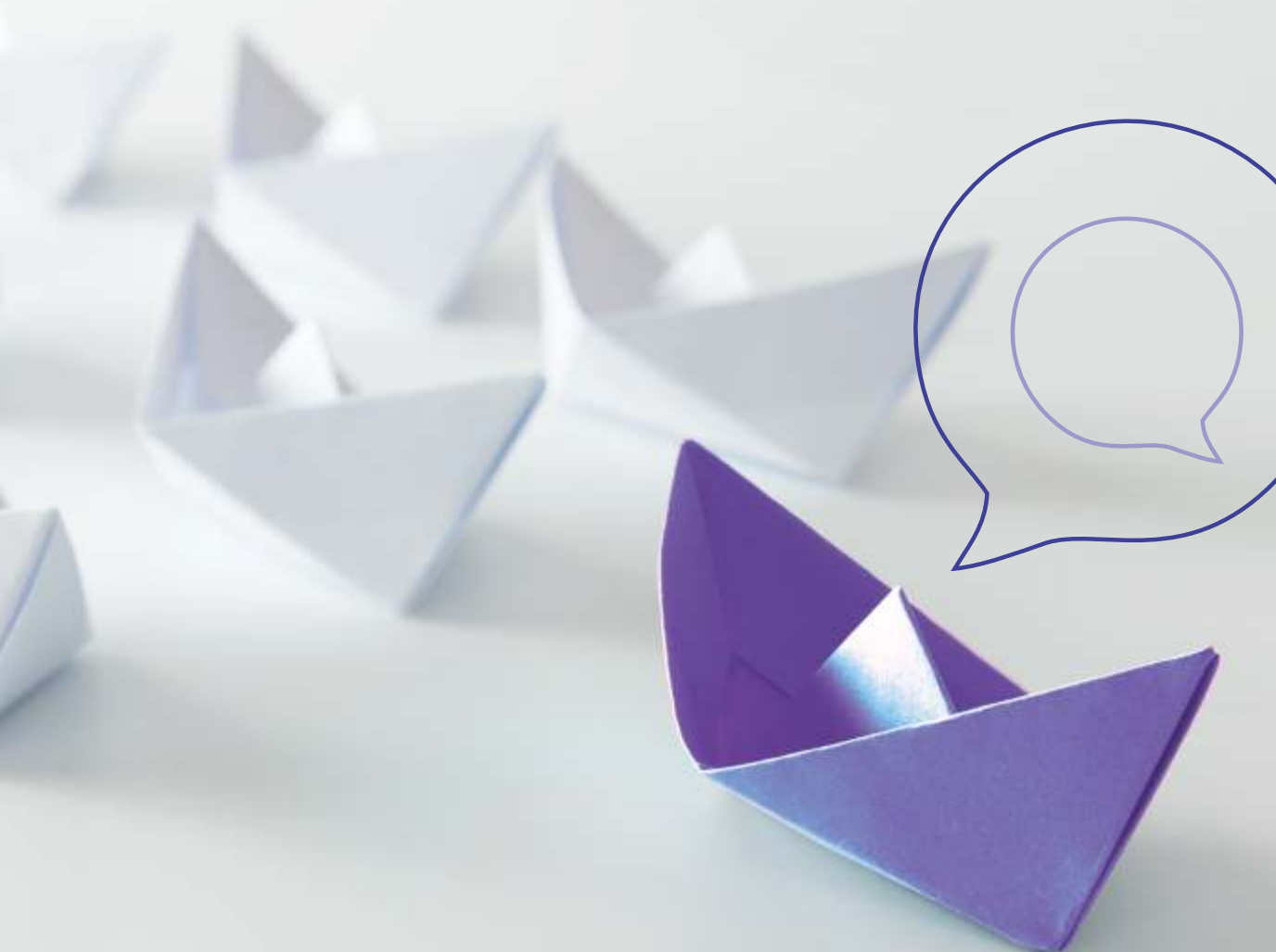


# BALKAN DIALOGUES

## ECONOMIC NORMALISATION



The BALKAN DIALOGUES is a project of the East West Institute (EWI)\* implemented in cooperation with the Belgrade Fund for Political Excellence (BFPE), first hosted in Belgrade in 2019, with high-level events taking place in Berlin in December 2019, Munich in February 2020, online in July 2020 and at the Belgrade Security Forum in October 2020. Comprised of decision-makers and experts from the six countries of the Western Balkans (WB6), along with the European Union, United States, and Russia, the dialogues are designed to help increase and deepen understanding while building trust between representatives of varying geopolitical interests present in the region today. The idea for this publication came from the community brought together by the initiative.

