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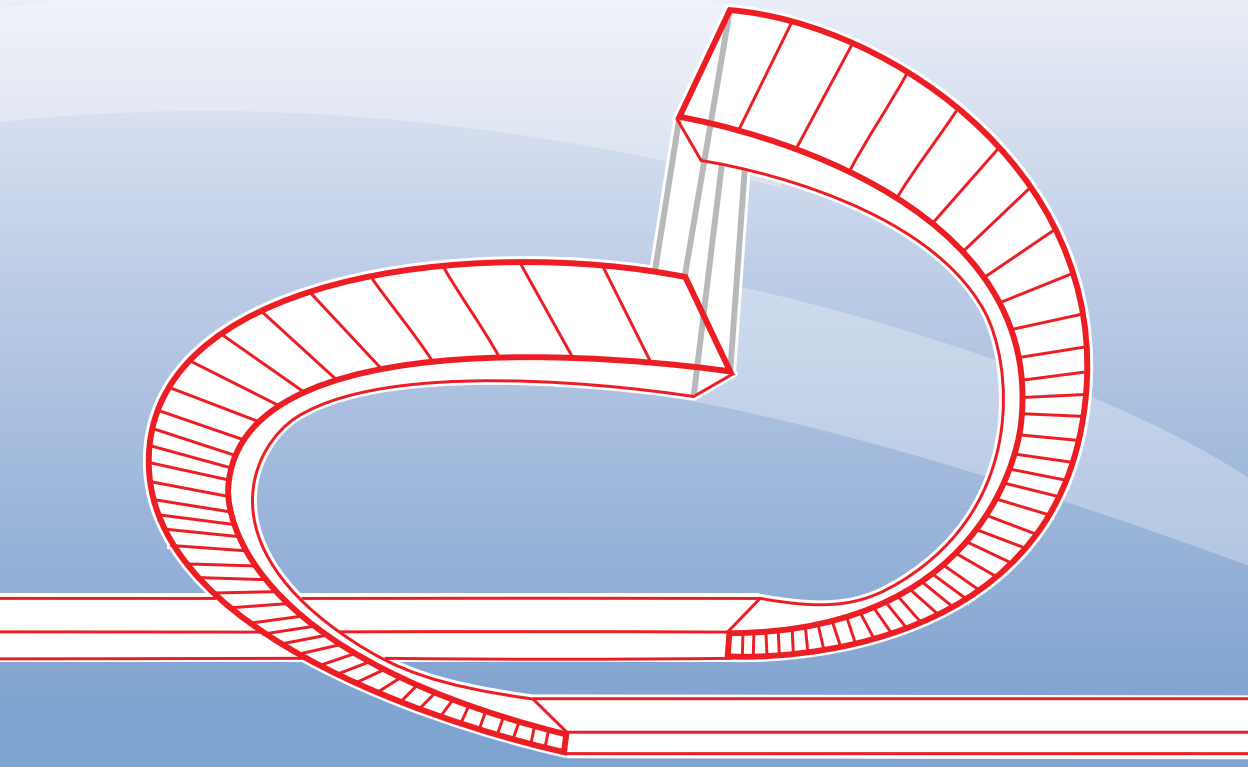
FORUM

FORUM ZA ETNIČKE ODNOSE | FORUM FOR ETHNIC RELATIONS

Policy Paper

ENHANCING COOPERATION BETWEEN BUSINESS COMMUNITIES OF SERBIA AND KOSOVO

REPORT AND RECOMMENDATIONS



ENHANCING COOPERATION BETWEEN BUSINESS COMMUNITIES OF SERBIA AND KOSOVO

REPORT AND RECOMMENDATIONS

PROJECT:
BRINGING THE EU-FACILITATED DIALOGUE CLOSER TO THE BUSINESS SECTORS IN SERBIA AND KOSOVO



FORUM ZA ETNIČKE ODNOSE
FORUM FOR ETHNIC RELATIONS

Belgrade – Prishtina, October 2020

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Acronyms and abbreviations

AEO	Authorised Economic Operator
GDP	Gross Domestic Product
CEFTA	Central European Free Trade Agreement
EBRD	European Bank for Reconstruction and Development
EMS	Serbian Electricity Transmission, System and Market Operator
KOSTT	Kosovo Electricity Transmission, System and Market Operator
EU	European Union
EUR	Euro
INDEP	Institute for Development Policy
KAS	Kosovo Agency of Statistics
MAP-REA	Multi Annual Action Plan for Regional Economic Area
IMF	International Monetary Fund
NBS	National Bank of Serbia
NPAA	National Programme for the Adoption of the acquis
NPISAA	National Programme for Implementation of the SAA
KCC	Kosovo Chamber of Commerce
CCIS	Chamber of Commerce and Industry of Serbia
REA	Regional Economic Area
RCC	Regional Cooperation Council
RIRA	Regional Investment Reform Agenda
SORS	Statistical Office of the Republic of Serbia
RYCO	Regional Youth Cooperation Office
FDI	Foreign Direct Investments
SAA	Stabilization and Association Agreement
UN	United Nations
UNMIK	United Nations Interim Administration Mission in Kosovo

USD	US dollar
WB6	Western Balkans 6
WB6 CIF	Western Balkans 6 Chambers Investment Forum

Introduction

This Report is a result of the work on the Project: *Bringing the EU-Facilitated Dialogue Closer to the Business Sectors in Serbia and Kosovo*, implemented by the Forum for Ethnic Relations, in cooperation with the Chamber of Commerce and Industry of Serbia, Kosovo Chamber of Commerce and the Institute for Development Policy. Within the project, a multidisciplinary research research on knowledge and awareness of the business community concerning the EU-facilitated dialogue was conducted in Serbia and Kosovo during 2019/2020. Findings of the research were used for this report too. A report on the research is available on the website of the Forum for Ethnic Relations (*www.fer.org.rs*).

This Report examines the key challenges that hinder the normalization of relations between Belgrade and Prishtina, as well as the opportunities and possibilities that can be used through stronger cooperation between business communities and evaluation of regional initiatives as a possible framework for encouraging normalization. A broader socio-economic context is observed, in which the cooperation between business people and communities is achieved, with a special focus on the process of advancing the normalization of relations between Serbia and Kosovo under the auspices of the EU (Brussels dialogue), the process of integration of Serbia and Kosovo into the EU, and opportunities offered by regional initiatives. The Brussels dialogue and regional initiatives serve as an explicit framework through which the effectiveness of various measures with significant impacts on the political and economic conditions of these economies is observed.

Based on the analysis of the accomplishments so far reached in the process of normalization of relations between Serbia and Kosovo and challenges that stand in the way of a more intensive development of their mutual economic cooperation, it is argued that previous efforts have not contributed significantly to the political, economic and social stability of these economies; which is the

fundamental goal and value of European integration policy. Accordingly, it is proposed to consider and affirm modalities for accelerating the overall economic and trade cooperation in with the purpose of:

- Lifting barriers that hinder cooperation between business communities, and hinder the normalization of relations between Serbia and Kosovo and the development of sustainable economic relations;
- Improving communication between business people and relevant national institutions regarding the facilitation of trade flows between businesses and communities;
- Enhancing the business environment and cooperation between businesses and communities in Serbia and Kosovo in the framework of achievements and potentials of the EU-facilitated dialogue on the normalization of relations between Serbia and Kosovo.

This Report is intended for competent institutions (governments, local authorities, international organizations), international business associations, experts and the wider public.

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As used in this Report, the following terms shall have the following meanings:

- "Kosovo" – as defined by Brussels Agreement: Designation, i.e. without prejudice to status and is in line with the UN Security Council Resolution 1244 and the Opinion of the International Court of Justice on the Kosovo's Declaration of Independence.
- "North Kosovo" - a region located north of the Ibar River, composed of four Serb-majority municipalities: Zubin Potok, Leposavić, Zvečan and Kosovska Mitrovica. This notion is not the same as the notion of "North Kosovo" officially used in Kosovo, which refers to broader region composed of the Albanian-majority municipalities: Mitrovica, Srbica and Vučitrn, in addition to four Serb-majority municipalities.
- The "Brussels dialogue"- the process of negotiations and agreements on the normalization of relations between Serbia and Kosovo, conducted under the auspices of the EU, and in line with the *UN General Assembly Resolution 64/298*, of March 2011.

PART I
The context and challenges of economic cooperation between Kosovo and Serbia

From the economic point of view, there is a long history of instability in relations between Serbia and Kosovo. In the second half of the twentieth century, Kosovo enjoyed political and administrative status of an Autonomous Province within the Republic of Serbia. This area was economically underdeveloped with a rudimentary infrastructure. Despite the high economic development achieved during the period 1950-1980, Kosovo remained by far the least developed region of former Yugoslavia. Political and economic relations between Serbia and Kosovo have been strongly influenced by their past history; in particular by the events at the end of the 20th century.

Serbia - Kosovo relations are extremely complex and have been in rapid decline over the last three decades, culminating in the war of 1999, and the complete dissolution of relationship following Kosovo's unilateral declaration of independence in 2008. This was one of the most turbulent periods in political history of Serbia and Kosovo, which saw the end of socialism and the breakup of Yugoslavia. This break-up assumed the characteristics of an inter-ethnic conflict, and in Kosovo it assumed the form of military-police repression and armed actions carried out by the Serbian authorities and armed formations of Albanians. This was the period marked by the creation of new states; ten-year long international isolation caused by the EU and UN sanctions and international military intervention – NATO (1999). Although the processes of institutional and structural transformation and

renewal started in 2000, both sides continue to bear the burden of their overall historical and economic heritage and incomplete transition.

The main challenge faced by the two economies was the economic deterioration and steep decline in economic activity, with an evident lack of capacity for a peaceful and efficient transition from a planned, socialist economy to market economy. Low economic growth rates, high unemployment, non-competitiveness, underdeveloped infrastructure, and unsuccessful privatization of socially-owned enterprises have left Serbia and Kosovo still significantly lagging behind more developed EU member states in terms of economic development, general competitiveness and living standards.

Given such economic circumstances, and fundamental reforms required to secure progress towards European integration, a technical dialogue between Belgrade and Prishtina was initiated, which in October 2012 turned into political negotiations on the normalization of relations, primarily aimed at the improvement of everyday life in Serbia and Kosovo. The signing of the Brussels Agreement in April 2013 was a fundamental change in the relationship between the two sides. Despite some progress achieved in the process of normalization of relations, the implementation of this agreement is lagging behind and hampers the establishment of deeper and more meaningful economic cooperation between the business communities of Serbia and Kosovo.

Despite the stagnation or even non-implementation of the agreement, and extremely complex political relations between Serbia and Kosovo, the economic exchange in the period from 2000 –the end of 2018 has shown a growing trend, peaking in 2017 at the level of EUR 464.1 million.[1] This undoubtedly shows that there is great potential and room for intensifying economic cooperation in the conditions of greater market convergence, improved business environment, stronger competitiveness and improved infrastructure.

In addition, the involvement of Serbia and Kosovo in numerous regional cooperation initiatives opens the space for strengthening cooperation and building a spirit of partnership that supports the realization of the economic potentials of Serbia and Kosovo. Strengthening economic relations on the basis of free movement of goods, services, people and capital is vital for production and realization of production potential. The current situation and the challenges facing these two economies indicate that regional initiatives are still not making significant progress. Understanding the causes and consequences of barriers to full regional cooperation and their removal is a necessary prerequisite for the improvement of trade cooperation and connectivity between business communities from Serbia and Kosovo.

1 According to data provided by CCIS, foreign trade exchange amounted to around EUR 442.2 million in annual exports from Serbia to Kosovo. Imports amounted to EUR 21.8 million, indicating a large surplus in foreign trade relations between Serbia and Kosovo.

PART II
Socio-economic profile – Serbia

In economic terms, the Republic of Serbia is among the transition countries in the process of accession to the European Union, which is the main catalyst of the reform process. In March 2012, Serbia was granted EU candidate status, and in January 2014, Serbia's accession negotiations formally started. The transition into a market economy in Serbia, as a former socialist country, has been extremely slow. The transition dynamics have been determined by a number of political factors.

