

BALKAN DIALOGUES

TOWARDS NORMALIZATION OF ECONOMIC RELATIONS

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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- 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 neighboring countries. Institutions of Republic of Serbia refused to establish any relations or lines of communication with independent Kosovo institutions and declined to recognize any of the documents released by Kosovo institutions.
- Following the adoption of UN General Assembly resolution no. 64/298, the European Union (EU) took the lead in facilitating the dialogue between Kosovo (Pristina) and Serbia (Belgrade). Its intention evolved over time to facilitate the normalization of relations between two countries and promote their potential European integration (as underlined in the EU's strategy for credible enlargement of the Western Balkans). By 2013, the "technical dialogue" resulted in a number of important agreements, by far the most important being the eponymous "Brussels Agreement". It was highly significant on many levels, as it concerned the issues of security, rule of law, and competences of local authorities in Serb-majority municipalities in Kosovo. Yet "normal" relations still remain out of reach. Why is this the case? And can Serbia and Kosovo develop their economic relations, if these are not preceded or followed in step by political normalization?
- In our understanding, "normal relations" are best understood with reference to the EU's European Neighborhood Policy (ENP). Two countries will develop "good neighborly relations" if they are friendly and supportive of each other, and achieve a significant level of cooperation. None of this is the case in current Kosovo-Serbia relations, starting from the issue of recognition. In economic terms, the implementation of ENP's principles would translate into free movement of goods, labor, and capital; meaning that countries sell and buy freely from and to each other (no tariffs or non-tariff barriers); that workers can travel and work in each of the neighboring countries; and capital (investments) moves freely from one country to another.

- In 2011 Serbia agreed to recognize Kosovo identification cards (Serbia does not recognize Kosovo passports). 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 Central European Free Trade Agreement (CEFTA), promising to implement free trade regimes. However, in reality, both sides imposed mainly non-tariff barriers continuously. While Serbia's institutions do not recognize documents issued by Kosovo's institutions, it becomes challenging, at times impossible, to export from Kosovo to Serbia, or to use Serbia's territory to transit to Europe. For this reason, Kosovo firms use alternative routes, which increases transportation costs. Trade tensions between the two countries culminated in 2018 when the Kosovo Government introduced the "100% import tariff" on goods from Serbia entering Kosovo, which stayed in place for 18 months. Finally, concerning capital mobility, one can easily conclude that there is lack of capital movement between the countries. With all this in mind, economic relations between Kosovo and Serbia are anything but "normal". However, as of recently, both sides have committed towards the normalization of such relations.

- The two countries have conflicting aims when engaging in the normalization process. Kosovo aims to become a member of international organizations and gain recognition from Serbia and the five remaining EU member states (Spain, Greece, Slovakia, Romania, and Cyprus). Serbia aims to gain EU membership and improve political and economic relations with the international community without recognizing Kosovo as an independent state. Neither thus sees the normalization process as an end in itself but as a means to other ends.

- Serbia claims ownership over assets and property located in Kosovo, a claim vehemently rejected by Kosovo authorities. One may argue that the nature of the problem is not economic but purely political; that is, if both parties manage to reach a "comprehensive, legally binding" political solution, remaining issues will be resolved. An overview of existing agreements reached within both the Brussels-led dialogue and US-led process show that this is not the case.

Agreements resulting from the Brussels-led dialogue

The dialogue in its early stages focused mostly on technical issues to ease everyday life. With more than thirty agreements concluded, considerable progress was made. Many of these, however, have yet to be implemented, with practical problems remaining in a wide range of areas. This is partly due to a lack of political will and the terminological ambiguity of the various agreements themselves. These agreements also suffer from legitimacy issues, since, except for the April 2013 Brussels Agreement, none have gone through the ratification process in their respective parliaments. In the following passages, we will highlight only those implications of the agreements that are relevant for economic normalization.

Freedom of movement (July 2011): As a result of the agreement, the Government of Serbia adopted a regulation by which passengers would receive an entry/exit document at the crossing point. The parties also agreed to interim solutions for purchasing temporary vehicle insurance while working for a commercial arrangement on mutual vehicle insurance. The Serbian authorities do not recognize Kosovo's new car number plates – only those issued by the UN – and require drivers to purchase temporary license plates to drive (transit) through Serbia.

