broiler producer x struggled to grow due to lower sales prices in the market and therefore needed protection from the import surge. To neutralize the under invoicing the Ministry of Trade and Industry (MTI) proposed that Kosovo customs use reference prices for custom valuation for imports of fresh poultry meat from Slovenian company. The aim of the reference price for custom valuation was not to be punitive, but to put importers and local producers on same level playing field. This research aims to show how the local broiler producer suffered during the period of time the Slovenian poultry meat exporter used under invoicing prices for custom valuation and the consequences of such unfair trade practices. The practices risked taking out of market, the first a local broiler producer and processor and subsequently lowering the general GDP in a small country with economy trying to recover in the post-war period.

## 2. Material and methods

In this study, the local broiler company (x) in Kosovo which registered lower sales due to the under invoicing prices introduced by a Slovenian broiler company (y) was object of the study. The local broiler company (x) provided the evidence that under invoicing of poultry meat imports was taking place at Kosovo's borders and that this unfair trade practice was hurting the local x company. After the case was investigated and the under invoicing prices were confirmed, monthly sales data were collected for a period of 24 months as to estimate the annual sales

and the consequences on sale due to the under invoicing prices. In order to determine the economic effects of reference pricing policy action on Slovenian imported poultry meat the monthly sales data were collected from the local company consisting of the quantitative data of the monthly sales for the whole year before under invoicing prices were discovered and the data of the monthly sales after the reference pricing policy was introduced were compared using the paired sample T-Test from the SPSS package [17]. The aim was to show whether there was a statistically significant difference in the monthly sales 12 before the under invoicing prices were introduced and 12 months after the reference pricing policy was introduced to neutralize the under invoicing practice for custom valuation. A linear regression model is used to learn the explained variability on monthly sales of x company caused from under invoicing price for custom valuation. Taking into consideration the safety and quality of products, the Kosovo local broiler company (x) can process up to ten thousand broilers daily, has implemented Good Hygiene Practices and internal Control Systems with vertical integration production. The quality and safety of broilers is comparable to the imported broiler from Slovenian Broiler Company (y).

## 3. Results and Discussion

Figure Nr. 1 shows the sales values in 2011 as the under invoicing prices were identified and the numbers and sales values in 2012 after the reference pricing policy was introduced. Since paired samples statistics revealed that the mean for local broiler company monthly sales after applying the reference price for custom valuation was greater than the mean for local broiler company monthly sales before applying reference price, it can be confirmed that the local broiler company's monthly sales increased significantly as result of applying the reference price for custom valuation on imports of Slovenian fresh poultry meat. The *p*-value of the results revealed to be 0.002 with the Confidence Interval (CI) between 95% and 99%, and as result we there was a statistically significant difference in the local broiler ranging from Euro 13,584.34 respectively Euro 47,827.60 per month. The absolute value of the *t*-stat was 3.947 which is greater than *t*-critical two tail, leading to an acceptance of the alternative hypothesis. A linear regression established that under invoicing price for custom valuation of imported fresh broiler

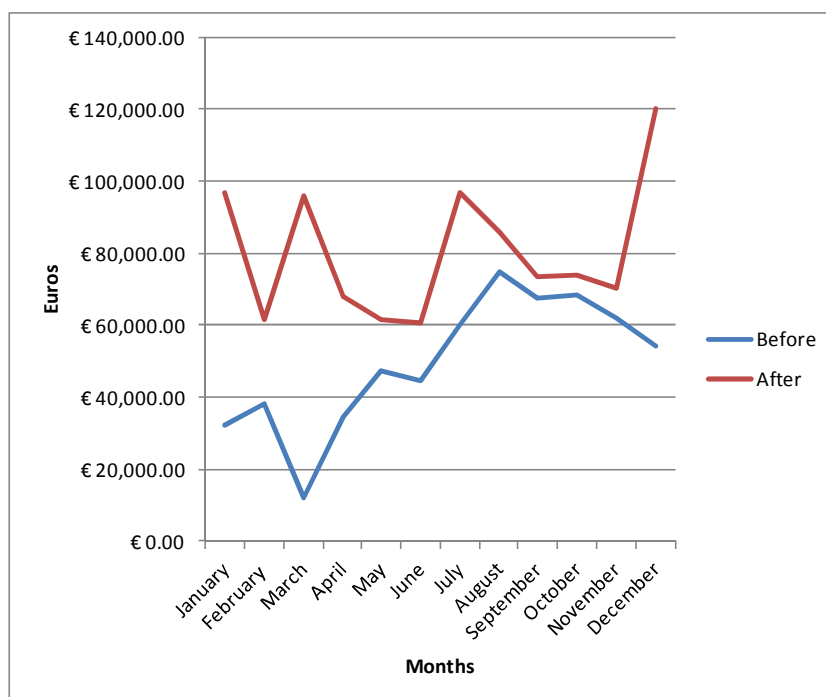
meat could statistically significantly predict fresh poultry meat monthly sales of x company,  $F(1, 23) = 16,45$   $p = .0005$  and under invoicing price for custom valuation of imported fresh poultry meat accounted for 40.2% of the explained variability in monthly sales of x company.