The ethnic composition of the population of the Republic of Serbia is very diverse, which is a result of the country's turbulent past. According to the latest census of 2011 (without data for Kosovo) in Serbia, out of a total of 7.2 million inhabitants, the majority nationality are Serbs (6 million or 83.3 percent).[2]

2 In terms of size, the most relevant national minorities are Hungarians (253.9 thousand or 3.5 percent), Roma (147.6 thousand or 2.1 percent) and Bosniaks (145.3 thousand or 2.0 percent), while others participate below 1 percent, specifically Croats (57.9 thousand or 0.8 percent), Slovaks (52.8 thousand or0.7 percent), Montenegrins (38.5 thousand or 0.5 percent), Vlachs (35.3 thousand) or 0.5 percent), and others. (*The Census of Population, Households and Dwellings in the Republic of Serbia, SORS, Book 1, 2012*).

Macroeconomic context

The main macroeconomic indicators show stability of Serbia's macroeconomic framework. In 2018 and 2019, the Serbian economy entered a stage of expansion. GDP growth reached a rate of 4.4 percent in 2018 and 4.2 percent in 2019. In 2018, the major share in the *GDP creation* was noted for the section of manufacturing, 14.5 percent, the section of wholesale and retail trade and repair of motor vehicles, 11.5 percent, the section of real estate activities, 7.0 percent the section of agriculture, forestry and fishing, 6.3 percent. On the other side, in GDP use, the share for household final consumption expenditure equaled 67 percent, while the share of gross fixed capital formation was 22.4 percent. In 2018, GDP per capita was EUR 6,137, with expected growth in 2019 to EUR 6,575.

In terms of *foreign trade* activity, the level of foreign trade deficit is quite high. Serbia's total export in 2019 reached EUR 17.5 billion (an increase of 7.7 percent compared to 2018). The foreign trade deficit amounted to EUR 6.3 billion (increase of 12.5 percent compared to 2018). Serbia's main trading partners are euro zone member states (primarily Germany and Italy), neighboring countries (Bosnia and Herzegovina, Montenegro), and Russia and China.

Inflation rate is low and predictable (moving around 2 percent annually). The *exchange rate* (RSD against EUR) is stable[3].This stability is based on the foreign exchange inflows through investment in government securities, tourism revenues and remittances of citizens temporarily or permanently employed abroad.

Serbia recorded a *government debt* equivalent to 52 percent of the country's GDP, which is below the "Maastricht criteria" of 60 percent of GDP.

According to the records registered employment, the number of employed persons was around 2.2 million in the first quarter of 2020. The *unemployment rate* in the same period had the value of 9.7 percent. This decline in the unemployment is a result of new jobs resulting from the expansion of service and production capacities, with a significant share of investments into industries (the Government's policy target was to reduce unemployment, which was close to 24 percent in 2012).

3 The average exchange rate of RSD against EUR was 118.27 in 2018, and 117.85 in 2019. In the first four months of 2020, the exchange rate was almost fixed at RSD 117.57 against EUR, indicating a slight appreciation over the past few years.

Business environment

The 2020 WB *Doing Business Report* shows Serbia at 44th place, four higher than in 2019. A better position was achieved due to easier procedures for obtaining construction permits, reduction of the administrative fee and improvement of reliability of electricity supply. The major problem is the area of starting a business. The reason for this is the method in which the procedure to prevent money laundering - registration of beneficial owners, was introduced.

The environment for investment is improving and *investment activities* in Serbia are growing each year. In 2019, the FDI inflows amounted to EUR 3.8 billion, coming mostly from EU countries (accounting for almost 60 percent of total FDI).

One of the key challenges for sustainable economic growth is the informal economy, including informal employment. It is estimated that the informal economy is at the level of 25-30 percent of GDP. Also, the progress of the informal economy is correlated with the weaknesses of institutions, especially the lack of transparency and prevalence of corruption.

According to the *Corruption Perceptions* Index of the international organization Transparency International, which includes 180 countries, Serbia was ranked 91st in 2019 (with 39 points), ranking it among the countries with widespread corruption. In its *report, Transparency International* stated that the Government itself openly violates and diminishes the anti-corruption rules that it proposed, and does not give clear answers to publicly stated and documented suspicions of corruption. Besides this, insufficient transparency of state bodies and suspension of anti-corruption mechanisms when contracting large infrastructural projects are the major problems.

Sectoral structure of Serbian economy

In the processing sector, which accounts for the biggest share in GDP, the most represented industries are: metal, chemical, food and textiles. Industrial production is dominated by the manufacture of parts and product components, i.e. primary processing and labor-intensive industries with end products requiring lower degrees of technological processing and having modest rates of added value.

Although Serbia is considered to be traditionally an agricultural country, the link between the sectoral base and the food industry is not efficient

enough. The structure of *agricultural production* in 2018 included plant production (crop growing, fruit growing and viticulture) which recorded a growth of 114.3 percent compared to 2017, and livestock production (cattle, pigs, sheep and poultry farming) which recorded growth of 101.3 percent compared to 2017.

Construction industry - the housing and construction of office buildings and traffic infrastructure is constantly increasing. Serbia's construction work value data was reported at around EUR 2.9 billion in 2018. This records an increase of 42 percent compared to 2015.[4]

Tourism is a fast-growing branch in Serbia. The number of tourists visiting Serbia is constantly growing, along with the tourism-carrying capacities. In 2018, tourism increased by 35 percent compared to 2014 (tourism brought Serbia around EUR 742 million).[5]

Energy - Serbia is heavily dependent on the import of crude oil and natural gas. In 2008, Serbia decided to sell a part of the energy sector - the production of oil, oil derivatives and gas - to the Russian company Gazpromneft, which holds a monopoly on the Serbian market. Unlike the gas and oil sector, Serbia has kept the *production of electricity* (Elektroprivreda Srbije - EPS) in state ownership. EPS operates coal mines in Vreoci and Kostolac, thermal power plants in Obrenovac, Kostolac, Svilajnac and Vreoci and hydroelectric power plants Đerdap and Bajina Bashta. Although it has adopted a strategy for the development of renewable energy sources (mini hydro power plants, solar, wind farms, biomass, thermal energy), Serbia has not yet significantly changed the structure of its energy production. In terms of *mining and mineral raw materials,* Serbia has 16 active mines, and mining is a significant base for industrial development. Low-calorie coals (lignite), which are mined in the surface mines of Kolubara and Kostolac, provide 65 percent of electricity in Serbia.

Connectivity and infrastructure

In terms of infrastructure, Serbia is an important European transport corridor. This is evidenced by 89 border crossings for international and border traffic to neighbouring countries. Important European road, rail, river and air traffic that connect the European continent with the Middle East pass through the territory of Serbia.

4 The value of construction work was RSD 344,670,414,000.00. This amount was convertedto euro according to the middle exchange rate of RSD.

5 RSD 87,687,000,000.00convertedto euro according to the middle exchange rate of RSD.

In railway traffic, Serbia is also a part of the global project "Belt and Road", which has been implemented by the People's Republic of China since 2012. A part of that project is the high-speed railway from Thessaloniki to Budapest. The railway infrastructure in Serbia is neglected and poorly developed.[6] With the help of European funds, banks and state aid of the Russian Federation, the reconstruction and modernization of the Belgrade-Nish railway is underway.

The Pan-European Corridor 10 passes through Serbia. Another two highways: E75 (Zagreb-Belgrade) and Corridor 11 (Belgrade-Bar) are connected to Corridor 10. Preparations are underway for the construction of the Nish-Prishtina-Durrës highway, which will open another exit to the Adriatic Sea for Europe.

The Danube, the second largest European river passes through Serbia in the length of 588 kilometers. Two more rivers - the Tisza (168 kilometers) and the Sava (206 kilometers) also pass through Serbia. The rivers are navigable and are important for international traffic. 8,515,265 tons of various goods and bulk cargo are transshipped annually through 23 river ports. Serbia is also an important hub for air traffic. The "Nikola Tesla" airport in Belgrade has become an important regional hub.

In the *telecommunications services* market, 38 operators were registered in Serbia in 2018. In the mobile telephone market, 3 network operators were active and 81 operators were registered for media content distribution services. The revenues from electronic communications had a share of 3.9 percent in the Serbia's GDP. The largest share in the total revenues of telecommunication services was realized from the provision of mobile telephone services - 58.2 percent of the total revenues (EUR 978 million).As regards the media sector, the structural changes have not been implemented in full, and the media market is oversaturated with a multitude of media outlets (there are 2,500 registered media outlets).

Social context

Demographic and labor market developments show negative demographic trends such as population aging, lack of skilled labor, brain-drain, and the outflow of skilled workers and young people.

The labor market is is relatively well-functioning, but labor supply and demand shows that it is neither stable nor balanced. On the one hand, there is a shortage of one type of highly educated workforce (IT experts, doctors), and

6 Of the 3,735 kilometres of railway lines, only 1,272 kilometres are electrified and 288 are double-track railway lines.

on the other hand, low-educated workforce profiles are dominant on the supply side (77.9 percent with elementary of secondary education).The *net average monthly salary* in Serbia amounts to EUR 510. The net median salary amounts to EUR 380, meaning that 50 percent of employees earn salaries up to the aforementioned amount. The minimum net salary is RSD 30,000.00 (about EUR 255). In 2019, there were 5,923,900 inhabitants above the age of 15 in Serbia. Of them, there were 3,236,900 active, 2,901,267 employed, 506,865 unemployed and 2,687,000 inactive residents.

Serbia is characterized by major changes in the *age structure* and accelerated demographic aging of the population caused primarily by a long decline in fertility rates. The results of the 2011 Census confirm the process of the aging population in Serbia, with 1.3 million (17.4 percent) people over 65, and 1.0 million (14.3 percent) young people (0-14 years). The aging index is 1.22 and the average age is 42.2 years, placing Serbia in the group of extremely old populations.

Additionally, Serbia faces a worrying population decline. The estimated population (SORS) in 2018 was 6.9 million, which is a decrease of about 300 thousand compared to seven years ago (2011 Census). Based on the negative natural population growth (-5.4 ppm), Serbia loses almost 38 thousand inhabitants annually.

Emigration is an equally worrying problem. According to OECD data, about 50,000 people leave Serbia annually, while data from the European Statistical Office show that this number is 52,049. Population emigration has long-term negative implications for the overall development of the country.

The *at-risk-of-poverty* rate[7] in 2018 was 24.3 percent, which is 1.4 percent lower than in 2017. Observed by age, persons aged 18 to 24 were most at risk of poverty (29.1 percent), as well as persons younger than 18 (28.8 percent). The lowest at-risk-of-poverty rate is among persons over 65 years of age (21.1 percent). According on employment status, among persons aged 18 and over, the most exposed to the risk of poverty were the unemployed (49 percent), while the lowest at-risk-of-poverty rate was among the employed (6.8 percent).

7 The at-risk-of-poverty threshold was RSD 16,615.00, on average per month for a one-member household. For households with two adults and one child under the age of 14, the at-risk-of-poverty threshold was RSD 29,907.00, while for a four-member household (with two adults and two children under the age of 14) this threshold was RSD 34,892.00.

PART III
Socio-economic profile – Kosovo

Kosovo has experienced an economic transition; however is still facing a lot of challenges to growth its economy. Structural deficiencies weigh heavily on Kosovo's economy, which is dominated by low value-added industries, and with the lowest GDP per capita among the Western Balkan countries. Efforts to move Kosovo closer to the EU are a key lever for reform. Kosovo and the European Union signed the Stabilization and Association Agreement in October 2015. Kosovo's integration into regional markets is lagging behind and the country is confronted with very large external deficits and has the lowest level of exports in the region.

According to the 2011 Census, Kosovo has a population of 1.78 million. With an average age of 30.2 years, Kosovo's population is the youngest in Europe. The majority of young people aged 10-24 years (61 percent) live in rural areas, while slightly over 30 percent live in towns.