Agreement on cadastral records (September 2011): The parties agreed for Serbia to deliver full cadastral records for Kosovo in a process similar to the civil registry agreement. Chaired by EU representatives, teams were composed of experts from both sides and were supposed to monitor the work of a technical agency, which was established after significant delays. The agency [Kosovo Property Comparison and Verification Agency] was established with the purpose of identifying gaps between current and pre-1999 cadastral documents. Since 2011, there have been severe delays in the implementation of this agreement. Kosovo first caused these delays, by adopting the Law on the Technical Agency for Comparison and Verification of Cadastral documents only in 2016. This should have opened the way for Serbia to provide scanned, verified copies of the cadastral records in question, which it has not yet done. This process is of vital importance for Kosovo: the state needs reliable cadastral records to protect the rights of those with legitimate claims to a given property, while property owners require such documentation for a number of reasons, such as the procurement of mortgage loans and other forms of financing. As a consequence of non-implementation, many assets in Kosovo cannot be put up as collateral.

New Paradigm in negotiating the Association

Agreement on custom stamps (September 2011): Serbia agreed to accept goods stamped with "Kosovo Customs" with no emblem or flag and committed to ensuring the freedom of movement of goods under the terms of the Central European Free Trade Agreement (CEFTA). 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 recognitions. After a change of government in Kosovo, the 100% tariff on Serbian goods was revoked in June 2020. Here is an example of how both parties can cooperate when it is in their mutual benefit but also how a "trade war" can be triggered to push a political agenda.

Recognition of Diplomas issued by Kosovo Institutions (November 2011): The parties agreed to ask the European University Association to certify university diplomas for use by either side, whether for higher education or employment. The final part of the agreement provides that "the EU will make every effort to ensure implementation of the above conclusions by January 2012". But the implementation of this agreement still lacks the political will and proper communication between respective institutions. In September 2015, both Kosovo and Serbia again agreed to commit to recognizing the diplomas, but again was not implemented. This provision was thus included in the 2020 Washington Agreement (see below). The agreement in question is fundamental for labor mobility. Without it, workers cannot get hired, especially in the public sector.

Agreement on energy (September 2013): According to relevant European regulation, energy transmission operators (TSOs) are obliged to control their zones and support neighboring countries to cover their needs in cases of energy shortfalls. In this regard, parties signed an energy agreement in 2013, which stated that discussions on energy (as well as telecommunications) would be intensified by the two sides and completed by June 2013. Despite signing it, Serbia refused to cooperate with Kosovo until mid-2020 when it began implementing the agreement.

Just recently [September 2020], the Kosovo Electricity Transmission, System and Market Operator (KOSTT) signed a connection agreement with the European Network of Transmission Systems (ENTSO-E) and its members, which means that eventually Kosovo will control its energy transmission lines. The breakthrough came after lengthy negotiations between KOSTT and its Serbian equivalent, which was facilitated by the European Network of Transmission System Operators for Electricity (**ENTSO-E**). Due to the delays in implementing the agreement, Kosovo lost considerable amounts of money (more than €10 million annually) and investments in the energy sector.

Agreement on Telecommunications (September 2013): The parties agreed that the International Telecommunications Union (ITU) would allocate a dialing code for Kosovo and migrate the three codes already used in Kosovo by 2015. Parties also agreed to harmonize their respective spectrums for global system for mobile communications (GSM) and television signals, with both agreeing not to intentionally violate the “border/boundary” of the other. After five years of planning, Kosovo was granted the +383 code by the ITU. This is considered one of the best-implemented agreements between Kosovo and Serbia. As was the case with energy, Kosovo lost considerable amounts of money and investments in the telecommunications sector due to not having its own dialing code.

Agreements signed within the US-led process:

Letter of Intent to Establish the Belgrade-Pristina Special Air Route (January 2020): Separately, the parties signed a letter indicating their intention to reopen the air link between Pristina and Belgrade, inexistent since the 1990s. US diplomats oversaw the signing of the agreement in the US Embassy in Berlin, which involving Lufthansa's budget carrier, Eurowings. As with the agreement on free movement, if implemented, this deal would help the two economies get closer, and become a strong symbol of normalization.

The Washington Agreement on Economic Normalization (September 2020): On 4 September 2020, the two sides signed up to a number of commitments, some of which repeated (i.e., on diplomas and the "Peace Highway") while others came as quite a surprise (the Gazivode/Ujmani lake, for instance). As has been the case with earlier agreements, opposition parties raised their voices in protest, while the general public was left confused. High skepticism on its implementation remains a critical issue, with one question continuously raised: **can we have an economic agreement that works, without having a comprehensive final political arrangement?** Moreover, can we isolate economic issues from sensitive political matters? This seems to be the path taken by the outgoing U.S. administration.

