

LIMITATIONS AND PROSPECTS OF ECONOMIC RELATIONS BETWEEN THE REPUBLIC OF KOSOVA AND SERBIA

Edison Jakurti
December 2022



Economic forces alone cannot do what the political will will not do



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A paradigm shift from *equality of opportunity* to *equity* and from *free* trade to *fair* trade can open horizons for more successful economic cooperation initiatives in the future

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Responsible: Renè Schlee

Project Coordinator: Rudina Nallbani Hoxha

Author: Edison Jakurti

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1. Introduction

Economic development is viewed as a means for resolving or, at least, mitigating various maladies in a country. Given that foreign policy is often portrayed as a reflection of domestic developments, then what is the power of economic forces, through bilateral or multilateral cooperation, to relax strained relations or even resolve opened issues between countries? In the context of the Republic of Kosova¹ and Serbia, the answer to that question has more often been superficial rather than analytical. A careful analysis of the past initiatives though, along with the nature of the core dispute i.e., the very state subjectivity of each other, reveal numerous limitations. However, a paradigm shift from *equality of opportunity* to *equity* and from *free* to *fair* trade, and an intensified focus on *within* progress, conditional on political will, can open horizons for more successful economic cooperation initiatives in the future.

2. Economic forces alone cannot do what the political will will not do

The level of economic development can be pivotal in shaping the political climate and orientation within a country. If put in an international context, especially with regards to trade relations, such a proposition could also be viewed as a potential path for conflict resolution and peace building between countries – a thesis propounded by Immanuel Kant in the renowned *Perpetual Peace: A Philosophical Sketch* published in the late 18th century but often supported by many economists to this day. In the spirit of this argument, Thomas L. Friedman, in his book *The Lexus and the Olive Tree: Understanding Globalization*, famously wrote: “No two countries that both had McDonald’s had fought a war against each other since each got its McDonald’s” (p.248). Of course, the McDonald’s here was used as a symbol of the international triumph of capitalism which, as claimed by such authors, has an intrinsic drive for peace too. Almost simultaneously with Friedman’s book publication, NATO bombarded Serbia, which already had McDonald’s. This of course was not the first and the last example which showed that having McDonald’s is not the ultimate solution for peace.

¹ Hereafter referred to as Kosova.

However, despite Friedman's defense afterwards, this event proved once again that there are issues for which political will is irreplaceable by economic forces.

A similar approach to Friedman's neoliberal type was initiated in 2020 as a way put forward to resolve issues between Kosova and Serbia. It was soon materialized on September 4, 2020, when the Trump administration signed separate agreements with the Prime Minister of Kosova and the President of Serbia. While the contents of these agreements deserve an analysis on its own given that they oddly squeezed in many non-related issues, it is this "two McDonald's" approach that ought to be questioned because there are two points that make it futile in our context.

First, while it is true that economic development plays a pivotal role in shaping politics in a country, it is naive to assume that economic cooperation alone will permanently end all existing and potential disputes between two countries – especially if they are neighbors. Neither is there such a guarantee that prevents war or hostile relations between countries. Many examples show how having "two McDonalds" or high trade volumes did not prevent conflict, invasion or war – e.g., the U.S. and Panama in 1989, India and Pakistan in 1999, Israel and Lebanon in 2006, Russia and Georgia in 2008, Russia in Crimea in 2014, and

Russia and Ukraine in 2022, – or resolved a conflict or tense relations – e.g., China and Taiwan, Israel and Turkey, Russia and Turkey, etc. Further, even in cases less extreme than war, there is no guarantee for a permanent negative correlation between the level of economic development and the birth of malign political tendencies. Economically developed countries provide countless examples where racism, xenophobia, homophobia, islamophobia, and many of the sorts are not just phobias but take the form of political manifestos, parties, programs, and actions.