Macroeconomic context

The macroeconomic environment is characterized by the absence of mass investments, the high unemployment rate (29.6 percent) and mass outflow of the working age population, with growing trade and financial exchange with other countries. According to World Bank reports, over the past ten

years, real GDP grew on average by 3.5 percent.[8] *In 2019, the GDP value was EUR 7,069,296,059.00.* The services sector is the largest in the economy with more than 50 percent of *GDP*. Industry accounts for 17.5, and agriculture 8.3 percent.[9]GDP by the expenditure approach increased by: export of goods and services by 14.3 percent; gross capital formation by 4.1 percent; final consumption expenditure of households and non-profit institutions serving households by 0.1 percent. However, economic growth has not been sufficient to either provide enough formal jobs or significantly reduce the high rates of unemployment.[10]

Kosovo has a negative *trade balance*. The highest trade deficit (12.7 percent) was in December 2019, compared to the same period in 2018, i.e. EUR 308.3 million compared to the deficit of EUR 273.5 million in 2018.[11]According to the data of the main groups for imports, the following are: (14.3 percent) machinery, mechanical and electrical equipment, (13 percent) mineral products, (12.7 percent) prepared foodstuffs, beverages and tobacco, (11.4 percent) means of transport, (10.3 percent) base metals and articles thereof, (7.0 percent) chemical industry products, (4.8 percent) plant products, (4.8 percent) plastics, rubber and articles thereof.[12]

During the first quarter 2019, the goods trade marked an increase of 8.6 percent compared to the same period of the 2018. In the second quarter of 2019, Kosovo's economy grew by 4.13 percent real terms and by 5.73 percent in nominal terms[13]. The real growth rate in the second quarter of 2019 is mainly attributed to total investment and net exports of goods and services.

According to CEIC data, the *unemployment rate* decreased to 29.6 percent in December 2018, from the previously reported number of 30.5 percent in December 2017. This trend has continued also in the third quarter of 2019, the unemployment rate dropped from 25.3 percent in the second quarter of 2019 to 24.5 percent.[14]The main cause of unemployment is low demand for labor. The private sector in Kosovo is weak, the majority of employees work in micro-enterprises in sectors that do not have a high rate of added value or perform jobs that require low skills.

8 World Bank (2018), available at: *https://www.worldbank.org/en/country/kosovo/overview*
9 World Bank (2018), available at: *https://www.worldbank.org/en/country/kosovo/overview*
10 CEIC (2018), available at: *https://www.ceicdata.com/en/indicator/kosovo/forecast-nominal-gdp-per-capita*
11 KAS (2019),available at: *https://ask.rks-gov.net/en/kosovo-agency-of-statistics/add-news/international-trade-statistics-december-2019*
12 Ibid
13 Kosovo Agency of Statistics (2019), available at: *https://ask.rks-gov.net/en/kosovo-agency-of-statistics/add-news/gross-domestic-product-by-expenditure-and-production-approach-q2-2019*
14 CEIC data, available at: *https://www.ceicdata.com/en/indicator/kosovo/unemployment-rate*

Business environment

The process of privatization carried out by the UNMIK Pillar IV responsible for economic reconstruction and development, managed by the EU in accordance with the *spin-off* method, as defined by the UN Security Council Resolution 1244, is not an example of best practice. It has not significantly contributed to sustainable economic development, inter alia, because of many unresolved property disputes.[15] The largest number of privatization processes occurred in the period 2006-2011. By the end of 2019, assets worth over EUR 732 million had been privatized.[16]

The level of investment in Kosovo is low, and major improvements are needed in the areas of reinforcing the *investment climate*. The amount of FDI in total investment is estimated at USD 200 million. Real estate attracts most investment and the most common investors are Diaspora members.

The 2020 World Bank *Doing Business Report* ranked Kosovo 57th, dropping significantly compared to 2019, when it was ranked 44th.[17]Despite the implementation of significant measures over the past years to improve the business climate, corruption, poor contract enforcement and unclear property rights remain the biggest constraints.

According to the *Corruption Perceptions* Index of the international organization Transparency International, which includes 180 countries, Kosovo was ranked 101st in 2019, with a score of 36.[18]The Corruption Perception Index uses a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean.

15 An example of the privatization that the UNMIK's EU Pillar refused to initiate are companies in North Kosovo, including those whose parent companies are in the Republic of Serbia. It wasn't until after the EU Pillar was closed, that the Kosovo authorities passed three laws: *the Law on the Privatization Agency of Kosovo (PAK); the Law Governing the Operation of the Special Chamber of the Supreme Court; and the Law on Reorganization of Certain Enterprises and their Assets, known as the Trepcha Law*. These privatizations have not been carried out to date and have not been part of the Brussels Dialogue due to resistance of Belgrade and political leadership of Serbs in Kosovo.

16 Privatization Agency of Kosovo, (2019), SOE Sales Report, available at: *http://www.pak-ks.org/page.aspx?id=1,37*

17 World Bank Group Flagship Report, Doing Business Training Reform, p. 12 *https://www.doingbusiness.org/content/dam /doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf*

18 Transparency International, Corruption perception Index 2019, *www.transparency.org/cpi*

Sectoral structure of Kosovo's economy

Industry accounts for 17.5 percent of Kosovo's GDP. In recent years, the *construction industry* has become one of the most important sectors, offering great economic potential for Kosovo.

Agriculture accounts to only 12.9 percent of Kosovo's GDP. Agricultural production is largely of mixed type, utilizing very old, traditional methods and is very inefficient. In order to move from individual to highly efficient production it is necessary to invest in specialized farms, mini-farms, which have self-sustaining resources; it is necessary to establish a network of control and veterinary care, as well as to search for solutions through associations of farmers.[19]

Kosovo has considerable potential for winter tourism (Brezovica ski resort), spa tourism (thermal springs in Zvechan), mountain (Leposavic), cultural, educational and hunting tourism and tourism related to water sports (Zubin Potok). In North Kosovo this industry is almost non-existent, and tourism infrastructure is extremely modest, and unresolved property issues hinder the development of tourism infrastructure.[20]

Kosovo's *electricity generation* relies on coal sources (lignite-brown coal).[21] The Kosovo Energy Corporation (KEK) is responsible for 90 percent of the total electricity generation in Kosovo. Kosovo imports between 10 and 15 percent of its total electricity needs. Kosovo has no gas resources, nor is it connected to gas lines, and gas is only used from butane gas cylinders. About half a million tons of petroleum products are imported annually. As far as alternative energy sources, on the Golesh hill near Prishtina airport, a wind farm project is under construction. Given the number of hours of sunshine per year, Kosovo should consider solar energy. The same goes for obtaining energy from biomass and geothermal sources. By connecting the power systems of Kosovo and Albania via a 400 kV power line in 2019, energy systems of Serbia and Kosovo gained in importance as a transmission potential. Since both Serbia and Kosovo purchase electric power, it is critical to upgrade and strengthen the Serbia-Kosovo transmission system up to 400 kV voltage level.

19 Dr Dušan Janjić, Normalization Challenges. Analysis of the Negotiation Process and Implementation of the Brussels Agreement, Policy Paper, 1A/ 2915, Forum for Ethnic Relations, Belgrade, 2015, 61, 62.

20 Ibid,62.

21 Brown coal (lignite) deposits, which are estimated at between 11 billion and 14 billion tons, are one of the richest in Europe.

Connectivity and infrastructure

The *infrastructural environment* of Kosovo is underdeveloped. Although Kosovo is not on the route of the pan-European corridors it is co linked with them via corridor VIII - the "Ibrahim Rugova" highway, which connects Prishtina and Tirana, and there are ongoing works linking Prishtina with Skopje (the section though Kosovo to the state border of North Macedonia have been completed) and Corridor X (Tirana - Prishtina - Nish).

Despite significant capital investments in road infrastructure, the road network in Kosovo is still underdeveloped, hindering the achievement of fast connection within Kosovo and with the region. Railway connections with Serbia and North Macedonia exists, but not with Albania or Montenegro. Technical prerequisites for the re-establishment of the railway connection with these countries exist, but the railway infrastructure needs to be upgraded.[22]

In 2011, Kosovo restructured the national railway company by unbundling it into two separate entities responsible for rail *infrastructure* management and train *operations*, *InfraKos* and *InfraTrain,* respectively. The *European Bank for Reconstruction and Development* recently approved the extension of a loan to the Government of Kosovo for the rehabilitation of railway lines north-south, from Leshak on the North Macedonia border (the area around the border/administrative crossing is scheduled for the last phase). Kosovo has two national airports (in Djakovica and Podujevo) and one international in Prishtina. The establishment of a direct air connection between Belgrade and Prishtina has been announced.[23]

Kosovo has nine border/administrative crossings of which six are with Serbia: Brnjak, Jarinje, Merdare, Mutivoda, Bela Zemlja and Muchibaba. As part of the technical dialogue between Kosovo and Serbia, in 2011 and 2012 an agreement was signed, and then a technical protocol on joint border management. Serbia is late in fulfilling its obligations in the second phase of the

22 On the side lines of the Munich Security Conference, on February 14, 2020, the representatives of the Kosovan and Serbian government, in the presence of Richard Grenell, as well as the Serbian and Kosovan presidents, signed the statement of intent to restore a railway link between Belgrade and Prishtina.

23 The letter of intent to re-establish flights was signed at the U.S. Embassy in Berlin on January 20, 2020, in the presence of Richard Grenell and U.S. National Security Advisor Robert C. O'Brien. On the Serbian side, the letter of intent was signed by State Secretary of the Ministry of Economy, Milun Trivunac, and by Director General of the Kosovo Civil Aviation Administration, Eset Berisha, on behalf of Kosovo. Lufthansa's carrier Euro wings will launch flights between Belgrade and Prishtina. This will at the same time provide a greater choice of destinations connected to Kosovo by air and will facilitate mail transport services. This step should have a positive impact on strengthening economic cooperation between Serbia and Kosovo (Gazeta Express: Kosovo-Serbia deal to restore flights between Prishtina is tax-free; source, *Gazette Express/KoSSev*, January 21, 2020, available at: *https://kossev.info/gazeta-express-dokument-sporazumom-o-avio-liniji-izmedju-pristine-i-beograda-ukidaju-se-takse-srbiji*)

agreement, which involves the construction of permanent structures on border crossings. At the beginning of 2020 this has not yet been completed.

In relation to the total water demand in Kosovo, the reserves are relatively small and unevenly distributed territorially at the expense of the eastern and south-eastern parts. The drinking water supply system is undeveloped; it suffers significant technological and commercial losses, and does not reach the majority of the population. There is no wastewater treatment system in Kosovo, while only 40 percent of the population, and less than 10 percent of the rural population has access to the national sewage system. With the Ibar River and the artificial lake Gazivoda which are partly situated in the municipality of Zubin Potok (and partly in the municipalities of Tutin and Novi Pazar), North Kosovo is rich in water resources. However, regardless of that, the water supply is far from satisfactory because it is transported through an old network and suffers from technical losses. The situation concerning waste water treatment is unfavorable because the sewage water from urban and rural areas is discharged directly into the Ibar River or other open channels without treatment. This activity is contaminating the soil surface and ground water and increases the risk of flooding and contamination.

In terms of the environment, the key problems are air pollution, water shortage and pollution, land degradation and loss of the role of the ecosystem. Very little has been achieved in the field of separation, recycling and processing of waste. The biggest threats to the environment in Kosovo come from mining - the metallurgical complex "Trepca", Thermal Power Plan "Obilic" and concrete plants in Prishtina.

When it comes to developing modern *telecommunication infrastructure*Kosovo is lagging behind. Kosovo is poorly covered by a fixed telephone system, and the rate of coverage is among the lowest in Europe. However, about 74 percent of Kosovo's population have subscribed to mobile phone services. There are two licensed operators of fixed telephones and the Internet - Post and Telecommunications of Kosovo (PTK) and IPKO Telecommunications. The same operators also provide postal services. IPKO telecommunications and Vala provide mobile telephone services. As for the *media*, Kosovo has 22 television stations (including 3 national), 9 newspapers and 92 radio stations.