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Thematic papers and the executive summaries are a product of four expert workshops held online in August and September 2020.

\*After East-West Institute ceased to exist in December 2020, the Balkan Dialogues initiative was transferred to the Atlantic Council in Washington DC.

Opinions expressed in this publication do not necessarily represent those of the Royal Norwegian Embassy, Balkan Trust for Democracy, the German Marshall Fund of the United States or its partners.



# BALKAN DIALOGUES: ECONOMIC NORMALISATION

\*Excerpts from contributions by **Lazar Rakic**, Alternative Dispute Resolution Centre (ADRC), and **Alban Zogaj**, Riinvest Institute

Economic interdependence makes conflict “unprofitable”. It is the key to breaking down prejudices and helps humanise “the other side”. Thus, indirectly, it aids political normalisation. Recent research, including that done by ADRC, shows that there is a direct causality between the (degree of) communication and ethnic distance. In Mitrovica, for instance, communication and interaction with the “other side” is mainly furthered by economic interest or business needs.

In economic terms, the implementation of good neighbourly relations would translate into free movement of goods, labour, and capital - meaning that countries would sell and buy freely to and from each other (no tariffs or non-tariff barriers), workers would travel and work in each of the neighbouring countries, and capital (investments) would move freely from one country to another.

There is a relatively free movement of Kosovo citizens to Serbia and vice-versa, although most of them are Serbs living in Kosovo who frequently travel to Serbia and back. In terms of movement of goods, both countries are parties to the Central European Free Trade Agreement (CEFTA), promising to implement free trade regimes. However, in reality both sides have continuously imposed barriers, though mainly non-tariff. As regards capital mobility, there is lack of capital movement between the countries.

However, while Serbia claims ownership over assets and property located in Kosovo, this is vehemently rejected by the Kosovo authorities. One may argue that the nature of the problem is not economic but purely political; that is, that if both parties manage to reach a “comprehensive, legally binding” political solution, remaining issues will be resolved.

Since 1999, Kosovo's institutions, initially with the support of the United Nations Mission in Kosovo (UNMIK), and later on their own, have been building relations with neighbouring countries. Initially, the institutions of the Republic of Serbia refused to establish any relations or lines of communication with independent Kosovo institutions and declined to recognise any of the documents released by Kosovo institutions. As a result of the first stage of technical negotiations between Belgrade (Serbia) and Pristina (Kosovo), a total of 6 relevant agreements, aiming, among other things, to regulate economic exchange, were reached in 2011 and 2012, regarding freedom of movement, civil registry, custom stamps, recognition of diplomas, IBM, and regional representation. The signing of the Brussels Agreement was followed by more agreements related to economic cooperation which were reached by 2015 – including the agreement on vehicle insurance, as well as the renewed memorandum of understanding between the Chamber of Commerce of Serbia and Chamber of Commerce of Kosovo.

In their first memorandum, signed in 2013, the two chambers agreed, among other things, to exchange information and analyse markets, support their members in trade and economic cooperation, organise joint events and promote partnership opportunities.<sup>1</sup> In the annex to this memorandum signed in 2013, it was further agreed to promote and cooperate on upgrading alternative dispute resolution mechanisms for the purpose of resolving commercial disputes between members.<sup>2</sup>

Trade was flowing quite smoothly (with Serbia exporting around EUR 400 million to Kosovo, and Kosovo exporting about EUR 40 million to Serbia annually) until November 2018, when Kosovo imposed a 100% tariff on goods from Serbia, as a reaction to Serbia's continuous campaign against Kosovo's campaign to gain additional international recognition. This move put a halt to the EU-facilitated dialogue for 18 months, until it was renewed in mid-2020 following the intervention of France and Germany<sup>3</sup>. This restored the economic exchange with Serbia, and the dialogue – the former facilitated by the EU, and the latter by the US.