Second, as always, the context is crucial for determining the resolving means. The past of these countries, which was very bloody, and it is still alive, is of a nature which is not a matter that can be addressed by the powers of the market. The unresolved issues between Kosova and Serbia stem from a colonial relationship which culminated in the 1998-99 war, when Serbia committed genocidal crimes in Kosova.² Almost every tenth person that was killed during the war is still missing.³ And almost every tenth person killed during the war was a child.⁴ It was estimated that between 10 to 20 thousand Albanian women were raped by the Serbian police and military.⁵ Over 90% of the Albanian population or around 1.45 million people were displaced.⁶

² An article published by The Irish Times on the 14th of April 2021 quoted the President of Kosova, Mrs. Vjosa Osmani, who said that Kosova intends to sue Serbia for genocide.

³ Based on a list released by the Humanitarian Law Center in 2014, there were 13,517 people killed or that went missing during the war in Kosova. Currently, around 1,600 are still missing.

⁴ Ibid.

⁵ See "Kosovo Health Sector Situation report Jan 2000" published by the World Health Organization on January 31, 2000.

⁶ See "An analysis of the human rights findings of the OSCE Kosovo Verification Mission from October 1998 to June 1999" published by OSCE on November 5, 1999,

Around 850 thousand were expelled from Kosova.⁷ Almost 40% of residential houses were partially or completely demolished.⁸

So, markets are completely incapable of resolving these and similar issues. And, even if one were to make the mistake of completely ignoring the wounds of the recent past, the problem today is of a very political and legal nature: Kosova declared its independence from Serbia while Serbia's Constitution still claims Kosova to be part of Serbia – even after contesting Kosova's right for independence at the International Court of Justice and receiving a clear verdict that recognized Kosova's right for independence.⁹ Thus, political answers are needed to resolve the dispute.

3. Regional economic cooperation – a necessity yet a not-so-successful reality

While it is true that economic relations cannot replace the political will, which is needed to resolve the remaining opened issues between Kosova and Serbia, one should not disregard them as useless. In contrary, given both the global interdependence and the size of the regional economies, economic cooperation is a necessity. The two countries have already signed

around 33 bilateral agreements covering various areas and we have witnessed several initiatives which promised to enhance the regional economic cooperation, but which have so far fallen short in their aims.

The first instance where the economic relations between Kosova and Serbia were formalized, in a regional context, was in 2007 when Kosova, proxied by United Nations Interim Administration Mission (UNMIK), joined the Central European Free Trade Agreement (CEFTA). One year later, Kosova declared its independence and three out of six other members of CEFTA today still do not recognize it. Although all members are officially committed to free trade, Kosova has continuously faced non-tariff trade barriers by these non-recognizing members, especially from Serbia, and it has sporadically responded through tariff or non-tariff barriers.

The second set of instances that had the potential of improving economic relations is associated with the European Union (EU) integration process. First, it was the Stabilization and Association Agreement (SAA) between Serbia and the EU in 2013, and the SAA between Kosova and the EU in 2016. Both trade liberalization and regional cooperation are core elements of the SAAs. Second, it was the Berlin Process launched in 2014 and followed by a number of intergovernmental summits aiming to foster both the relations of countries within the Western Balkans and between them and the EU member states.

⁶ See "An analysis of the human rights findings of the OSCE Kosovo Verification Mission from October 1998 to June 1999" published by OSCE on November 5, 1999,

⁷ See "The Kosovo Refugee Crisis: An Independent Evaluation of UNHCR's Emergency preparedness and response" published by the UNHCR Standing Committee on February 9, 2000.

⁸ Ibid

⁹ See the Advisory Opinion of the International Court of Justice "Accordance with international law of the unilateral declaration of independence in respect of Kosovo" published on July 22, 2010.

So far, neither of these initiatives have had a substantial improvement on economic relations between Kosovo and Serbia.

The third initiative which is incomparable to the three aforementioned, yet nonnegligible, is the so-called the Mini-Schengen or Open Balkan, which was initiated in 2019 in a meeting held in Novi Sad where the President of Serbia hosted the Prime Ministers of Albania and North Macedonia. While such an idea might have existed even earlier, the current endeavors of these three political leaders have a number of serious shortcomings which drastically reduce the probabilities for it to turn into a successful, regional economic cooperation initiative.