Social context

The labor market in Kosovo suffers from high unemployment and insufficient employment opportunities, especially for young people entering the labor market. There is a significant mismatch between the skills of young jobseekers and the demands of the labor market, especially at the professional level.

The high unemployment rate in Kosovo is associated with high the *poverty* rate. The analysis of the Kosovo household budget, conducted by the KAS, reveals that 19 percent of Kosovo's population is poor. According to the data of the Household Budget Survey (HBS) 2017, it is estimated that 18 percent of Kosovo's population lives below the poverty line, with 5.1 percent of the population below the extreme poverty line.[24]

Emigration has been a notable demographic trend in Kosovo. According to the KAS, the number of people (those born in Kosovo only) who emigrated from Kosovo is 380,826. In relation to the resident population in Kosovo, 21.4 percent of the population are living abroad. The main destination countries are Western Europe countries (Germany, Switzerland, Italy, and Austria).

* * *

The economic systems of Serbia and Kosovo were developed as a subsystem within a single economic system of the former Yugoslavia. Thus, despite significant changes, there are many similarities and interdependence between these two economic systems. This facilitates trade and economic cooperation, based on economic interests of equal partners.

Both economies are characterized by low productivity and competitiveness, mismatches between labor skills and market demands, narrow export base, high informality rate, underdeveloped infrastructure which, in combination with socio-demographic pressures, causes extreme economic and social vulnerability and instability. Each of these factors affect the speed, direction and quality of the process of normalization of relations, as well as the strength of the private sector to contribute to overcoming past problems and generate immediate benefits for both communities.

In order to ensure sustainable economic cooperation and trade, significant improvements are needed in many areas, especially in relation to strengthening competitiveness and the investment environment in line with EU standards. These would help to create compatible policies for joint business, joint projects, association of small and medium enterprises, which in turn has the potential to open additional space for economic cooperation and political solutions.

The implementation of economic and social reforms in Kosovo and Serbia and progress achieved with the Brussels dialogue in normalizing relations between Serbia and Kosovo are interconnected and mutually conditioned processes. Namely, progress in the normalization process has immediate and long-term positive effects on the acceleration of business cooperation and the intensification of economic and trade ties between the parties. First, the

24 World Bank, available at: *https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=XKX(accessed on February 2020)*

implementation of the agreed solutions represent the adoption of the new European standards in areas of vital interest to the people in Kosovo and Serbia (for example, improvement and digitalization of the public register, increasing the mobility of the population, goods, services and ideas, raising the capacity of customs and other services, etc.).[25] In turn, business community cooperation acts as an important agent in the process of the normalization of relations, as economic cooperation and trade generates direct economic benefits for both communities and has the potential to provide a significant impetus to reconciliation across the region.

The role of economic, political and state leadership is crucial and both the speed and quality of solutions and their implementation depend on their leaderships' capacities. This is confirmed by the findings of empirical research conducted within the project with business representatives from both sides, which shows that there is a tradition of cooperation between companies from Kosovo and Serbia, but that the main obstacle for intensifying their cooperation are political relations and problems related to them.

This has been clearly confirmed by the cooperation results achieved so far, proving that the role of politics is extremely important when it supports and even more crucial when it blocks or discourages cooperation between business communities. A positive example of cooperation is the decision to establish the Provisional Fund for Economic and Infrastructural Development of North Kosovo (North Kosovo Development Fund) in January, 2013, based on the Customs Agreement. According to this decision funds collected from goods upon entering Kosovo through customs points Jarinje and Brnjak are required to be sent to the North Kosovo Development Fund and used to support economic development of the municipalities of North Mitrovica, Leposavic, Zubin Potok and Zvechan. The purpose of establishing the Kosovo Development Fund was to increase the quality of life of citizens in these municipalities and increase it to the level of other areas in Kosovo.[26] From 2013 to December 2019, of the EUR 15,729,416.72 collected by the Kosovo Development Fund, over EUR 11 million were awarded to the four northern municipalities. Of this amount, EUR 8.6 million (78 percent)were invested in capital projects.[27]

A decision of the Kosovo government of November 2018 to impose a 100 percent tariff on imports from Serbia and Bosnia and Herzegovina, almost brought trade with both countries to a halt, and is a decision which has

25 Dr Dušan Janjić, Normalization Challenges. Analysis of the Negotiation Process and Implementation of the Brussels Agreement, Policy Paper, 1A/ 2915, Forum for Ethnic Relations, Belgrade, 2015, 55.

26 Overcoming the barriers that hamper free business activity and normalization. Analysis of the economic and legal framework for doing business between Serbia and Kosovo, Forum for Ethnic Relations and Heinrich Boll Stiftung Serbia, Montenegro, Kosovo, Belgrade, June 2017, 20.

27 Ministry of Finance of Kosovo, (2020), Official communication with Mr. Muharrem Shahini – Head of Division of Public Communication.

produced a completely counter-productive effect. Undoubtedly, such a measure had a significant impact not only on business relations and trust between Serbia and Kosovo, but also on the overall relationship and behavior, undermining the foundations and results of cooperation, and cancelling great efforts to build trust and ties between business communities. The tariff remained in force for full seventeen months. Then, on March 31st, 2020, the Government of Kosovo issued a decision on gradual application of reciprocity as a principle in relations with Serbia.[28]Unlike Serbia, the tariff on imports from Bosnia and Herzegovina was lifted unconditionally.

A direct negative effects of this measure is already visible - it is assessed that the introduction of a 100 percent tariff on Serbian products has a negative effects on exports of up to EUR 400 million a year.[29] Small and medium-sized companies in Serbia suffered the biggest losses, while multinational companies that were doing business with Kosovo from Serbia were able to overcome the problem set by the tariff by exporting goods to Kosovo from other countries in the region.

On the other hand, the proclaimed goals of introducing the tariff were that local producers in Kosovo would benefit the most, and the level of production and employment would increase. Referring to the report of the GAP Institute from Prishtina, conducted during March 2019, these goals were not achieved. According to the report, Kosovo's trade deficit increased by 5.4 percent from November 2018. The processing industry has not accelerated in either generation of new employment or volume of work.[30] The imports of goods from Slovenia, Croatia, Hungary, North Macedonia, Greece, Bulgaria and Turkey increased several times. The change in the country of origin of products imported to Kosovo was reflected in the increase in the general price level by 2.4 percent, compared to September 2018. The most significant increase was seen in food prices - bread and cereals (12.5 percent), meat (3.2 percent), and oils and fats (3.0 percent).[31]

In addition to the immediate quantifiable economic impact, the tariff also had an immeasurable effect on trust and the business environment, due to a shift in public discourse that discourages economic cooperation, stifling sound economy and stimulating informal economic activity and business.

28 The decision states "1. All trade relations with Serbia, references used in the documents below will be in accordance with the Constitution of the Republic of Kosovo and applicable legislation: 1.1 Phytosanitary certificates and relevant accompanying documents for food and non-food products of plant origin and non-animal origin are subject to border phytosanitary control. 1.2 . Veterinary certificates and relevant accompanying documentation for food and non-food products of animal origin are subject to border veterinary control.

29 Information on the assessment of the impact of the tariffs on the import of goods from central Serbia, UNMIK, Kosovo, Belgrade, November 2019.

30 The impact of 100 percent tax on the reduction and consumer prices in Kosovo Comparing periods: January - October 2018 and January - October 2019, Institute GAP, Prishtina, March 2020.

31 European Union (2019). Kosovo Economic Report March-April 2019, 11. KAS, "Harmonized Index of Consumer Prices"

It is indisputable that this measure has far-reaching economic and political implications. It is also a direct violation of the CEFTA agreement, which is the basis for cooperation and integration in the region. The deepening of business cooperation and trade exchange between Serbia and Kosovo is burdened by a number of problems due to frequent violations of the provisions of the CEFTA agreement and the introduction of non-tariff trade barriers in agricultural and food products, and certain industrial products. Non-tariff barriers that burden economic relations and raise tensions on both sides are mostly technical barriers to trade, sanitary and phytosanitary measures and standards, export restriction measures or anti-dumping measures, as well as those related to public procurement procedures. In addition to barriers related to the political or international status of Kosovo, there are a number of other barriers of a different nature, which are largely a reflection of the non-implementation of the Brussels and CEFTA agreements, and which are often equivalent to import bans. However, most of these restrictions stem from the mutual non-compliance of regulations and procedures, and their non-compliance with EU norms and standards (lack of mutual recognition of product quality certificates, product safety certificates, laboratory test results, etc.). In this context, strong efforts are needed on harmonization of regulations and standards in the field of food safety and production quality levels, as well as modernization of quality infrastructure (including standardization, conformity assessment, metrology and accreditation) in order to reduce or eliminate barriers to trade and enable better access to companies in regional markets and the EU market.

Despite considerable structural challenge, the implementation of what has already been agreed within the Brussels Agreement and connecting the economies of Serbia and Kosovo through regional initiatives and agreements is an imperative. The two economies must join their forces and give a strong impetus to the normalization of Belgrade-Prishtina relations.

PART IV
Interdependence of the EU accession process and normalization of Serbia-Kosovo relations

The Brussels dialogue moves along the path determined in the United Nations General Assembly Resolution as "normalization with the aim of achieving peace, security and stability in the Western Balkans, and promoting cooperation and European integration to improve living conditions for all people".[32]

Until now, 48 agreements were reached within the Brussels dialogue, including dozens of arrangements, technical protocols and conclusions. The first significant step was made on April 19, 2013, when *the First Agreement of Principles* was initiated, and on the 22 May, when the plan for its implementation was agreed. The importance of the agreement lies in the fact that these are the first positive signs that both parties agree to look forward to easing the enmities. And while there is a relatively high degree of agreement about the nature of the *First Agreement of Principles,* there is a pronounced disagreement regarding the fulfillment of some parts of the agreement, in particular those concerning the Community/Association of Municipalities with Serb majorities (ZSO).[33]

32 UN GS Resolution 64/298 *http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/64/298*

33 Dr. Dušan Janjić, "Normalization Challenges: Analysis of the Negotiation Process and the Implementation of the Brussels Agreement", Policy Paper, Forum for Ethnic Relations, Belgrade 2015.

In order to bring the two business communities closer together, the most important agreements are: the freedom of movement of people and goods[34], supported by agreements on integrated border management[35], customs revenue collection and VAT and customs stamps (establishment of the North Kosovo Development Fund), agreement on energy[36] and agreement on telecommunications.[37] The implementation of the agreements allows the establishment of EU standards that support normalization between Kosovo and Serbia and creates the preconditions for elimination of barriers to faster economic development of Kosovo, including North Kosovo.

The process of transposing the EU *acquis* over time shall lead to more harmonious bilateral economic relations between Serbia and Kosovo, as it will be developed on identical and harmonized legal bases. Serbia signed the SAA in November 2007. Kosovo signed a relevant SAA in October 2015 (unlike the EU SAA with the Western Balkans countries of a "mixed" character – i.e. signed simultaneously by the EU and its Member States, the EU SAA with Kosovo is concluded only on behalf of the EU and not by its member states). These agreements have similar or comparable provisions on regional cooperation, as well as on the obligation to transpose the EU *acquis*.[38]

34 Freedom of Movement was established by the "agreed conclusions" on 2 July 2011, and on 2 December 2011 the *Operational Conclusions* related to the implementation of this agreement were harmonized. The implementation of the agreement began on 26 December 2011. The main points of the agreement are: the use of ID cards issued in Kosovo, driving licenses, vehicle registration plates, car insurance and new procedures for travelling in the two territories. The first passengers with Kosovo identity cards began to travel through Serbia on 1 May 2013.(Overcoming the Barriers to Business and Normalization. Research of the Economic and Legal Framework for Doing Business between Serbia and Kosovo, Forum for Ethnic Relations and Heinrich Boll Stiftung Serbia, Montenegro, Kosovo, Belgrade, June 2017, 13).

35 An agreement on the Integrated Border Management (IBM) was reached in the period from November 30 and December 2, 2011. Its implementation started as of 10 December 2012. (Overcoming the Barriers to Business and Normalization. Research of the Economic and Legal Framework for Doing Business between Serbia and Kosovo, Forum for Ethnic Relations and Heinrich Boll Stiftung Serbia, Montenegro, Kosovo, Belgrade, June 2017, 14, 15).

