

01. Regional economic integration: Chances and challenges for Kosovo¹ and the neighbouring republics of former Yugoslavia

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Summary

With the disintegration of Yugoslavia, the economic infrastructure of its successor states became seriously damaged. Kosovo, a small landlocked area with limited means for economic growth could enhance its economic leverage by means of regional integration with neighbouring countries. The successor states of Yugoslavia are facing similar economic challenges. Trade data is suggesting that the enhancement of economic and trade relations between Kosovo and regional countries as well as closer economic relations with the EU and integration into supranational economic institutions (WTO etc.) will have upside effects for Kosovo's economy as well as for the region. In order to provide the reader with a general picture of the areas economic problems, the so-called three sector model has been chosen. Furthermore, Kosovo's economy has been put into a historical perspective regarding different economic indicators of the area of former Yugoslavia as all economic activity was and is still closely linked to regional factors. Data indicates that only the revival and development of traditional trade, production and supply chains will contribute to growth, prosperity and stability.

Keywords: integration, Kosovo, Yugoslavia

Bölgesel ekonomik entegrasyon: Kosova ve eski Yugoslavya'nın komşu cumhuriyetleri için fırsatlar ve zorluklar

Öz

Yugoslavya'nın dağılım sürecine müteakip, bütün halef devletlerinin ekonomik altyapısı ciddi biçimde hasar görmüştür. Denize doğrudan bağlantısı olmayan ve iktisadi gelişim potansiyeli düşük olan Kosova bölgesi, ekonomisini bölgesel işbirlik ve kalkınma girişimler sayesinde tanzim edebilir. Binaenaleyh, Yugoslavya'nın diğer halef devletleri de benzer iktisadi sorunlar ile karşı karşıya kalmıştır. Elde mevcut ticari istatistikler, Kosova'nın iktisadi ve ticari ilişkilerini bölgesel bazda gelişmesi halinde, aynı zamanda DTÖ gibi beynelmillel iktisadi teşekküller ile münasebetlerini geliştirdiği takdirde müspet etki oluşturabileceğine dair işaret etmektedir. Bölgenin genel ekonomik sorunları hk. farkındalık oluşturmak amacıyla üç sektör modeli tatbik edilmiştir. Ayriyeten Kosova'nın ekonomisi tarihi perspektifte gösterilmiştir; eski Yugoslavya coğrafyasının bölgesel ekonomik aktiviteleri çeşitli endikatörlerle sunulmuştur. Elde mevcut veriler, bölgenin ancak geleneksel ticari ilişkileri canlandırıp üretim ve dağıtım zincirlerini canlandırdığı takdirde istikrara kavuşabileceği, sürdürebilir bir büyümeyi yakalanabileceği işaret etmektedir.

¹ This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo (unilateral) declaration of independence

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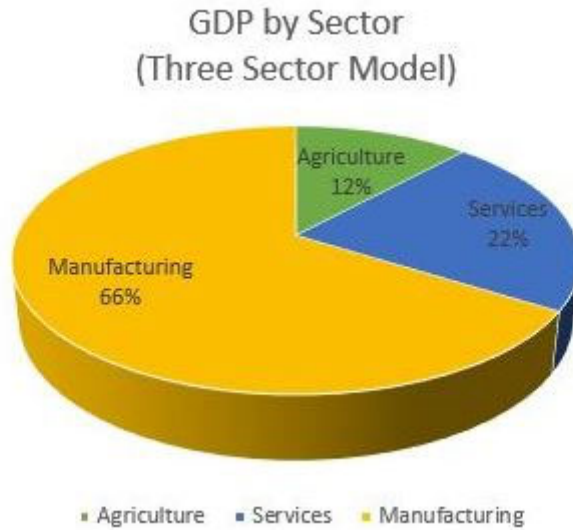
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Anahtar kelimeler: entegrasyon, Kosova, Yugoslavya