First, while "Balkan" is in the name of it, as an all-encompassing feature of countries that aim to join the EU, three Western Balkan countries – Kosovo, Montenegro, and Bosnia and Herzegovina, are not part of the initiative. Even if Montenegro and Bosnia and Herzegovina join, given that they have given some signals in recent days, Kosovo is not likely to join which will make the initiative exclusive. Second, the initiative seems to mimic the Berlin Process, but it falls short of it because it lacks a written platform where goals, strategies, platforms, mechanisms and budgetary commitments are well-defined. Third, its claimed purpose is not very distinct from the previous regional initiatives. Its founders claim

that the main vision of this initiative is the free movement of people, goods, services, and capital.¹⁰ However, this is exactly what CEFTA, SAA, and especially the Common Regional Market, as a derivative of the Berlin Process, aim to do. While a counterargument could be that this initiative is precisely to address the failures of the earlier initiatives, it is very unconvincing given the two aforementioned arguments i.e., it is exclusive, and it lacks a written plan with commitments backed by finances. And fourth, while it mimics the Berlin Process, it was claimed that this initiative was born out of the discontent with the EU's approach towards the region.¹¹ For as long as all six Western Balkan countries aim to integrate in the EU, such projects could simply create unnecessary frictions and further delays in the integration processes. Thus, so far, this initiative has been more divisive than uniting for the region.

4 Prospects for improving outcomes

The shortcomings of the earlier initiatives should not discourage future attempts. Neither should a divisive project, such as Mini-Schengen/Open Balkan, be allowed to anathemize the potentials of bilateral or multilateral economic cooperation in the region. Such a cooperation though needs to be continuously nurtured and the only rational way to create a driver for that is through mutually beneficial initiatives.

¹⁰ See "Eine Perspektive für den Balkan" authored by Edi Rama, Aleksander Vučić, and Zoran Zaev, published by Frankfurter Allgemeine on December 21, 2021.

¹¹ See "Eine Perspektive für den Balkan" authored by Edi Rama, Aleksander Vučić, and Zoran Zaev, published by Frankfurter Allgemeine on December 21, 2021.

Indeed, such initiatives demand rationality from political leaders and a focus on socio-economic benefits for the many.

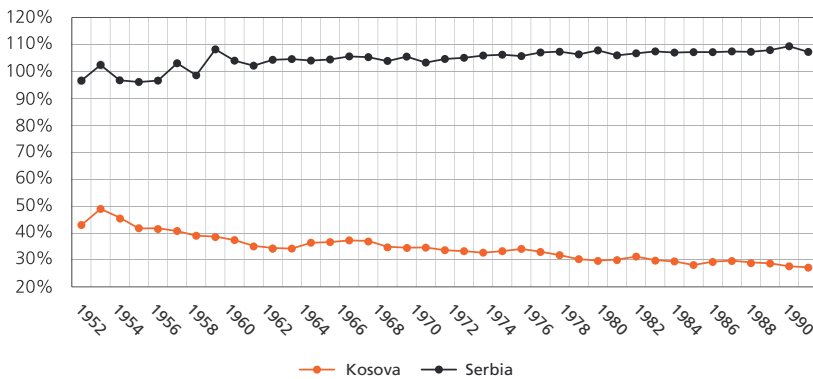
4.1. A paradigm shift from equality of opportunity to equity

For any economic cooperation initiative to be truly successful, it has to entail incentives that generate the effort from all sides to reach the best outcome. In other words, it has to be both mutually beneficial and it has to take into account the existing economic differences. For example, such initiatives need to take into account the inequalities that exist between the two economies. With a constant Gross Domestic Product (GDP) more than six times bigger and a population almost four times bigger, Serbia has

a pronounced advantage with a nonnegligible historical dimension.

Figure 1 below shows Kosova's and Serbia's respective share of average income in the former Yugoslavia between 1952 and 1990.¹² The first observation here is that the average income of a citizen in Kosova was much lower and decreasing compared to the average income of a citizen in the former Yugoslavia. Specifically, over this period, a citizen in Kosova had, on average, only around one-third of the income of a citizen in the former Yugoslavia. For Serbia, however, the situation was the opposite. The average income of a citizen in Serbia, for most of the period, was above the average income of a citizen in the former Yugoslavia and had an increasing trend. On average, a citizen in Serbia had an income of 5% higher than the average income of a citizen in the former Yugoslavia.