36 The Energy Arrangement, governing future relations between the EMS and the KOSTT was initiated in Brussels on 08 September 2013, based on which KOSTT became a member of the ENTSO and a separate control area, in June 2020. In accordance with this agreement, the company "Elektrokosmet" was transformed into a new company "Elektro-Sever", which should obtain a licence by October 2020, to be able to supply and distribute electricity for four municipalities in North Kosovo. KOSTT is responsible for the transmission of electric power in the main electric networks, outside and through Kosovo (See: *http://www.balkaninsight.com*).

37 The Agreement on Telecommunications was reached between Serbia and Kosovo in 2013. As provided for by this agreement, Kosovo obtained its own country code +383. The agreement enabled Telecom Serbia to legally operate and register a company for provision of mobile telephone and Internet service in the Serb-majority municipalities in Kosovo. The two parties agreed on drafting a Technical Agreement to harmonize the use of spectrum for GSM and television signals. The implementation of this agreement was not fully achieved before 2019.

38 Some obligations in Article 13 of the SAA between the EU and Kosovo should indirectly facilitate bilateral economic cooperation with Serbia. Kosovo undertakes to gradually normalize relations with Serbia, to implement all agreed agreements, and to respect the principles of regional cooperation. (Stabilisation and association agreement between the European Union and the European Atomic Energy Community, of the one part, and Kosovo *, of the other part, *OJEU*, L 71).

In order to prepare for integration into the EU, Serbia adopted the National Programme for the Adoption of the *acquis* - NPAA. The last, third revision of the NPAA was adopted in March 2018. [39]. The NPAA is a plan for the alignment of domestic legislation with EU regulations by the end of 2021, followed by a period of follow-up. Kosovo adopted the NPISAA in March 2016, which presents a mid-term framework of the legislative reforms (2016-2020), needed to meet the obligations deriving from SAA and implement the appropriate legislation.[40]

Regarding the degree of harmonization with EU regulations in the areas of free movement for goods, services and capital, the most relevant comparative document in this area is the European Commission's Communication on EU Enlargement Policy, which is published each year (the latest was published in May 2019).[41] In this document, the European Commission states that Serbia has made some progress and is "moderately prepared" in developing a functioning market economy and enforcing fair competition. Kosovo, on the other hand, is at an "early stage" of preparation for a functioning market economy. The challenges remain, including the widespread informal economy and high prevalence of corruption.

In regard to individual chapters, the European Commission assessed that Serbia is "moderately prepared" for all three chapters related to free movement of goods, services and capital (Chapters 1,3, and 4) while a "good level of preparation" has been reached in the area of customs union (Chapter 29). With regards to Kosovo, in the area of free movement of goods (Chapter 1) and capital (Chapter 4) "some level of preparation" was reached, while in the cases of Chapter 3 (Services) and Chapter 29 (Customs union), Kosovo is "moderately prepared". Compared to the previous 2018 report, Serbia did not receive a more positive rating in any of the four chapters mentioned above, while Kosovo made progress regarding Chapter 1 (free movement of goods) from "early stage" to "some level of preparation".

A new agreement, "Quality infrastructure" is of great importance for the free and uninterrupted movement of goods on the market, as it is essential for conformity assessment for products, and possible "mutual recognition" of institutions as well as issued documents on quality or compliance, as a precondition

Article 74 of the SAA between the EU and Kosovo provides for an obligation for Kosovo to ensure that existing law and future legislation will be properly implemented and enforced. This approximation shall start on the date of signature of the SAA and shall be completed by the end of the transitional period (10 years). Article 74, paragraph 3, emphasizes that approximation will, at an early stage, focus on fundamental elements of the EU *acquis*, i.e. in the field of the internal market, and in the field of freedom, security and justice, as well as on trade-related areas. Approximation shall be carried out on the basis of a programme to be agreed between the European Commission and Kosovo.

39 *http://www.mei.gov.rs/srl/dokumenta/nacionalna-dokumenta/npaa.*

40 *http://mei-ks.net/en/national-programme-for-implementation-of-saa.*

41 European Commission, *2019 Communication on EU Enlargement Policy*, COM (2019) 260 final, Brussels.

for free exchange. Overall, it can be stated that Serbia is *at a higher level of adopting regulations equivalent to those of the European Union*, as well as establishing quality institutions, which are prerequisites for membership in international bodies for standardization and sectoral regulations. In this context, Serbia and Kosovo should ensure compliance with Articles 34-36 of the Treaty on the Functioning of the European Union[42]. Serbia is a full member of the European standardization bodies (CEN, CENELEC). The rate of adopted CEN European standards is 99.95 percent; as well as 98.11 percent of CENELEC standards. The number of conformity assessment bodies is 590 compared to 39 such bodies in Kosovo. Kosovo bodies responsible for accreditation as well as standards are not yet included in the relevant European structures, unlike the bodies from Serbia.

* * *

The implementation of the Brussels Agreement so far has had a limited effect on improving the cooperation between Serbia and Kosovo, but it is important to point out that despite the many challenges to implementation, the Brussels Agreement enabled a more regulated and predictable business environment. However, a major obstacle to cooperation between the two business communities is the existing macroeconomic environment. This relates to limitations in the process of building a Kosovo economic system, as well as to the business climate in Serbia, which is under the influence of the unsolved political status of Kosovo. History teaches us that the process of transforming a once unified economic system into two independent economic systems is neither quick nor easy. Regional cooperation in the Western Balkans at present represents new hope for normalization of relations between Kosovo and Serbia. However, the political and security environment in the Western Balkans has not yet been fully consolidated, which could pose a challenge. By all accounts, what has to be done is to organize all economic and other capacities "from below", and to use regional and EU instruments only to support reforms in individual countries.[43]

The normalization process facilitates political decisions on cooperation in the field of economy (especially in the fields relating to trade flows, telecommunication and infrastructure development, and energy security) of both – Serbia

42 Article 34 prohibits quantitative restrictions on imports and all measures having equivalent effect between Member States. Article 36 provides for exceptions to the provisions of Article 34 in circumstances relating to public security, public morality, protection of health and life of humans, animals or plants, the protection of national treasures possessing artistic, historic or archaeological value, or the protection of industrial and commercial property.

43 Overcoming the barriers that hamper free business activity and normalization. Analysis of the economic and legal framework for doing business between Serbia and Kosovo, Forum for Ethnic Relations and Heinrich Boll Stiftung Serbia, Montenegro, Kosovo, Belgrade, June 2017, 22.

and Kosovo. The normalization promotes further strengthening of such cooperation. For its part, energy security and economic cooperation between Serbia and Kosovo is one of the pillars of overall normalization of Kosovo and Serbia, including their mutual relations.[44]

The normalization process aims at achieving peace, security and stability in the Western Balkans, and promoting cooperation and European integration to improve living conditions for all people by adopting the EU *acquis.* The normalization process, in turn, facilitates the adoption of political and business decisions on cooperation as an important element of economic development and overall normalization of relations between Kosovo and Serbia.

44 Energy sector of Serbia and Kosovo: Preliminary Analysis, Policy Paper 3/ 2017, Forum for Ethnic Relations, Belgrade/Prishtina, July 2017, 5.

PART V
Regional dynamics and context

The Stability Pact for South-Eastern Europe was established in 1999. Since then, a number of initiatives in different formats have been launched to encourage co-operation and rapprochement between the Western Balkans countries. The territory designated as the Western Balkans includes Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro and Serbia. Despite a good location, climate and significant natural resources, geographically and economically these are relatively small and insufficiently connected economies with modest market and development potentials, substantially lagging behind developed Europe. In terms of market volume and capacity, the Western Balkans as a whole could compete with developed countries, ensure long-term sustainable development and attract foreign investors. However, legacy of the past, complicated political and economic relations are producing a relatively low level of mutual economic cooperation and connection. In short, weak economic performance combined with political instability continues to impede the region from becoming an attractive market for new investment and development.

The circumstances are further complicated by the fact that the Western Balkans is in an advanced stage of depopulation. About 18 million people live in a sparsely populated area of 207,763 square km. According to Eurostat, in the period 2008-2019, the population has declined by about 1.2 million citizens, due to low-birth rate and depopulation in most regions, caused by mass migrations abroad (economic migration), especially of young people. Given the current trend, the region's population will continue to decline, which will

additionally limit the workforce - one of the main factors of economic development. According to the national statistics the estimated number of inhabitants in the region is 18 million, but in fact there are probably two to three million people less, given a significant number of citizens who have been working abroad "temporarily" for a long period of time, but are still calculated into the statistics. According to the World Bank, economic migration is (percentage by population) most pronounced in Bosnia and Herzegovina and Montenegro, followed by Albania, North Macedonia, Kosovo and Serbia. Local governments' measures toward increasing the birth rate have produced very limited results, so only mechanical demographic changes can be expected. This has formed a large Diaspora that transfers money to the region through remittances to their families, which is especially important for consumer activity in less developed parts of the country.

According to the World Bank, the total economic activity of the Western Balkans taken as a sum of individual GDPs comes to about USD 113 billion, with 3.2 percent growth rate in 2019. Regional GDP is mostly based on the consumer component (around 60 percent), which is supported by public spending and a strong remittance inflows (especially in Bosnia and Herzegovina). The increase in the GDP growth rate in recent years could be interpreted as the economic recovery of these countries, but that is only partially true. The achieved growth rates are largely due to a significant decline in production in the previous decade, i.e. the low starting position, which is why the gap with developed countries remains unchanged. This is best evidenced by the fact that the average regional GDP per capita in 2019 was recorded at USD 6,412 which is only 18 percent of the EU average.

Despite drastic *unemployment* rate drop during 2014-2019, from 24 percent to 15 percent, the Western Balkans has a pronounced unemployment problem. High unemployment rate coupled with high informal employment rate best reflects the state of these economies and social processes developing in them.

In the period 2014-2019, the *inflation rate* was relatively low and predictable, ranging from 1-2.2 percent. The Western Balkans economies currently enjoy a fair degree of price stability, which is largely due to the global decline in commodity prices as well as stable exchange rate regimes. During 2019, the regional fiscal balance increased slightly to -2 percent of GDP (budget deficit), but *public debt* remained below 50 percent of GDP, significantly below the "Maastricht criteria" (drastic public debt increase relative to GDP was recorded only in Montenegro, from 60 percent in 2014 to 78.6 percent in 2019).

Foreign direct investments remained stagnant across the region in the period 2013-2015, averaging annually at about USD 4.7 billion[45]. A rapid increase in FDI came in early 2016, and in 2018 the investment net inflow came to USD

45 UNCTAD World Investment Report 2019

7.4 billion. However, the level or quantity of investments is not crucial for the development of the region. It is about the quality of investments. Some investments are only expanding the market to investors, but they fail to contribute at any significant rate to the production and technological progress, which can even lead to capital outflows and increased unemployment in the long run. Over the past few years, both domestic and foreign investment activities had a higher share in the GDP structure, but the negative component in the form of the foreign trade deficit has reduced GDP growth.

The *foreign trade balance* across the region has been extremely negative and in recent years the current account deficit came to the level of 6.3 percent of GDP in 2019, with a declining tendency in the context of the current crisis. The current volume and structure of regional foreign trade reflect the level of development and structure of these economies, as well as the policies pursued by individual countries in their economic cooperation. In general, the regional foreign trade is dominated by agricultural products, raw materials, semi-finished products, and products of low level of technological processing, while imports are dominated by final products. Such foreign trade structure indicates low competitiveness of these economies, so the trade volume is significantly below the real needs and possibilities. Low complementarities of these economies is one reason for the low trade volume and integration of the Western Balkan countries, since their economic structure is relatively similar, marked by low technological development. In other words, these economies are characterized by low productivity, slim economic and export base, limited foreign direct investments in high technologies, high level of informality, which coupled with political instability and socio-economic pressures limits the economic and trade exchange possibilities.