In Washington, the parties agreed to work together on the Belgrade-Pristina highway and rail projects, signed in Munich in February 2020, but now with the support of the United States International Development Finance Corporation (DFC), which opened its first office outside the United States in Belgrade in late September. If implemented, the highway would more directly link the two markets and decrease transportation costs. The so-called "Peace Highway" (PH) would connect the Serbian city of Niš and Prishtina. The PH would drive economic development and regional integration by connecting not only Niš and Prishtina, but also Belgrade with Prishtina and Durres, Albania, providing Serbia with access to yet another port on the Adriatic. On the Kosovo side, the highway from Prishtina to Durres is already built; now the remaining part of the highway from Prishtina to the border with Serbia will need to be constructed. The project is in place, the European Bank for Reconstruction and Development (EBRD) and the Kosovo Government have agreed in principle to finance it. The total cost of the project is around EUR 200 million. In contrast, implementing a rail project linking Prishtina with Belgrade seems like a more long-term commitment, given the existing state of infrastructure.

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 will mimic the EU's "Schengen Zone" then it will initially reduce controls at the borders within the "Zone", and have a long-term goal of 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. The project itself benefits all of the parties involved, affecting individuals and firms in various ways, with an emphasis on mobility, trade, and security.

What should be clearly emphasized—as it gets misinterpreted frequently—is that "Mini Schengen Zone" is not supposed to be a "Customs Union". Countries participating in this initiative would continue to have their own independent customs zones, at least initially. A "Western Balkans Customs Union" could be the next step, which, as we have stressed before, requires a high level of cooperation and trust. By the time the countries of the "Mini Schengen Zone" become ready for a customs union, some may have qualified for EU accession.

A case in point: Gazivode/Ujmani Lake

Stemming from the Washington Agreement, Kosovo and Serbia's commitment to work with the U.S. Department of Energy on a feasibility study concerning **Gazivode/Ujmani Lake** as a shared, reliable source of water and energy supply, has caused consternation among opposition parties in Kosovo, with the dominant narrative being that "(our) lake is being divided". The Kosovo side's main argument is that the lake is almost entirely located in Kosovo (more than 80%), that 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 Kosovo energy system, agriculture, and industry.

The implementation of the Gazivode/Ujmani Lake 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 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 over ownership of assets in SFRY. It is also true however that the Fund was not part of any succession process between the former republics. Therefore, in our view Serbia has no right to claim ownership over Gazivode/Ujmani Lake.

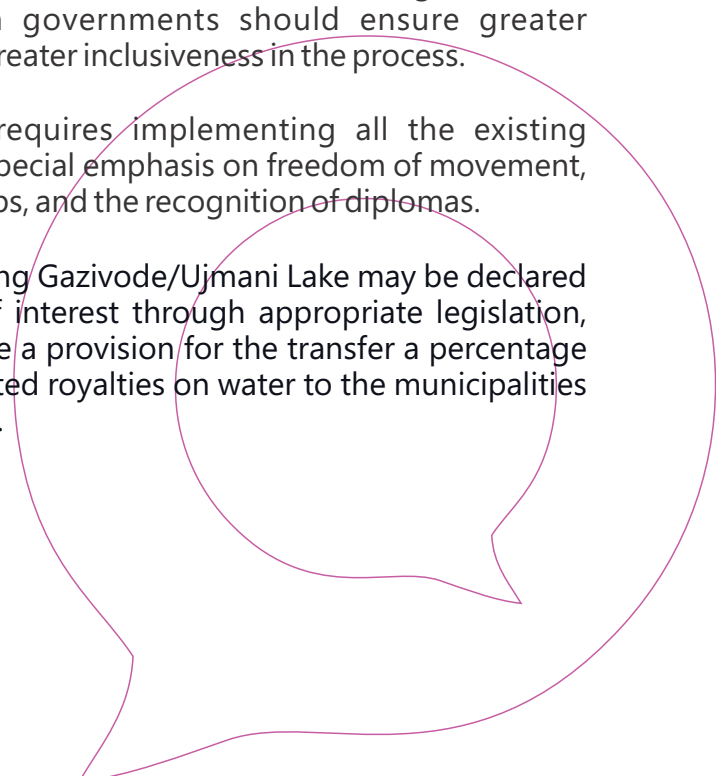
On the other hand, the World Bank report from 1986 says the following: "The borrower was the Socialist Federal Republic of Yugoslavia (SFRY) which on lent the proceeds of the loan to the Ibar-Lepenac Enterprise (ILE). The enterprise was created in 1967 specifically to undertake the development of the Ibar and Lepenac river systems and 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."¹