Figure 1. Share of average income in the former Yugoslavia 1952-1990



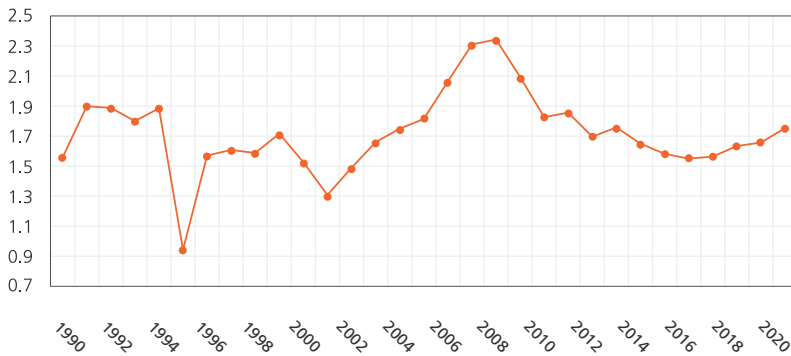
Source: Own calculations using Milanovic (2011) estimates provided to the Maddison-Project.

¹² Here income is defined as GDP per capita expressed in 1990 international dollars.

From the '90s on, the inequality between two countries has also persisted. Figure 2 shows the ratio of average income in Serbia to the average income in Kosova.¹³ Between 1990 and 2020, the average ratio was 1.7.

That means, on average, a citizen in Serbia had 70% more income than a citizen in Kosova. These and other similar figures reflect the disparities in economic capacities of the two countries, which should not be neglected.

Figure 2. Ratio of average income in Serbia to average income in Kosova



Source: Own calculations based on UNdata.

Due to such disparities, any economic cooperation initiative between the two countries or at the regional level, should aim for equity instead of equality of opportunity. That is because, given the unequal beginnings, equal opportunities are likely to yield unequal outcomes. This is also one of the reasons to why agreements such as SAA implement asymmetrical trade liberalization. For example, while the EU eliminated almost all tariffs for Kosova's imports beginning in 2016, Kosova was given a 10-year period to gradually eliminate its tariffs on EU's imports. Similar "asymmetries" or

affirmative actions should also become part of future bilateral and regional economic cooperation initiatives to not only address the historical inequalities, but also as a sign of good will and true intentions for the region to prosper.

4.2 A paradigm shift from *free trade to fair trade*

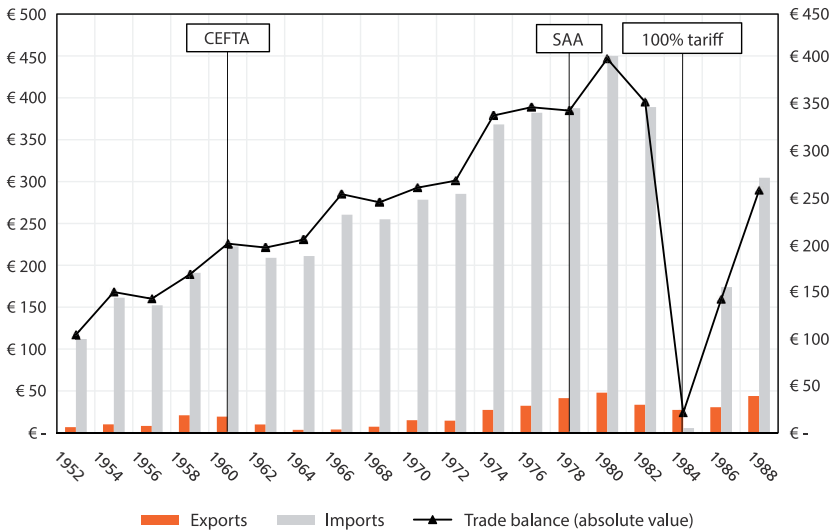
With no exemption, all the aforementioned initiatives heavily focused on the aspects of trade liberalization i.e., removing trade barriers. Indeed, if done properly, free trade can bring mutual benefits to the trading partners. However, this has not really been the case between Kosova and Serbia.