The advancement of cooperation in the Western Balkans is marked by challenging political and socio-economic circumstances, and all efforts are made against the background of significant constraints, two of which are dominant: complex bilateral relations between Serbia and Kosovo and inadequate implementation of regional policy. This is best evidenced by the presented macroeconomic parameters, which show that the level of economic development and connectivity between the Western Balkan countries is still far below the required and preferable. Progress in this field requires accelerated structural reforms and a coherent regional framework by which countries would adopt the same rules and standards, harmonized with EU regulations. Under such a framework, the implementation of the existing and future bilateral agreements between Serbia and Kosovo would be more efficient because it is additionally ensured by appropriate regional obligations and decisions, and would lead to normalization of relations between the two sides and the entire region. However, the requirements and challenges faced by the economies of the Western Balkans suggest that regional initiatives have made limited progress in this regard.

To improve and strengthen the economic and business connectivity between these economies, primarily Serbia and Kosovo, it is crucial to understand the barriers, both political and those introduced to protect the domestic market, which are obstructing the path.

PART VI
Regional cooperation

Regional cooperation in the Western Balkans is the key precondition for achieving political stability and good neighborly relations, which is a fundamental goal of the European integration policy, especially bearing in mind the fact that all countries except Albania once shared a common state in which they attained a certain level of development and similar business customs, and acquired economic interdependence. Each of the existing regional initiatives has contributed to the renewing of the spirit of regional cooperation and partnership, supporting the process of trust-building and social cohesion in the region. Their significance and role can hardly be over-emphasized. However, despite a considerable number of regional integration arrangements, the Western Balkans economies still continue to be constrained by various boundaries and remain largely unintegrated. Efforts to build a consolidated region have been mostly undermined by the complexity of bilateral relations, leading to fragmentation and fragility of the entire region.

Regional networking is the central theme of various initiatives, the most important of which are briefly outlined below.

CEFTA 2006 is a trade agreement that is a cornerstone of regional cooperation in the field of economic and trade relations. A key objective of establishing CEFTA 2006 was to pursue economic integration with a view to eliminating barriers and facilitating trade between the signatories. The CEFTA parties have made significant progress in eliminating quotas and establishing a tariff-free trade area, as well as committed to ensuring the gradual liberalization of trade in services and approximation to EU rules, standards and practices in the areas of competition, public procurement and intellectual property rights.

The framework provided by CEFTA 2006, signed both by Serbia and UNMIK on behalf of Kosovo (UNMIK-Kosovo), has contributed to increased bilateral trade, removing certain non-tariff barriers, and better understanding of the importance of deepening trade relations, considering that the CEFTA market is an important export destination for both economies. Data on the value of exports and CEFTA share in their total exports[46] shows just how important the CEFTA market is to both economies. The realized value of Serbia's exports was EUR 3.2 billion, or 19 percent of its total exports in 2018; exports to Kosovo amounted to 412 million, or 13 percent of total exports to the CEFTA market. The dominant destination for Serbian exports in the region is BiH with 40 percent of total CEFTA exports, and Montenegro with 24 percent. It is important to point out that Serbia has a significant surplus in exchange with CEFTA economies, which in 2018 amounted to EUR 2.2 billion. On the other hand, Kosovo's exports to the CEFTA market in 2018 came to EUR 173.5 million, or 47 percent of total exports. Of that, 33.5 million were exported to the Serbian market or 19 percent of total CEFTA exports, or 48.2 million or 26 percent in 2017. The most important regional market for Kosovo's exports is the Albanian market with 39 percent of total CEFTA exports, and North Macedonia with 25 percent.

However, the fact that UNMIK is a signatory to the agreement on behalf of Kosovo is a serious burden on relations and the functioning of CEFTA. Kosovo has repeatedly stated that it will withdraw from CEFTA unless the agreement is changed and Kosovo is properly represented (as the Republic of Kosovo), suggesting the possibility of accepting an alternative way of representation other than the constitutional name. The change of name requires the consent of all parties, including Serbia, which has not happened so far. Due to numerous challenges facing the Kosovo economy in terms of regional trade, and a chronic trade deficit, CEFTA is widely perceived as unfavorable for the development of Kosovo's economy, specifically because local production was not ready for the sudden foreign trade liberalization brought by CEFTA 2006.

Bilateral trade relations are still burdened by a number of obstacles. Apart from those related to Kosovo's political and international status, there are administrative and technical barriers - non-harmonized certificates, non-implementation or irregular interpretation of the Brussels Agreements - and most importantly the lack of political will to normalize relations, as evident from constant dissatisfaction and complaints by the private sector.

In response to the need to lift the remaining non-tariff trade barriers, Additional Protocol 5 was integrated into the CEFTA framework as a trade facilitation agreement, which entered into force in April 2018. This Protocol standardizes and modernizes procedures for import, export and transit of goods

46 Sources: SORS (*https://www.stat.gov.rs/*) and KAS (*https://ask.rks-gov.net/en/kosovo-agency-of-statistics*), as well as CEFTA statistics (*https://statistics.cefta.int/home*)

in the region, with electronic exchange and harmonization of data and documents according to the EU model. In addition, the Protocol introduces mutual recognition of programs, documents and results of customs and inspection controls between the signatories, and therefore between Serbia and Kosovo, based on the achieved harmonization with EU rules and standards. This means in practice that in the case of import or goods in transit, the CEFTA signatories recognize the undertaken inspections and documents, provided that the laws and procedures of the importing country are harmonized with EU regulations. For the agreed principle to be operational and for the private sector to see concrete benefits from mutual recognition, parties need to have in place procedures for recognizing EU harmonization status adopted by the CEFTA Joint Committee. The procedure for the recognition of programs and status of "Authorized Economic Operator" (AEO) was adopted in December 2019 in Tirana and so far the two signatories (North Macedonia and Serbia) have initiated the procedure for validation of their programs. The realization is expected as soon as the circumstances allow the visit of the validation team. Successful validation of the program implies that all AEO status holders will enjoy the same treatment by all signatories in the regional market, without additional checks or other requirements.

Additional Protocol 6 on the liberalization of trade in services was adopted in December 2019 as an important step towards enhancing regional cooperation and integration, enabling economic operators trading in services to operate in all signatory countries without restrictions and additional requirements for recognition of professional qualifications, specific licenses, and other technical standards, provided that they comply with the relevant EU regulations and standards. In order to see the agreed principle operational and concrete benefits for the private sector, it is necessary to determine in advance the procedure for checking the status of EU harmonization, which is planned for 2020.

The *"Berlin Process"* is an initiative aimed at stimulating regional cooperation and high-level political dialogue. It was launched in 2014 on the centenary of the outbreak of World War I at the initiative of the Federal Republic of Germany. The initiative provides an important platform for dialogue between the leaders of the Western Balkans countries and the European Commission, Austria, France and host Germany. Italy (which organized the summit in Trieste in 2017), Great Britain (which hosted the summit in 2018) and Poland (which hosted the summit in 2019) also joined the initiative. Despite efforts by a number of European Union member states to jointly formulate initiatives and policies towards the Western Balkans and share responsibility for their implementation, it seems that the Berlin Process remains a priority for the countries that initiated it. A summit is planned for the end of 2020, which will be jointly organized by Bulgaria and North Macedonia in order to ensure greater engagement of the Western Balkans countries. Serbia did express a desire to host the 2018 summit.

Priority activities under the Berlin Process include engagement in resolving bilateral relations and developing good neighborly relations in the Western Balkans, combating corruption and organized crime, and strengthening institutions and the rule of law. Significant emphasis is placed on economic development and higher economic growth, improvement of infrastructure and energy connectivity in the Western Balkans, which is a precondition for economic development and more investment.

As part of the Berlin Process, at the initiative by the SCC and KCC, the Chamber Investment Forum (WB6 CIF) was established as a joint initiative by chambers of commerce of the Western Balkans countries as well as the Regional Youth Cooperation Office (RYCO), aimed at promoting inter-cultural youth exchange. The Declaration on Regional Cooperation and Resolution of Bilateral Disputes was also signed, which has given priority to reconciliation and resolution of the remaining open issues in the region.

There are a number of regional transport and energy projects that are especially important for achieving conditions for better cooperation between Serbia and Kosovo, such as the construction of the Nis-Prishtina-Tirana motorway i.e. Black Sea - Adriatic Sea; modernization of the railway route Nish-Doljevac-Merdare-Prishtina; electrification of railway route 10 (Lapovo-Kraljevo-Frushe Kosovo / Kosovo Polje-Uroshevac / Uroshevac-Skopje; air traffic, and construction of gas interconnector between Serbia and Bulgaria.

In addition to the integration agenda, the improvement of the framework and harmonization of regulations governing economic cooperation have been placed at the centre of the Berlin Process. At the Trieste Summit in 2017, the regional governments committed themselves to working together, with EU support, to create a Regional Economic Area in the Western Balkans where goods, services and labor will be able to move freely. This will also represent an investment incentive because it will enable the creation of a single area; a regional economic space based on the harmonization of business rules and requirements.

The Regional Economic Area is one of the key levers in the process of integration of the Western Balkans and consolidation and deeper integration of the regional market. In this regard, the Multi-annual Action Plan on Regional Economic Area (MAP REA) has been agreed as a multi-annual action plan for the creation of a regional economic space. It contains over one hundred points by which governments have committed themselves to change legislation and bylaws, improve practices and implement regulations governing the free movement of goods; modernize border crossings; recognize professional qualifications and remove obstacles to the mobility of students, researchers and members of the academic community; and, finally, to work on a building digital infrastructure that includes reduction of roaming costs, introduction of broadband internet, and ensuring data protection and cyber security. Generally observed, MAP REA is based on four pillars of integration: trade,

investment, mobility and digital connectivity, and its implementation is monitored by the Regional Cooperation Council (RCC), established to coordinate a comprehensive regional connectivity agenda.

Four Freedoms is an initiative launched in 2019 to underpin economic cooperation in the Western Balkans through the implementation of the four fundamental freedoms of the common market (free movement of people, goods, services and capital). The main goals of the initiative are defined in declarations made in Novi Sad, Ohrid and Tirana. The initiative was launched as a trilateral co-operation between Albania, North Macedonia and Serbia, with an invitation to other Western Balkan economies to join. Priority areas of cooperation have been defined towards creating a single economic area by strengthening cooperation and removing obstacles that hinder the valorization of an integrated market potential. Priority areas are focused on creating conditions for free movement of goods in the region by 2021; passport-free travel between the three countries; the possibility of obtaining work permits and recognition of qualifications without additional requirements. These declarations place special emphasis on mutual recognition of qualifications, student exchange and cooperation in joint research and development projects. Equally important are the specific goals that deal with the liberalization of investments and capital flow, with the necessary harmonization of legislation with the European norms in this area.

Although this initiative basically integrates the commitments already made under the CEFTA agreement and the Regional Economic Area, unlike most other cooperation forums initiated and driven by the European Union, this initiative is an attempt by Western Balkan leaders to take political responsibility for concrete steps in implementing reforms. At the same time, the initiative is a response to the dissatisfaction with achieved results within the existing formats of regional cooperation. Its importance comes from the imperative to strengthen the political visibility of the initiators, to provide additional support for solving specific problems and removing obstacles to achieving deeper regional economic cooperation, and to accelerate the implementation of the existing agreements. Specifically, at the meeting in Tirana, Serbia unconditionally accepted to adopt all previous agreements within CEFTA, and the formal adoption was conditioned by the abolition of the Kosovo tariffs on goods from Serbia. With the consent of Serbia, preconditions were created for the adoption of; Additional Protocol 6 on Trade in Services; Validation procedure for the Mutual Recognition of Authorized Economic Operators' Programs; Decision on Facilitating Trade of Fruit and Vegetables; Joint Strategy and Action Plan for Customs Risk Management. Also, unlike MAP REA, which included the harmonization of professional qualifications as one of the priority measures (which was not implemented even after four years), the signatories of the Four Freedoms initiative committed themselves to fully harmonize labor,

social legislation and health insurance in order to fully open the labor market. If fully implemented, with the automatic recognition of academic titles, these measures will ensure greater labor mobility and will represent one form of prevention of workforce migration outside the region.