<sup>1</sup> <http://www.kim.gov.rs/doc/pregovaracki-proces/1%20Memorandum%20PKS-PKK.pdf>

<sup>2</sup> <http://www.kim.gov.rs/doc/pregovaracki-proces/2%20Aneksi%20MOR%20PKS-PKK.pdf>

<sup>3</sup> However, it should be noted that the EU-led dialogue was also renewed as a "positive consequence" of the pressure of the U.S. administration on the Kosovo government to abolish reciprocity, due to the US's separate interest in fast-tracking the negotiation process to lead to the Washington Agreement, signed on 4 September 2020.

In September 2020, facilitated by the US Administration, Belgrade and Pristina signed the Economic Normalisation Agreement<sup>4</sup>, thus complementing the previously signed letters of intent on establishing air, railway, and highway connections. The agreement contains points related to: conducting a feasibility study for the purposes of sharing Lake Gazivode/Ujmani as a reliable water and energy supply; another feasibility study on linking the Belgrade-Pristina railway infrastructure to a deep sea port in the Adriatic; cooperation with the US International Development Finance Corporation (DFC), which would open its office in Belgrade for the purpose of operationalising the Peace Highway, railway links, and providing financing to support small and medium-sized enterprises (SME's); and the membership of Serbia and Kosovo in the "mini-Schengen zone".<sup>5</sup>

The document signed has produced several results, with DFC offices opening in Belgrade, and "Investment Incentive Agreements" being signed by the governments in Pristina (31 December 2020) and Belgrade (21 January 2021).

### **Kosovo's economic profile:**

According to the World Bank's overview of Kosovo's economy, its growth has outperformed its neighbours' in the past decade, but it has not been sufficient to provide enough formal jobs, particularly for women and youth. Despite the steady growth rate, the unemployment rate – along with other labour market indicators – remains the highest in the Western Balkans. Growth still relies on remittances to fuel domestic consumption, and has only recently shifted to being more investment- and export-driven.

In the Serb-majority areas, the economy remains broadly dependent on Serbia's budget, namely, as regards salaries, pensions and social welfare. Data from recent research undertaken by the Institute for Territorial Development (InTER) indicate that approximately 80% of the inhabitants of four municipalities in the north are in some way financially dependent on Serbia's budget.

<sup>4</sup> <https://kryeministri-ks.net/wp-content/uploads/2020/09/ENG-ALB-SRB-Marveshja-e-Skenuar-2.docx>

<sup>5</sup> <https://www.euronews.com/2019/11/11/western-balkan-leaders-plot-their-own-mini-schengen-zone>

## Key obstacles to increased cooperation:

Talks at the technical level on harmonising veterinary and phytosanitary certificates have been conducted for years. The phytosanitary certificate was the first certificate to be harmonised, and it was agreed that Kosovo should be labelled with the abbreviation "XK". This was supposed to serve as an example of how other certificates should look (when referring to Kosovo). Up until now, **15 out of 52 certificates have been harmonised, and the majority of these certificates relate to meat and dairy products.** The problem of non-synchronised certificates creates an obstacle for both parties to export the goods which those certificates relate to.

**Kosovo businesses have experienced continuous issues as regards exporting goods with documentation that implies Kosovo's status,** be it a certificate, customs declaration or commercial invoice. According to the study conducted by the GFA Consulting Group and published by Kosovo's Ministry of Trade and Industry, in 2018 there were a total of 198 Kosovo companies which were exporting to CEFTA countries. For the purpose of the study, 27 companies which engaged in export to Serbia were interviewed, and 14 of them reported that they had faced obstacles exporting to Serbia.

**Companies which collect old and scrap metals,** which is a top Kosovo export product to CEFTA countries, **are not allowed to sell to or transit these goods through Serbia.** According to companies interviewed, the Serbian authorities told them that Kosovo exporters could not export to or transit through Serbia, because Kosovo is not a member of "the Basel Convention on the control of transboundary movements of hazardous wastes and their disposal".

Although **recognition of diplomas** was discussed several times and agreed upon with the facilitation of both the EU and the US, this issue **remains unresolved** and **continues to prevent free movement of labour.** The practice in the implementation of these agreements showed that the process is too slow and burdened with long administrative procedures. In September 2015, both Kosovo and Serbia again agreed to commit to recognising the diplomas. This provision was thus included in the 2020 Washington Agreement.<sup>2</sup>

<sup>2</sup> <http://www.kim.gov.rs/docs/pregovaranje/propis/29629A%20%20MOS%20PKS-PKK.pdf>  
<sup>3</sup> However, it should be noted that the EU-led dialogue was also renewed as a "positive consequence" of the pressure of the U.S. administration on the Kosovo government to abolish reciprocity, due to the US's separate interest in fast-tracking the negotiation process to lead to the Washington Agreement, signed on 4 September 2020.