The three sector model: the example of Kosovo

For reasons of simplicity it is assumed that the economy of any given area consists of three basic sectors: agriculture, services and manufacturing⁴. Within the scope of a simple three sector theory model analysis, the composition of Kosovo's GDP can be summarized as a consumer driven, largely service orientated small regional economy. (ASK, Statistical Yearbook, 2015, 7) Agriculture is providing roughly 40 per cent of the workforce but comprising just 12 per cent of total GDP. The share of the manufacturing sector in total GDP consists of 22 per cent but is facing challenges of low productivity, a small consumer base and liquidity issues. (ASK database, 2021) The service sector, with 67 per cent of GDP share is the driving part for the consumer economy. It is significant for job creation and supported by transfer payments (official and unofficial.) (ASK, Statistical Yearbook, 2015, 12)

GDP by Sector (Three Sector Model)



Source: own work, compiled from data provided by the Kosovo Agency of Statistics

Kosovo: Background information on economic characteristics

Kosovo's economy can be characterized as a small middle income economy with transfer payments supporting consume as a driver of local economy. According to the World Bank, Kosovo's GNI (Gross National Income) in 2014 amounted to \$3,990⁵. After the wars that resolved in the dissolution of Yugoslavia, the production and supply chains for the area as a whole have been severely damaged. Besides Kosovo's local and close area production and supply chain being severely disrupted, basic economic issues as currency and financial policy had been left in shambles, too. (Woodward, 1996, 356)

⁴ The three sector theory, developed by Alan Fisher is assuming that economic activity can be divided into three main sectors. Within that scope, economic processes are interactively shifting from the primary, through the secondary and finally to the tertiary sector. In other words, raw materials are gathered, processed through industrial input and further enhanced through service input.

⁵ The World Bank definition for middle income economies is a per capita income of more than \$1,045 but less than \$12,736 GNI

⁶ Kosovo Agency of Statistics, Database. At: <https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/>

As the banking system was defunct, Kosovo basically became a cash based economy, a pattern that partially is continuing until today, lessening the level of control regarding illicit flows of money. Furthermore, the German Mark respective the Euro had de-facto replaced the Yugoslav Dinar. Subsequently, Kosovo adopted the Euro as currency which means that labour market and money policies have to be harmonized with the respective legislation of the European Central Bank. (Svetchine, 2005, 233-42)

All three economic sectors (service, agriculture, and manufacturing) are supported by transfer payments, boosting economic growth. The rate of foreign direct investments (FDI) remains dissatisfactory low and could be enhanced if greater levels of transparency and legal security would be provided to prospective investors.⁷

Agriculture

Agriculture's share in the area's GDP still comprises about 12 per cent but provides roughly 40 per cent of employment. While having an important contribution towards overall employment, it has to be noted that only a part of the workforce is formally employed in the agricultural sector. While informal employment in the agricultural sector is providing jobs to people who would otherwise have no means of participating to the production process, official unemployment rates are distorted⁸. Nevertheless, it should be noted that small farms still provide an important role in preserving the social fabric of rural areas.

Within that scope, The average farm size of 1, 5 ha in Kosovo is disproportionally small on international standards with the average size of farms in the EU-27 being 14, 5 ha.⁹ This reduces opportunities for the agricultural sector to contribute towards overall growth. With small farm sizes, often focusing on subsistent production, the productivity of the agricultural sector is limited. Furthermore, while Kosovo is still being spared the exposure to international rivalry on the agricultural market due to special clauses in the SAA, agriculture is providing only niche markets as winery in terms of export relevant production. (European Council, Interinstitutional File:2015/0095, Article 34, 2015)

According to the FAO, agriculture accounts for roughly 16 per cent of Kosovo's exports, nevertheless, agricultural products continue to be imported into Kosovo (25 per cent of total imports) which is having negative implications for the balance of payment. The GoK is addressing this challenge through the implementation of the Agriculture and Rural Development Plan (ARDP) for 2009-13, supported by the European Fund for Agriculture and Rural Development. The focal points of the ARDP are listed as following: altering competitiveness and efficiency of agricultural production for import substitution through improving processing and marketing of agricultural products; setting higher quality and hygiene standards; addressing infrastructural issues, heighten environmental standards and the quality of life in rural areas; creating employment through rural diversification and the alignment of Kosovo's agriculture with that of the EU.¹