If the other economies in the Western Balkans decide to join, the initiative has a great potential to capitalize on the political momentum in the process of regional integration, and thus contribute significantly to the advancing relations between Serbia and Kosovo. Like other previous regional initiatives, this one will be a great test of the political will to bring Serbia and Kosovo closer and normalize relations, with the acceptance of Kosovo as an equal partner. So far, the initiative has been met with some skepticism in Bosnia and Herzegovina and Montenegro, while Kosovo was the only one that was resolutely against joining the initiative.

Regional initiatives are based on the assumption that economic cooperation and networking have positive effects on overcoming economic and political differences and divisions. From this premise it follows that there is a connection between increased economic cooperation and political stability, and therefore the encouragement of commercial ties and business cooperation is essential for the normalization of relations between Serbia and Kosovo. However, experience to date suggests that economic benefits are not always a sufficient or dominant motive, as there are other variables at play in this relationship.

Implementation status - achievements and limitations

Observing the role and results of regional initiatives, a conclusion could be drawn that in the Western Balkans time is not valued as a development resource, since no idea or project has been realized according to plan or schedule. There are obvious delays in the implementation of plans, and despite numerous agreements on regional cooperation no significant results have been achieved.

However, regional initiatives are undoubtedly important and necessary. They have proven to be successful tools for fostering communication and cooperation in the region while raising awareness on common challenges and goals. Some progress has been made in certain areas, although the overall impact of these initiatives on bilateral relations between Serbia and Kosovo has so far yielded only limited concrete results. The key areas where very limited progress has been made and where significant gaps can be observed are:

Free movement of goods and services: Despite an evident degree of liberalization of the flow of goods, the trade agenda remains unfinished. Significant efforts are needed to remove the remaining non-tariff barriers, liberalize the trade in services and effectively implement the CEFTA agreement by all signatories. Successful implementation of the CEFTA agreement has been burdened with numerous unresolved issues, especially in Belgrade - Prishtina relations. The mere fact that the CEFTA agreement was signed by UNMIK on behalf of Kosovo, while in reality UNMIK's involvement has been reduced to a minimum, essentially undermines the effective functioning of the Agreement. Moreover, the implementation of the Agreement has often been hampered as the parties have tended to introduce some protective measures, which directly violate the Agreement, jeopardizing the trust and spirit of cooperation. The situation was further exacerbated when Kosovo introduced a 100 percent tax (tariff) on all goods imported from Serbia and Bosnia and Herzegovina; two countries that did not recognize Kosovo's independence. The measure was in force for 17 months, causing great losses and damage to the involved parties and the entire region, and only abolished after intensive involvement and pressure from the international community, primarily the United States and the EU. However, the measure had implications beyond economic effects, due to a widespread loss of trust and further hindrance of Belgrade-Prishtina relations.

The implementation of the plans covered by the MAPREA agenda has so far been very slow, without visible and significant results for the beneficiaries of the agreed policies, i.e. the citizens and the business community of the region. One exception is the agreement on the gradual reduction of roaming prices for calls within the region, and movement of priority products during the Covid-19 pandemic, the so-called "Green corridors". Realization of other priorities from the four pillars of MAP REA has been blocked by unrealistic goal planning, which has not taken into account the needs and real possibilities of the countries, and also by bureaucratization of activities as a substitute for the lack of political will to implement agreed measures or to initiate a change in framework to suit the needs of beneficiaries.

Labor mobility: Some progress can be observed in efforts to facilitate cross-border mobility of highly qualified professionals and researchers and in the opening of negotiations on mutual recognition of qualifications for certain professions. However, reforms in this area are significantly delayed with no visible results. Intensive and coordinated efforts are needed to encourage the mobility of human resources and cooperation between countries in the region through common policies, measures and instruments.

Investment and capital mobility: Modest progress can be observed in the implementation of the regional program for investment reforms aimed at positioning the region as a single investment destination. The Regional

Investment Reform Agenda (RIRA) has been prepared, the Regional Online Platform for Investment Promotion has been launched, but the implementation of concrete reforms in harmonization with EU and international standards of good practice is lacking. In addition, in order to attract quality investments to the region, the regional capital market must be functional, since the financial market is the backbone of economic integration. However, no progress has yet been made in consolidating the regional market and intensive work is needed to align policies and incentives for effective financial market integration.

Infrastructure connectivity: So far, the progress in this area has been merely symbolic and largely limited to the signing of letters of intent and agreeing on plans and measures to build a functioning infrastructure network in the areas of transport and energy. One example of an extremely slow realization is the construction of the highway that will connect Corridor X in Serbia with Prishtina via Merdare, marked as a symbol of reconciliation and the desire for the normalization of relations between Belgrade and Prishtina, which is why it was dubbed the Peace Highway. The total value of the construction of the first section between Nish (Meroshina) and Plochnik is EUR 255 million (about 35 km). The EU's contribution is EUR 40.6 million in investment grants and EUR 7.4 million in technical assistance. These grants supplement a EUR 100 million loan from the European Investment Bank and EUR 80 million from the EBRD, while the Government of the Republic of Serbia has allocated EUR 27 million. The construction of the first section has not started yet, and the first works are expected at the beginning of 2021, almost seven years after the initiative was announced at the Berlin summit. Consequently, it is necessary to significantly accelerate the implementation of the prepared plans that have a decisive impact on the integration and socio-economic development of Serbia and Kosovo, and the entire region.

Governance and institutions: Building a legal, regulatory and institutional environment for the economic integration of the Western Balkans has not made much progress. Very little has been achieved in certain areas, and all the Western Balkans economies continue to struggle with widespread and deep-rooted corruption, legal uncertainty and other challenges. Overcoming these challenges requires extensive structural reforms, strengthening the rule of law, transparency, increasing competitiveness, and creating a stimulating environment for businesses and investments. Progress in this field is necessary in order to achieve deeper forms of cooperation between Serbia and Kosovo, as well as other countries in the region, because it goes beyond the measures applied at the border. Otherwise, even the most successful infrastructure projects will not be enough for faster convergence of the WB6 economies.

Understanding the implementation challenges

According to the previous analysis, regional cooperation has shown some progress, but the achieved level of economic integration is still low; lagging far behind plans and expectations. This is confirmed by the results of the conducted field research within the project. There are a number of challenges, among which the following are dominant:

Lack of political will and credibility: The main reason why regional integration initiatives have achieved only limited success can be found in the governments' failure to meet the commitments made under regional initiatives. It is clear that there is a real gap between the declared intentions and the political reality. There is an obvious lack of political will to implement the agreed commitments as governments do not show enough commitment and readiness to subordinate their short-term political interests to long-term goals, and implement measures that go beyond the duration of their political mandates. The discrepancy and the gap between what is said and what is actually done shows how the successes of regional integration should be measured.

Lack of accountability in the implementation of obligations: Non-compliance with agreements and agreed obligations by the signatories is one of the reasons for frequent and significant disturbances in economic and political relations in the region. In these circumstances, there is a need to introduce trade discipline and legitimate control into the regional regulatory framework, in order to ensure a more efficient resolution of trade disputes and their political consequences. It is therefore necessary to establish an effective dispute settlement mechanism as a step towards achieving greater security and trust among countries.

Discrepancy between goals and actual needs and challenges faced by the countries, and the time frame for their realization. Objectives are often unclear and are defined at the level of activities and processes, which makes it difficult to measure the effects and also limits the objective review of the results. In order to have clear and realistic goals, it is necessary to make the planning process more inclusive, transparent and to involve all relevant actors, primarily the civil and private sectors. The integration of broader needs and interests must be taken into account when planning specific goals, not only in order to ensure greater engagement and full implementation of the agreement, but also to create public support for the reform agenda, which is necessary to build trust and credibility at all levels.

Inherent weaknesses of the regional structures: There are a number of regional initiatives with some overlapping and unclear division of respective mandates, with no enforceable mechanisms in place to assure accountability. In the absence of such a mechanism or authority, cooperation relies solely on voluntary action, which only works when national interests are well-aligned to common goals. The

attitude shown by the states involved in the Berlin Process towards the implementation of priorities contributes to the slow dynamics or non-implementation of the objectives. The agenda of the summits, which are organized once a year at the highest level, include topics of regional cooperation of the Western Balkan countries and EU integration, but an adequate political mechanism has not been set up for the accountability of the implementation of agreements, either at the level of regional governments or at the level of the most important actors in the Berlin Process. It has been shown that the RCC cannot play this role because it does not have the political capacity and responsibility to adopt and implement policies, which are left to the regional governments and the European Union, which as an institution, has the instruments to support the implementation of certain policies.

Lack of appropriate incentives: Implementation of reforms requires significant resources, and potential effects and benefits are often uncertain or difficult to quantify, or would materialize over a longer time period. In such circumstances, EU membership is emerging as the dominant reason why the Western Balkans economies are getting involved in regional initiatives. However, promoting that goal at a time when EU accession is still only a distant prospect for these economies is not sufficiently stimulating and results in a lack of enthusiasm for the normalization process between Serbia and Kosovo. In addition, the asymmetry of the EU's relationship with each of the Western Balkan economies undermines regional cohesion and each countries' commitment to meeting regional goals. A clear and credible EU membership plan could act as a stimulus for cooperation and reform processes.

Externally driven initiatives: A review of regional initiatives shows that most initiatives were initiated and led by the EU, confirming the fact that the Western Balkans economies are still not mature enough to independently come together around common interests and regional policies. When an initiative is externally imposed and is not necessarily rooted in national motives and interests, its future is often questionable. In such a framework, regional integration is not necessarily perceived as inherently valuable or indeed a goal of the region, but as an imposed task aimed at achieving some other goals. It is precisely this perception that is an essential challenge and the reason for the lack of consistency and engagement of the countries concerned, and significant efforts and investments are needed to raise the level of information and understanding of the benefits of regional integration.

Since the implementation of reforms lags far behind the plans, it is important to look at the overall effectiveness of various initiatives through discrepancies between the set goals and current implementation. Progress cannot be measured through commitments but through their consistent implementation and practical application. Their effect on the improvement of economic cooperation between the countries, i.e. Serbia and Kosovo, should be considered and evaluated on these bases.

PART VII
Recommendations

The relations between Serbia and Kosovo over the past two decades have been extremely complex and burdened with unresolved issues that hinder their overall development. The Brussels Dialogue laid the foundation for the normalization of relations between Kosovo and Serbia, and so far it has managed to significantly improve the freedom of movement and trade. However, an essential turn towards the normalization of these relations has yet to happen. That is why it is important to continue to build on the initiated process, with the support of the EU and in cooperation with the USA.

Given that political normalization and economic integration go hand in hand, addressing key obstacles to progress in the economic sphere must be the focus of attention. The main responsibility, however, lies with political leaders and decisions they take, which should be primarily aimed at normalizing relations and stabilizing the situation in Serbia and Kosovo. In addition, a more pragmatic approach to resolving the existing obstacles to business and overall cooperation is necessary, by preparing development projects that can contribute to the economic development of Serbia, Kosovo and the Western Balkans.

The role of the private sector, business people, companies, chambers of commerce and business associations are indispensable for the normalization process and overall development of Serbia and Kosovo.

The following recommendations stem from the findings of field research and analysis of the attitudes of the business community, the experience of chambers of commerce in removing barriers to economic cooperation and improving regional economic cooperation, and find their foothold in a common goal - Serbia and Kosovo's EU membership.

Recommendations related to regional cooperation

Strengthening regional cooperation and normalization of relations are interrelated and mutually conditioned processes. Normalization of relations between Serbia and Kosovo contributes to the elimination of numerous barriers to business, primarily those concerning non-harmonized regulations and standards, and their harmonization with EU standards. In turn, strengthening regional co-operation helps in addressing political and other challenges created by the normalization process.

The proposed recommendations and measures are primarily aimed at supporting the removal of restrictions on business cooperation and at creating conditions for full implementation of the already agreed as well as new obligations in regional cooperation, which will improve the competitiveness of these economies.