In Kosovo, the long period of social segregation after the conflict has led to a point where the majority of Serbs and Albanians do not speak each other's language, thus creating a **language barrier**.

**The private sector in Serbian-majority areas remains underdeveloped.** The underdeveloped businesses and lack of investment affects the competitiveness of these companies and their positioning in the wider Kosovo market. The fact that **economic dependency on the public sector causes lack of motivation among the community to start and engage in a business is an additional obstacle.**

Trust in both Serbia and Kosovo's judicial systems remains low, while Kosovo's institutional system is not sending enough positive messages that investments in general will remain safe. One notable point of contention will be the **status of the usurped property that used to belong to Kosovo Serbs**; another, the pensions **and benefits claimed by Kosovo Albanians** who previously worked for state-owned enterprises.

Last but not the least, although most of the Serb and Albanian businesses interviewed expressed willingness for potential cooperation, few of them expressed **concerns about "emotional economy"** as a practice, whereby the economic decisions of buyers and consumers are affected by interethnic relations rather than their economic interest.

The commitment Kosovo made in the Washington Agreement to join the **"Mini-Schengen Zone", to which** Serbia, Albania, and North Macedonia agreed in October 2019, is an intriguing step forward. As it stands, the initiative is quite vague and poorly presented by all parties, even though the idea is not a new one. If the concept reflects the EU's "Schengen Zone", then it will initially reduce controls at the borders within the "Zone", and have as a long-term goal abolishing these same borders entirely. However, **implementing such an initiative requires a high degree of cooperation** between the participating countries, as the project would need to anchor rules and procedures for cooperation in criminal and judicial matters between countries. But the project itself benefits all of the parties involved, affecting individuals and firms in various ways, with an emphasis on mobility, trade, and security.

## A case in point: Gazivode/Ujmani Lake

Stemming from the Washington Agreement, the commitment by Kosovo and Serbia to work with the U.S. Department of Energy on a feasibility study concerning Lake **Gazivode/Ujmani** as a shared, reliable source of water and energy supply, has caused consternation among opposition parties in Kosovo, with the dominant narrative recounting that “(our) lake is being divided”. The main arguments on the Kosovo side are: that the lake is almost entirely located in Kosovo (more than 80%); and that the installations were built by the former Socialist Autonomous Province of Kosovo (former SAPK) and financed with a loan from the World Bank and the former “Fund for the Development of Less Developed Republics and Autonomous Provinces” (Federal Fund) established by the Socialist Federative Republic of Yugoslavia (SFRY), and used by the Kosovo energy system, agriculture, and industry.

The implementation of the Lake Gazivode/Ujmani project started in 1972 and lasted for almost two decades. According to the World Bank's 1986 final audit report, the project's implementation experienced extensive delays, which led to increased costs (from the planned \$93.3 million to \$203.7 million). The World Bank loan amounted to \$45 million (around 20% of the total project cost). The rest of the funding came from a loan raised by the former Federal Fund (65%), the former SAPK budget, the former SFRY budget, and what used to be the Joint Bank of Kosovo. Land expropriation was paid for from the SAPK budget and managed by the former Municipality of Titova Mitrovica. The loan agreement with the World Bank was signed by the former SFRY and was ratified both by the SAPK and SFRY assemblies. According to the aforementioned World Bank audit, neither the government nor any of the institutions of the Socialist Republic of Serbia were involved in financing this project. The Federal Fund belonged to the former Federal Republic of Yugoslavia and not to the Socialist Republic of Serbia. Moreover, the financial contributions to the Federal Fund were made by enterprises from all federal units, including Kosovo. With this logic and approach, all ex-Federal Units of Yugoslavia can make claims to ownership of assets in the SFRY. It is also true, however, that the Fund was not part of any succession process between the former republics.