⁷ Transparency Cefta Website. At: <http://transparency.cefta.int/faq/general/>

⁸ Informal Employment in the Agricultural Sector: In developing countries as well as emerging markets, informal employment in the agricultural sector often provides employment to persons outside the formal workforce with youth and women often consisting a significant part of the labor force. As neither social security benefits are paid nor are they appearing in official statistics, the real unemployment rate is misrepresented.

⁹ http://ec.europa.eu/eurostat/statistics-explained/index.php/Agriculture_statistics_-_the_evolution_of_farm_holdings#Analysis_of_farms_according_to_farm_size_in_terms_of_area

¹ http://www.mbpzhr-ks.net/repository/docs/743026_Agriculture_and_Rural_Development_Plan_2009-13.pdf (p.7)

Industry/Manufacturing Sector

Yugoslavia since the 1950's did actively encourage the development of heavy as well as light industries. This policy reflected itself through the establishment and/or enhancement of state owned factories, including the Trepca mines. (Chittle, 1975, 16)

Within that policy scheme, Yugoslavia did seek to enhance the local production of strategic assets (i.e. the defence and car industry). The industrialization process in Kosovo began to accelerate after the adoption of the new Yugoslav constitution in 1974. With Kosovo being a receiver of net fiscal transfers within Yugoslavia, the enhancement of the power base of the local (Kosovar) leadership level of the League of Communists of Yugoslavia (Stranka Komuniste Jugoslavije/SKJ) led to an increasing activity in the autonomous provinces building and producing sector. (Palairat/ Sadiku, 1992, 897-912)

After the dissolution of Yugoslavia and the conflict in Kosovo, the industrial base was severely damaged. Kosovo was basically forced to start industrial production from scratch. The disruption of closely linked industrial production and supply chains led to a breakdown of the industry in Kosovo as well as in neighboring areas in an area that had once been a single market. (Woodward, 1996, 356) The pre-war export of mining products from Kosovo to other former Yugoslav Republics with prices under world market level discouraged the development of local accumulation and production processes which weakened the chance for industrial entities to survive without backing from the central government. (Reuter, 1982, 68) One of the biggest problems remaining is not only the lack of capital (financial/human/production) but also the small size of the local economy as a consumer base. (Fejza/ Livoreka/ Bajrami, 2017, 33-48)

The manufacturing sector (including the building sector) with 22 per cent of GDP share is occupying a relatively small share in Kosovo's economy. It should be considered that the relocation of production processes from industrialised to developing countries and the outsourcing of related operations, together with the rise of the e-economy does show a similar picture for EU countries. In 2013, the average industrial production in the EU (EU-28) accounted for 19, 1 per cent of GDP, if the building sector is included, the share rises to 24, 8 per cent.¹ On the other hand, the productivity level in the manufacturing sector in Kosovo is not as high as the EU average.

Despite the re-distribution of industrial production on a global scale, the United Nations Industrial development Organisation is pointing out that one in six jobs globally are generated by the manufacturing sector. While the share of industry is declining in developed countries, manufacturing related services and the developing of high-tech industrial processes are mitigating the aforementioned fall. It is assumed that less developed countries have the potential to enhance their share of industry while investing into the agroindustry while middle income countries are encouraged to invest into basic industries. (UNIDO, 2013, 1) The current state of the global economy with financial liquidity issues limiting growth expectations is posing a challenge to (re-)industrialisation efforts.

Kosovo's industrial base remains limited. It has to be noted that the building sector which has been growing constantly has been included into the manufacturing sector. Industry excluding mining and the building sector is amounting only for 10, 3 per cent of GDP. (ASK, Statistical Yearbook, 2015, 221) The local government, within its National Development strategy seeks to support the re-industrialization process through incentives or subsidies. Furthermore, legal issues as privatization are to be addressed.