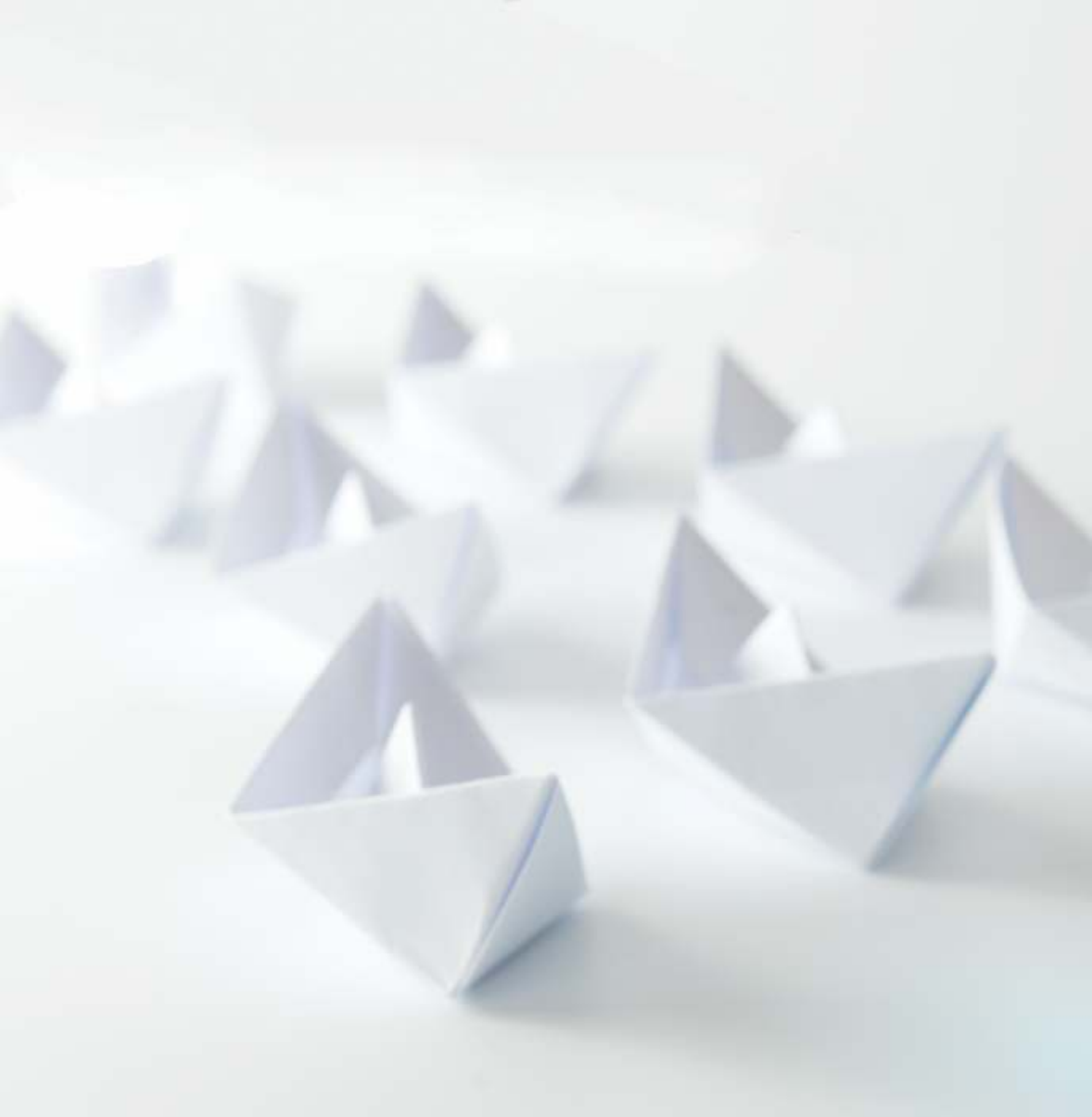
¹ <http://documents1.worldbank.org/curated/en/933231468327407409/pdf/multi-page.pdf> p. 7.

Since 1999, Gazivode/Ujmani Lake resources on the Kosovo side have been managed by the "Iber Lepenci/Ibar Lepenac" enterprise (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 (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, 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 of a 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".

Conclusions and recommendations:

- There is a need for a “final, political legally binding agreement” that will close the issue of Kosovo's status and open the door for thorough normalization of relations.
 - The only way to reach such an agreement, which will secure Kosovo membership in the UN and other international organizations, is through a dialogue process that is supported and supervised by the EU and the US together. Moving on with separate tracks for advancing the Kosovo-Serbia dialogue, with the US dealing with economic issues and the EU with political ones, will not achieve the desired outcome and will 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 in the process.
 - Rebuilding trust requires implementing all the existing agreements, with special emphasis on freedom of movement, IBM, customs stamps, and the recognition of diplomas.
 - The area surrounding Gazivode/Ujmani Lake may be declared a “special zone” of interest through appropriate legislation, which could include a provision for the transfer a percentage (e.g. 20%) of collected royalties on water to the municipalities where lake belongs.
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