On the other hand, the World Bank report of 1986 states the following: "The borrower was the Socialist Federal Republic of Yugoslavia (SFRY) which lent the proceeds of the loan to the Ibar-Lepenac Enterprise (ILE). The enterprise was created in 1967 specifically to undertake the development of the Ibar and Lepenac river systems, and the enterprise has implemented the project." Also, from the same report: "the remaining financing was covered by loans from the "Federal Fund for Underdeveloped Republics" channeled through the Banka Kosova, grants from both the Federal and Provincial Governments, and a small grant from the Djerdap Enterprise towards the construction of the Gazivode Dam."<sup>6</sup>

Since 1999, the Lake Gazivode/Ujmani resources on the Kosovo side have been managed by the "Iber Lepenci/Ibar Lepenac" enterprise (a Kosovo publicly owned enterprise). The water was mainly used to cool the turbines of Kosovo "A" and "B" thermal power plants, for energy production and distribution (the hydro-electric plant and the Valaç/Vallaq power substation located in north Kosovo), to feed irrigation systems in central Kosovo, and to supply potable water. According to the company's latest financial report, the total annual revenue amounts to €5 million, with most coming from energy production.

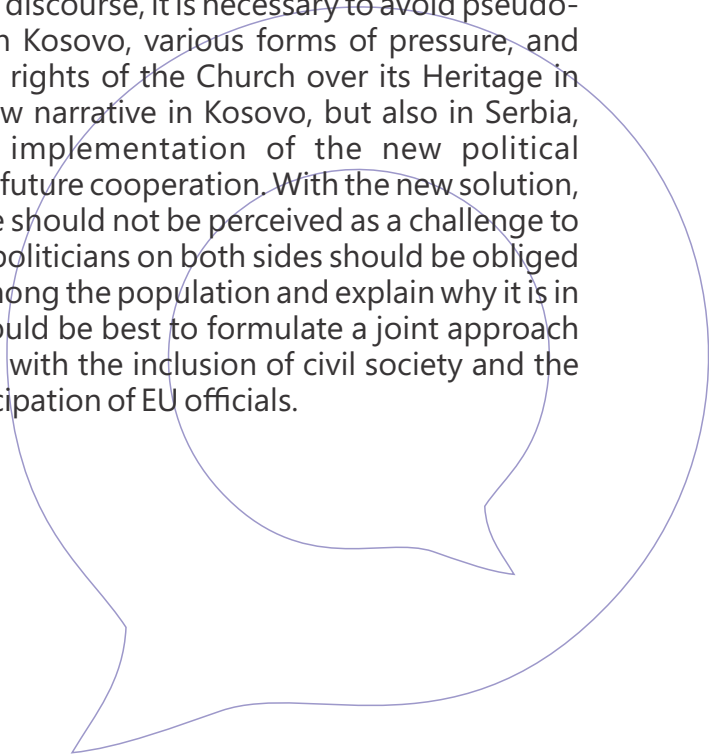
Perhaps the best question to ask is **how the local community can benefit from the lake's resources**. One solution may come from Obiliq/Obilić municipality. In 2016, the Kosovo Assembly passed a law that defines the municipality of Obiliq and its surroundings as a "zone at particular environmental risk"—a consequence of the continuous pollution of air, land, and water generated by the lignite-fired Kosovo "A" and "B" power plants—with the aim to improve quality of life and protection of health. The law allocates special financing to the zone, stating that funds dedicated to the Special Zone shall be provided by the collection of royalties from the power plants and that 20% of the total collected will be "reallocated from the Central Budget to the Municipal Budget" and be earmarked for investments at the local level, "in the field of environmental protection, infrastructure, sport, health, and education".

<sup>6</sup> <http://documents1.worldbank.org/curated/en/933231468327407409/pdf/multi-page.pdf> p. 7.

Regardless of the model used in defining the status of the Church and its Heritage, it is necessary that the Serbian Orthodox Church based in Belgrade, i.e., the Diocese of Raska and Prizren, whose supreme authority is the Patriarch and the Holy Synod of the SOC, has *de facto* and *de jure* spiritual administration over them. However, a special civilian body, with a clear and strong link to the government in Belgrade, should be in charge of the protection and administration of the Heritage.