¹³ Here income is defined as GDP per capita in U.S. dollars at current prices.

Figure 3 below shows Kosovo's merchandise trade balance with Serbia, which was an average deficit of over 231 million euros between 2003 and 2021. The only year over the entire period where Kosovo had a trade surplus was in 2019 when it implemented first a 10% and, soon after, a 100% tariff on imports from Serbia. In 2020, the tariff

was replaced by partial, trade reciprocity measures, which were soon lifted and thus had a lesser impact on reducing the trade deficit. Note that neither joining CEFTA nor the enforcement of the SAA improved the trade deficit, but the tariff on imports, which is considered a trade barrier, did.

Figure 3. Kosovo's merchandise trade balance with Serbia 2003-2021 (in million)



Source: Own calculations using data from the Kosova Agency of Statistics

The moral of the story here however should not be an approval of more trade barriers. Kosovo's tariff or non-tariff reciprocity measures were as a response to Serbia's own non-tariff barriers on Kosovo's imports – a continuous impediment to trade, which was never resolved by CEFTA authorities, either. Such measures became more pronounced since 2008 which, again,

had to do with Kosovo's declaration of independence. The takeaway here is that trade has not been truly liberalized and the ideal scenario here would be to truly adhere to free trade principles. That means, Serbia would give up on its non-tariff barriers to imports from Kosovo, so Kosovo would not have to resort to any counteraction.

However, even if trade were to be truly free between the two countries, that would not be enough. Not only because of trade deficits at the macro level or the losses that it may create to smaller countries. But because free trade per se does not address issues such as workers' wages or working conditions, fair prices to small industrial producers or farmers, or the state of the environment. The first and most immediate winners of free trade are actually large producers and trading companies. Hence, a shift in the paradigm would mean a shift from simply pursuing free trade i.e., eliminating all tariff and non-tariff barriers to trade, to engaging more in fair trade – which also includes free trade but with a focus on more fairness in terms of workers' wages and working conditions, small producers' and farmers' profits, and the reduction of negative externalities that further deteriorate the environment.

4.3 An intense focus on *within* progress which reflects on *between* progress

As it is the case in international relations, where internal developments reflect on external relations, a similar logic exists in the economic realm. Internal economic agendas are crucial for external cooperation. From a progressive perspective, for example, economic inequality is a key issue that ought to be tackled by any progressive

government. While earlier we saw the income inequality between two countries, there is a high magnitude of income inequality within each country, too. For example, the top 10% in Kosovo and Serbia share around one-third of total income in each country, while the bottom 50% share less than one-fifth of total income.¹⁴ As it is the case in all other countries, wealth inequality is even more severe.¹⁵ While data for Kosovo is missing, the wealthiest 10% in Serbia share over 55% of wealth, while the bottom 50% share only around 6%.¹⁶ More economic democracy, better working conditions, stronger trade unions, tighter anti-oligarchic legislature, etc., are some of the ingredients that could help shape more progressive institutions that both address these within inequalities and are willing to improve neighboring relations. Thus, bilateral or regional economic cooperation could have a higher chance to succeed as it would be built within these progressive contours which are reflected from within progress.

5. Conclusion

While economic development remains crucial for addressing a multitude of issues in any given country, there are limits to what economic cooperation initiatives at the bilateral or regional level can achieve. The key, unresolved issue between Kosovo and Serbia is of a political nature for which the markets do not have the power to resolve. Given the size and the development level of their respective economies, however, it is clear that regional economic cooperation is a necessity – even though that is not going to solve

¹⁴ See World Inequality Database.

¹⁵ Ibid.

¹⁶ Ibid.

the main political issues. Yet, numerous shortcomings from the initiatives so far indicate that current paradigms have not produced the desired outcomes. Thus, providing that there is some serious political will, a paradigmatic shift from *equality of opportunity* to *equity* and from *free* to *fair* trade, and

an intensified focus on *within* progress, could set more appropriate contours for either current initiatives, such as the Common Regional Market in the Berlin Process, or for future regional economic cooperation initiatives to produce more successful outcomes.

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