Priority measures

- Consider the establishment of *ministries for regional cooperation* in all Western Balkans countries, to enable better coordinate and implement policies important for improving regional cooperation.
- Consider *expanding and improving the existing free trade agreement* in order to integrate instruments and measures to improve its efficiency and measures related to the creation of a single market in the region that would also incorporate provisions related to the free movement of people and capital.
- Support intensification of economic relations and cooperation in the Western Balkans based on the principles of *respect and equality*, respecting the interests of all participating countries in order to create preconditions for accession of all Western Balkan countries to the "*Four Freedoms Initiative*".
- *Active role of the European Union and the member states* involved in the Berlin Process is necessary in order to insist on the full realization of priority projects and given promises.

Technical and operational measures within the CEFTA agreement

- Implementation of the adopted *Decision on mutual recognition of AEOs* in order to enable concrete benefits for companies with this status.
- Implementation of the adopted *Decision on facilitating trade of fruit and vegetables* in the CEFTA region.
- Preparation and implementation of procedures for *mutual recognition of documents and results of customs controls* and other inspection bodies.
- Implementation of *electronic exchange of data and documents* between customs and any other inspection or control authority (with the support of the SEED + platform), enabling electronic exchange of documents (phytosanitary, health and veterinary certificates).
- *Mutual recognition of certificates* confirming safety and quality of the products
- Establishing a regional *dispute settlement mechanism*, by means of Additional Protocol 7.
- *Completion of the zone of cumulation of origin* of products between the EU, CEFTA, the Mediterranean and the Western Balkans (Euro-Mediterranean Free Trade Area), by creating better investment conditions and cooperation between companies in production and export.
- Strengthening regional cooperation in the field of *quality infrastructure* in order to transpose and implement EU standards as well as technical requirements in the regional market, enabling unhindered trade in technical goods.
- Strengthening regional cooperation in *market surveillance*, and establishing electronic system for the exchange of information on unsafe products in the region (similar to RAPEX, ICSMS models).
- Strengthening cooperation in the areas of *competition and state aid*, including cooperation between competent bodies that regulate these areas, creating preconditions for achieving healthy and fair competition in the regional market.
- Elimination of discriminatory requirements and practices in the areas of *public procurement.*
- Removal of regulatory barriers to the *free provision of services* in the regional market in accordance with Additional Protocol 6.
- Preparation and application of procedures for *mutual recognition of qualifications* and *licenses* required for the provision of services under the same conditions in all regional markets.
- Improve regulatory requirements for the development of a single regional *e-commerce market.*
- Cooperation in the field of *protection of intellectual property rights* in the region, which is crucial for the development of new products, services, and technologies, and for attracting foreign and domestic investors.

Technical and operational measures within the Berlin Process

- Initiate the development of a common *regional energy strategy*, especially in the field of electricity generation and transmission / trade, with emphasis on relying on their own resources to make the region more sustainable and energy safe, as well as environmentally sustainable, in line with EU policy on the Green New Deal and its applications in the Western Balkans
- Develop a *strategy for the optimization of resources, production facilities and investments* in production facilities at the regional level
- Intensify work on *standardization in the field of renewable energy sources* at the regional level and in accordance with EU practice, with the aim to attract investments and achieve regional energy sustainability.
- Ensure urgent and consistent implementation of measures and activities to create a *single investment space* in the region in order to increase the possibilities of economies of scale, improve competitiveness, develop the financial market and improve infrastructure connectivity.

Other measures

- Ensure a more rapid flow of goods through establishment of *green corridors between the EU and the Western Balkans*, as a permanent solution until the region joins the EU. Long waiting times for trucks at the border crossings when exiting the region and in the cross-border area, between the WB region and the EU (border crossings with Croatia and Hungary), makes the transport and other associated sectors significantly uncompetitive and has a negative impact on the investment environment in the region.

Recommendations related to the normalization of Serbia-Kosovo relations

Achieving effective and sustainable progress towards the normalization of relations and cooperation between Serbia and Kosovo is a precondition for their development and the development of the entire Western Balkans.

It is therefore necessary to ensure full and consistent implementation of the agreements already reached within the Brussels Dialogue and to take the necessary measures towards faster and sustainable normalization of economic and general relations between Serbia and Kosovo.

Priority measures

- It is proposed to establish a *joint team for economic cooperation within the political dialogue* - consisting of persons with the highest degree of respect of the leaders of negotiating delegations and the EU, and who would jointly elect a team of associates. Among other things, the team would prepare proposals for an investment agenda for Serbia and Kosovo, while monitoring progress in the negotiation process, remove obstacles, and resolve open issues pertaining to business cooperation.
- More *active role of the EU and the US* is needed in the modernization and construction of road and railway infrastructure that connects Serbia and Kosovo. This should be done by establishing a joint Project Council (or Fund) consisting of representatives of Kosovo, Serbia, EU, USA and relevant financial institutions. This council would coordinate its work with the Joint Economic Cooperation Team.
- "Wiping the slate clean" can strengthen trust, facilitate agreements and improve economic cooperation, so it is necessary to gain *insight into mutual claims* and to determine the methodology for resolving this issue. It is recommended that mutual claims, whenever possible, be resolved through compensation, or through new joint projects without conditioning the resolution of property issues through succession negotiations.
- It is necessary to consider the possibility for *creating a mini-region according to the Euro-region model*: work on encouraging interest relations through regionalization and decentralization of space and resources by considering the possibilities provided by the intra-regional approach according to the EU regional policy model, the so called Euro-region. The core aim of such cooperation is to encourage the recognition of common challenges and interests, and the specifics and peculiarities of individual, mostly border municipalities and areas, which most often share the same or similar economic, geographical, infrastructural and other challenges.

  Examine the possibilities and parameters for the formation of two mini regions: the first, Prokuplje, Novi Pazar, Mitrovica (North / South) - Pec, and, the second, Vranje - Gnjilane - Kumanovo.

  Mini Euro-regions would have the appropriate legal status and the founders would be signatories who would form the Team for drafting legal and statutory acts of these mini regions. The formation of a mini-region through the implementation of the four fundamental freedoms of the common market should accelerate the development processes in the respective territories, primarily by encouraging direct contact

between business people, with financial and technical support for infrastructure development for small and medium businesses, especially in the areas of agriculture and services. The EU should support the establishment and development of such mini-regions from funds for cross-border cooperation of local communities, funds to support the Berlin Process and other appropriate funds such as the already established the North Kosovo Development Fund.

- It is necessary to establish *transparency of the Brussels dialogue and normalization process* in order to provide timely information to citizens. With this transparency in the background, it is necessary to provide political public support, which is especially important in the context of necessary constitutional and legal changes.
- *Adapt public messages and public speeches* of all political representatives of both sides in the Brussels dialogue and in the process of normalization, prepare the public to respect the necessity and importance of reaching an agreement on comprehensive normalization of relations between Serbia and Kosovo.

Technical and operational measures

- It is necessary to take measures to *strengthen infrastructural connections* through the implementation of priority projects that are important for the further process of normalization, as follows:
  - Belgrade - Prishtina - Durrës "Highway of Peace": expedite the start of construction of the section Nish - Plochnik and simultaneously start designing and finding ways to finance the section Plochnik - Merdare - Prishtina;
  - Design and reconstruction of railway infrastructure on the route Nish - Doljevac - Merdare - Prishtina - Kosovo Polje (reconstruction of the Merdare tunnel, raising the railway load-bearing capacity from 16 to 22 tons along the entire section, and construction of the missing railway on the route Podujevo - Kosovo Polje), and
  - Electrification and reconstruction of the railway on the route Lapovo - Kraljevo - Raška - Mitrovica - Prishtina-Kosovo Polje - Skopje.
- Implement the agreements on the establishment of *air and railway traffic*, which were reached with the mediation of the special U.S. Presidential Envoy for the negotiations between Serbia and Kosovo.
- Build *mutual trust in the field of energy production* (management of electricity production and artificial Lake Gazivode) as well as innovative projects in the field of energy, e.g. construction of a combined power plant for solar energy with the use of lithium batteries.

- Establish clear and realistic deadlines for the establishment of *postal traffic*.
- Strengthen capacities and *modernize the transmission network* between Kosovo and Serbia.
- It is recommended to improve the *monitoring of implementation and statistical compatibility*, with an active role of the private sector in order to monitor the implementation and preparation of analyses, and to have a timely and effective impact on the implementation of the agreement. Economic interdependence needs to be monitored by harmonizing official statistics with international standards and EU recommendations in order to provide compatible data in both communities and monitor progress in a systematic way.
- Strengthen the role of the Chambers of Commerce of Serbia and Kosovo as equal partners to governments in *strengthening trust and overcoming "psychological barriers*" in economic cooperation and in encouraging and promoting "bottom-up integration".
- Regularly review and *report problems* that hinder bilateral trade and economic cooperation and propose measures to address these problems.
- *Harmonize the remaining documentation/certificates* for unhindered movement of goods between Serbia and Kosovo: veterinary certificates for milk, meat and their products.
- Encourage sectoral dialogue through cooperation and analysis of opportunities to create *joint products and joint ventures* between companies from Kosovo and Serbia, by connecting the supply chain, especially in the field of agricultural and food products.
- Take necessary measures to encourage *broader cooperation and strengthen partnerships* between communities through cooperation in the areas of education and science, and between academic communities and research institutions of Serbia and Kosovo, and to encourage joint research.
- Establish academic *cooperation between the University of Belgrade and the University of Prishtina* by means of an agreement on cooperation which would include the formation of joint study programs in English. This would enable the exchange of students and teaching staff. Students would also be able to learn Serbian or Albanian languages.
- Take the necessary measures to *strengthen the investment potential* of both economies given the importance of foreign direct investments for their development, with special emphasis on industries and investments in *border areas*.

Recommendations aimed particularly at Kosovo

- It is necessary to work on the preparation and implementation of a comprehensive strategy for *sustainable economic development of northern Kosovo* and cooperation between municipalities within Kosovo and across the border
- In cooperation with experts from Belgrade and Prishtina, international experts, and the civil sector, representatives of municipalities from northern Kosovo should be encouraged and supported to form *joint working groups and prepare studies on priority problems and solutions* in the field of environmental protection, waste management and water supply, as well as an action plan to solve other issues and problems. These working groups should, if necessary, include representatives of southern Mitrovica, Vuchitrn, Srbica, Raška, Tutin, Novi Pazar and Kraljevo.
- Ratify *Additional Protocol 5* as soon as possible, to enable the implementation of adopted decisions and agreed obligations legally founded in AP5.
- Ratify *Additional Protocol 6* as soon as possible as a legal basis for the implementation of agreed obligations in the field of the liberalization of services in the regional market.

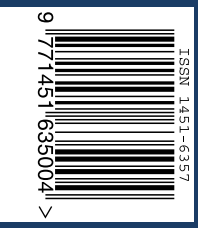
Recommendations aimed particularly at Serbia

The government and other competent authorities should, in consultation with business community representatives, determine measures to address the following issues as soon as possible:

- *Opening of the Serbian market* for Kosovo products
- *Payment operations*, especially the current practice by which goods are invoiced in foreign currency and payment is effected in dinars, whereby the conversion performed by the National Bank of Serbia results in large exchange rate differences that burden business-people and companies.
- Banks in Serbia do not provide *guarantees in favor of domestic companies that do business with companies from Kosovo*, so it is necessary to adopt appropriate legal solutions and repeal the current Instruction on temporary execution of certain payment operations in the Federal Republic of Yugoslavia, "Official Gazette of the FRY, no. 11 of 12 March 2001.

- *Excise products* cannot be imported from Kosovo, due to the requirement that these goods do not have mandatory excise stamps featuring the "Republic of Kosovo" insignia.
- Enable the *placement of products labeled "Made in Kosovo"* on the Serbian market.
- The issue of *transit*, especially *food of animal origin* for which a decision on determining veterinary - sanitary requirements for transit of consignments, is issued by the Ministry of Agriculture - Veterinary Directorate.
- Non-recognition of documents issued by Kosovo institutions that are required for the *participation of companies from Kosovo in public tenders* in Serbia.
- *Non-recognition of RKS plates* as valid license plates.

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