¹ http://ec.europa.eu/eurostat/statistics-explained/index.php/National_accounts_and_GDP/de

Foreign financed development activities in the energy sector could provide larger growth potential if liquidity is provided. This is dependent on the development of the financial sector on a global base.

The Service Sector

The Service sector with 67 per cent of GDP share is the driving part for the consumer economy. It is significant for job creation and supported by transfer payments (official and unofficial.) Without transfers, the economic growth potential for the service sector as well as for Kosovo's economy as a whole would be diminished significantly.

The service sector is the only sector which is providing upside (positive) effects on the balance of trade. Tourism revenues are a significant part of the positive effects with the diaspora being an important impact. (OECD, 2013,22) Furthermore the service industry in Kosovo has been developing a niche market that comprises communications (call centres) and electronic infrastructure services (programming services etc.). The aforementioned fields are profiting from the low level of wages in Kosovo but also from the pool of technologically and linguistically skilled young workforce. Kosovo has potential to profit from outsourcing processes in industrialized countries provided it enhances investments into the educational sector. (Hoti, 2018,24) On the other hand, a skilled workforce in the service sector can only be expected to remain in Kosovo if wages are gradually enhanced within a satisfactory income generation process. Rising wage levels, though, are lowering the attractiveness of the service sector for foreign investors.

In the employed GDP analysis model tax revenues have been included into the service sector. A rising level of fiscal control would therefore enhance the economic growth potential for the service sector provided that no over-taxation is developing. In that case, incentives for the private sector to invest into the service sector would be diminished significantly.