**Notwithstanding the question of whether Belgrade and Pristina come to a “comprehensive settlement,” it is necessary to ensure that the Heritage is integrated in the immediate environment (in its political, economic and social dimensions), respecting the principle of cultural heritage as a civilisational value regardless of religious and ethnic differences. Heritage should become a point of improved communication and cooperation, which is necessarily predicated on its being accepted as a cornerstone of Serbian identity.**

In the public socio-political discourse, it is necessary to avoid pseudo-historical interpretations in Kosovo, various forms of pressure, and challenging the legitimate rights of the Church over its Heritage in Kosovo. This requires a new narrative in Kosovo, but also in Serbia, which would assist the implementation of the new political agreement and encourage future cooperation. With the new solution, the Church and its Heritage should not be perceived as a challenge to Kosovo's sovereignty, and politicians on both sides should be obliged to promote the solution among the population and explain why it is in the common interest. It would be best to formulate a joint approach in the form of a campaign, with the inclusion of civil society and the media, and the active participation of EU officials.



## Key recommendations

### ***General recommendations:***

- There is a need for a “final, legally binding political agreement” that will close the issue of Kosovo's status and open the door to a thorough normalisation of relations.
- The only way to reach such an agreement, which will secure for Kosovo membership in the UN and other international organisations, is through a dialogue process that is supported and supervised by the EU and the US together. Moving forward along separate tracks in advancing the Kosovo-Serbia dialogue, with the US dealing with economic issues and the EU with political ones, will not achieve the desired outcome but only preserve the status quo.
- The final agreement between Kosovo and Serbia should address all open issues that are raised by both parties.
- For a successful continuation of the Brussels Dialogue—after a long delay—both governments should ensure greater transparency and greater inclusiveness during the process.
- Rebuilding trust requires implementing all existing agreements, with special emphasis on freedom of movement, IBM, customs stamps, and the recognition of diplomas.

### ***On improving economic cooperation between Serbia and Kosovo:***

- The Chambers of Commerce should resume, intensify and expand their cooperation. Their cooperation should be prioritised and encouraged at the political level.
- The economic negotiations at the technical level should be continued, and parties should work on harmonising all phytosanitary and veterinary certificates.
- Negotiating teams should work on mapping all the bureaucratic obstacles to trading exchanges, and try to resolve them in good faith. The problem of the symbolics could be overcome by using the terminology on which the parties have previously agreed on. The Economic Normalisation Agreement signed in Washington DC referred to parties in a consensually acceptable manner: Serbia (Belgrade) and Kosovo (Pristina). It can be suggested this wording be implemented and used in trade affairs as well (customs declarations, entities of origin, commercial invoices, etc).

- The key problem in implementing negotiated agreements lies in the mismatch of the two administrative systems. Political negotiations need to involve legal experts, in order to reach agreements which could be implemented in a less complex and speedy manner. In this respect, the agreement on diploma recognition should be re-discussed with experts from the educational systems of both parties.
- The parties should remain committed to the implementation of the Washington agreement. The priority should be the development of an implementation plan on operationalising highway, railway and airline connectivity between the parties, joining the mini-Schengen area, and completing the feasibility study on sharing Lake Gazivode/Ujmani as a reliable water and energy source. The economic interests of the municipalities where the lake is located should be incorporated into the study and an eventual agreement.
- The parties should abandon the practice of introducing anticompetitive policies and promoting “emotional economy”/ethnic-based economic behaviour.

***On improving economic cooperation between Albanian and Serbian businesses within Kosovo:***

- The Chambers of Commerce of Serbia and Kosovo should seek funds for a standing language learning project.
- The parties should work on finding a module for introducing the Serbian language into Albanian schools and the Albanian language into Serbian schools, for the long-term purpose of overcoming the language barrier.
- The Community/Association of Serb-majority municipalities should, through its economic department, work on establishing an SME development fund, where companies could apply for low interest business loans.

- To facilitate a feeling of institutional security, Kosovo should implement the 2015 agreement most important to the community – the establishment of Community/Association of Serb-majority municipalities. In addition to this, the negotiating parties should work on mapping the causes of the institutional insecurity of the K-Serb minority and incorporate its resolutions into the comprehensive agreement.
- Apart from the already established Development Fund for North Kosovo, which is a time-limited provisional solution, Kosovo should consider stimulating local economic growth by introducing a fiscal decentralisation policy throughout Kosovo, where municipalities would materialise part of the VAT collected on the territory of their municipality. This would support economic integration and would stimulate municipalities to engage more in economic development, and combat the shadow economy on their territories.
- The area surrounding Lake Gazivode/Ujmani might be declared a “special zone” of interest through appropriate legislation, which could include a provision for the transfer of a percentage (e.g., 20%) of collected royalties on the water to the municipalities to which the lake belongs.



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