In this study the reduction of the sales for the Kosovo broiler company (x) was caused as result of the under invoicing prices for custom valuation declared at custom posts, which were introduced by the Slovenian broiler company (y). This was confirmed by the broiler company x and consequently a complaint was filed to the Kosovo Ministry of trade and Industry (MTI). The investigation by MTI found that the price of the same brand of poultry meat in the retail stores in Slovenia (the country of origin) was € 3.85/ kg (although the VAT for meat products in Slovenia is 8.5%, while in Kosovo it is 16%), and this was used as an evidence that Slovenian company was applying under invoicing prices for custom valuation in Kosovo market because in the country of the origin the price of the fresh poultry meat was higher. As the local broiler company (x) entered in the fresh poultry meat market, the Slovenian broiler producer company (y) lowered the retail price for fresh poultry meat from € 3.00/kg to € 2.13 /kg (Personal communication x local company 2012). After investigating the facts, on MTI request, the Kosovo customs authorities were asked not to recognize the transaction value of Euro 1.57 /kg of fresh poultry meat but to apply reference price of Euro 2.07 for custom valuation of imported poultry meat from Slovenia. The Slovenian broiler company had an incentive to declare lower prices for imported goods at the border because this reflected in lower customs duties. Kosovo, as a developing country in the Balkan region is a CEFTA signatory and applies value added taxes and custom taxes. The major duties levied at Kosovo's borders are a 10% customs tariff and 16% VAT on goods coming from EU. The customs tariff and the VAT are levied on an ad valorem basis. Duties levied at the border have the effect of increasing the price of imported goods in the local marketplace, and hence act as a protective shield for local products in the local market. In other words, customs undervaluation undermines the effective protection of local products from unfair trade practice. In this context, the MTI proposed that Kosovo customs use reference prices for custom valuation for imports of poultry meat from Slovenian company to neutralize the under invoicing. Reference prices are

floor prices below which the invoice price (Transaction value) is not used for assessing tax; instead the reference price is used. Under the Brussels Definition of Value, goods are valued on the basis of their "normal price": that is to say, the price which the imported goods would fetch at the time when the duty becomes payable on a sale in the open market between buyer and seller independent of each other [18]. The primary basis for customs valuation under the GATT Agreement is "transaction value". The WTO and the EU advise that countries use transactions values for assessing dutiable value of imported goods. When there is suspicion for undervaluation, they recommend that customs administrations deal with it through legal instruments such as post-entry audits [16].

The EU average price for poultry meat is 2.65 EURO (EU-Commission for Agriculture and Rural Development 2015) which supports the decision of the Kosovo MTI to introduce a reference price of 2.07 EURO which is still lower than the EU reference price. Prior to the introduction of reference pricing for customs valuation for imported fresh poultry meat, the Kosovo broiler company (x) was experiencing injury from unfair trade practices applied by Slovenian broiler producing company and after introduction of reference price policy a significant increase in monthly sales after introducing the reference pricing policy occurred at  $t(11) = 3.947$ ,  $p = 0.002$ .

The monthly sales of x company had increased steadily since introducing reference prices for customs valuation to neutralize the under invoicing. In December of the 2014, the monthly sales have peaked at 328,580.92 Euros. This shows that the introduction of a reference price policy protects the economy of a country, especially Kosovo undergoing economic recovery of the economy in the post-war time. A typical argument for protection of industries in the developing countries, applicable to Kosovo, is the "infant industry argument" [10]. According to this argument, temporary trade protection is needed to set up an industry and to protect it during its infancy stage against competition from more established and efficient foreign firms until it can reach the economies of scale that would permit it to market products successfully locally and internationally.

**Figure Nr. 1:** Monthly sales of x company before and after introducing reference price for custom valuation

#### 4. Conclusions

This study suggests that the fresh poultry meat selling price has the highest impact in gaining the additional market share for new entrants in a competitive market. Therefore government officials and company managers must take the responsibility to avoid unfair trade practices and ensure that there is level playing field for all actors in the market and that the under invoicing for customs valuation in developing countries is monitored closely to avoid distorting competition through applying unfair trade practices. It is essential for broiler companies to fully understand the poultry meat market environment in Kosovo, and be able to evaluate if the market is working efficiently and whether the company is getting an acceptable share of the Kosovo fresh poultry meat market. Consumers are assumed to buy a product up to the point where the perceived value of the product equals the price of the product [19]. In case of under invoicing for custom valuation, this research findings suggest that reference pricing policy for custom valuation should be an important mechanism to combat under invoicing in the developing countries. To avoid injuries to infant industries from well established companies in cases of under invoicing, the developing countries for custom valuation could use the transaction value previously accepted for similar goods sold to the same country of importation. This study points out the opportunities

for appropriate approaches in the future to neutralize that unfair trade practices that contribute to reducing competitiveness of local fresh poultry meat production thereby gaining additional market share.

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