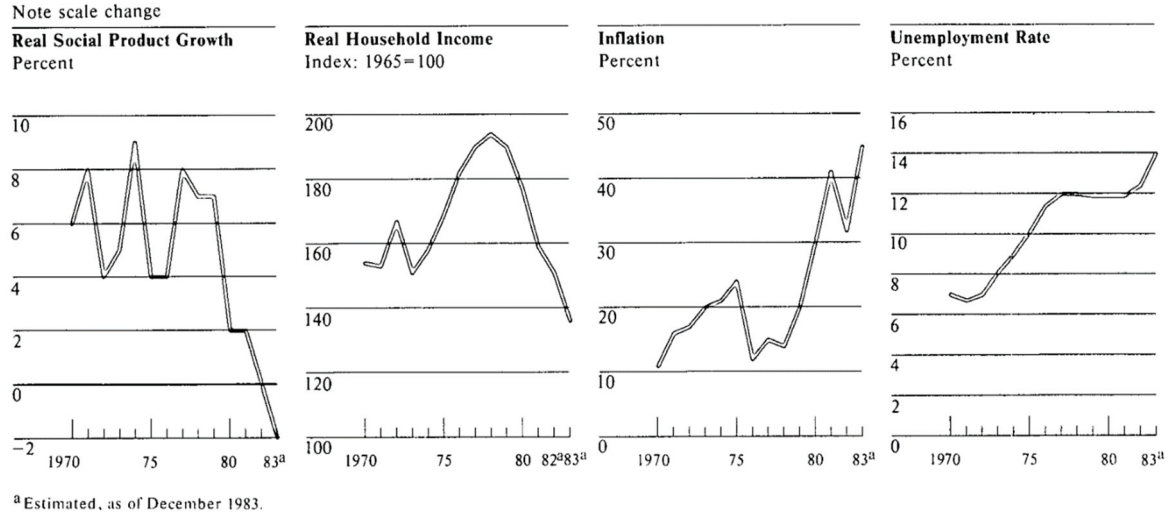
Share of GDP by activities

3	Share of GDP by activities	
4		2014
5	A Agriculture, forestry and fishing	11.9
6	B Mining and quarrying	2.1
7	C Manufacturing	10.3
8	D Electricity, gas, steam and air conditioning supply	2.8
9	E Water supply; sewerage, waste management and remediation activities	0.8
10	F Construction	6
11	G Wholesale and retail trade; repair of motor vehicles and motorcycles	12.4
12	H Transportation and storage	3.5
13	I Accommodation and food service activities	0.9
14	J Information and communication	2
15	K Financial and insurance activities	4
16	L Real estate activities	9
17	M Professional, scientific and technical activities	1.4
18	N Administrative and support service activities	0.6
19	O Public administration and defence; compulsory social security	9
20	P Education	3.9
21	Q Human health and social work activities	1.8
22	R Arts, entertainment and recreation	0.4
23	S Other service activities	0.2
24	T Activities of households as employers; undifferentiated	-
25	BVSH me çmime bazë	82.9
26	Taxes on product	17.1
27	Subsidies	..
28	Gross Domestic Product	100

Source: own work, compiled from data provided by the Kosovo Agency of Statistics

Brief overview on the characteristics of the economy of the former Yugoslavia and Kosovo

The economy of the former Yugoslavia was defined by divergent trends: high but fragile economic growth linked to credit growth, wage-price inflation, accelerating foreign debt and closely linked production supply chains for its economic output. (Woodward, 1996, 331) Yugoslavia experimented with a distinctive model of workers' self-management (radnicko samouprave) and within the scope of its federal structure established transfer mechanisms between more and less developed regions. (Flaherty, 1992, 92-108)

Domestic Economic Indicators SFR Yugoslavia 1970-1983**Figure 3**
Yugoslavia: Domestic Economic Indicators, 1970-83

Source: World Bank (World Bank, Indicators)

Closely linked industrial production and supply chains in the area all over the country were severely disrupted or broken after the disintegration of Yugoslavia. (Dallago/ Uvalic, 1998, 71-90) While a large number of Yugoslav producers including those in Kosovo exported goods to international markets, dependency on local buyers and suppliers as well as on local financing led to the collapse of production after the outbreak of the war. Only producers that were exporting a significant amount of their goods (i.e. the machine industry in Slovenia) and therefore were in the position to secure foreign credits could adapt themselves to changing conditions. (Boduszyński, 2010,135)

As already indicated, Kosovo was a net transfer receiving entity within Yugoslavia's regional inter-republic fiscal adjustment system. The establishment and/or enhancement of state owned factories, including the Trepca mines, led to a certain level of industrialisation that was supported with subvention mechanisms. (Bombelles, 1991,439-465) Nevertheless, the income level in Kosovo remained low within the area, leading to economic migration within Yugoslavia as well as abroad. (Boduszyński, 2010,67) After the disintegration of Yugoslavia and the conflict in Kosovo, unresolved legal issues as disputes regarding the property of state owned enterprises and high levels of intransparency are additional factors to hinder economic growth. Up to the present day, Kosovo continues to be dependent on net transfers and remittances from its diaspora as well as the international community.

Kosovo: limited local opportunities

In light of all factors specified above, Kosovo is landlocked, its small industrial base has become largely dysfunctional after the conflict and with its small population possesses only limited growth potential. Kosovo, possessing limited production factors and only a relatively small consumer base is affected more by external factors and greater vulnerability than bigger economic entities. (Fejza, 2013, 53) The WTO is acknowledging that small states are more sensible to external shocks and is proposing appropriate policies regarding foreign trade. (Schiff, 2003, 7) Using the Euro as currency without having leverage in

deciding on monetary policy is limiting Kosovo's means of control regarding economic policy and its sovereignty regarding monetary policy but is also contributing towards reducing vulnerability to exogenous shocks. However, for Kosovo, the usage of the Euro as currency unit is shielding Kosovo from inflationary pressure, reduces transaction costs and helps in securing macroeconomic stability. (Badiviku-Pantina/Berisha-Namani, 2009, 343-353) Currently Kosovo is a net importer of finished goods, even the number of intermediary goods¹ is relatively low in relation to its GDP. As assumed before, statistical data points out that Kosovo's economy is mainly driven by consumption supported by transfer payments (official and non-official).

Key Trade Partners Kosovo 2005-2013

TAB 19.9: KEY PARTNERS IN KOSOVO IN 2013

Country	Exports	%	Imports	%	Trade balance
Italy	74.363	25,3	228.519	9,3	-154.156
Albania	43.774	14,9	110.597	4,5	-66.823
India	28.953	9,9	14.429	0,6	14.523
FYR Macedonia	26.139	8,9	185.020	7,6	-158.880
Montenegro	17.310	5,9	11.387	0,5	5.923
Serbia	14.463	4,9	285.356	11,7	-270.892
Germany	10.985	3,7	252.594	10,3	-241.609
Turkey	7.393	2,5	204.922	8,4	-197.529
Total	293.842	100,0	2.449.064	100,0	-2.155.221

Source: Statistical Yearbook of Kosovo 2015

Regional economic integration: the case for Kosovo

Kosovo's economic integration process towards the EU in scope of the Stabilisation and Association Agreement (SAA) is a big step on overcoming isolation and integrate its economy in an international scale. (European Council, Interinstitutional File:2015/0095, 2015) A possible membership for Kosovo in international institutions as the World Bank, the International Monetary Fund, the European Bank of Reconstruction and Development etc. is a positive development as access to funding and participation in information exchange mechanisms will contribute towards enhancing opportunities for growth potential. (Rose, 2005, 682-698) However, Kosovo is recording a chronic negative foreign trade and a negative current account balance, is dependent on transfers and possesses a limited potential to export goods. A possible membership in the World Trade Organisation, while currently unlikely due to the international status of Kosovo, might have beneficial impacts as shown on the example of other small economies. Nevertheless, Kosovo is taking steps towards technical preparation.¹ (Eutrade database)

Free trade agreements with several regional states (Albania, Bosnia-Herzegovina, FYR of Macedonia, Moldova, Montenegro, Serbia) within the scope of CEFTA and the Stabilisation and Association Agreement with the EU have had beneficial effects for the development of Kosovo's trade relations. (Transparency Cefta) A greater inclusion of Kosovo with other regional states, especially Serbia (a development that is dependent on political developments) might help to establish or re-create

¹ An intermediate good is used in the eventual production of a final good, or finished product. (i.e. parts for a car that is assembled in another country)

¹ http://www.eutrade-ks.eu/kosovo_content_3715498.html

production and distribution chains in the area of the former Yugoslavia and help Kosovo to regain economic growth potential.

It can be constituted that the EU-facilitated dialogue between Kosovo and Serbia did led to upside effects regarding the volume of trade between both sides as restrictions regarding the movement of goods and persons were partially removed and customs agreements were reached. While the trade balance for Kosovo towards Serbia remained negative, (2013: -270.892.000 Euro) mirroring the countries underperforming producing sector, trade with Serbia continued to accelerate and increase in volume: between the years 2005-2013, imports from Serbia increased in an average rate of 12 per cent per annum, while exports to Serbia increase in an average rate of 7 per cent. (ASK, Statistical Yearbook, 2015, 208) Declines in the years 2008 and 2013 were politically motivated and were compensated for in the following period. (Demjaha, 2016, 181-96) Increasing trade will not lead only to closer cooperation but may also contribute towards the improvement of bilateral relations. In 2013, Serbia did remain Kosovo's biggest import partner with 11, 7 per cent of total imports.

Kosovo-Serbia Trade Volume 2005-2013

TABELA 19.15: FLOW OF GOODS IN TRADE WITH SERBIA

('000 €)							
Period	Exports	%	Difference	Imports	%	Difference	Trade balance
2005	8.158	14,5	-18,9	152.257	13,2	-5,6	-144.099
2006	20.910	18,9	156,3	191.053	14,6	25,5	-170.143
2007	19.280	11,7	-7,8	222.534	14,1	16,5	-203.254
2008	9.893	5,0	-48,7	208.951	10,8	-6,1	-199.058
2009	3.504	2,1	-64,6	210.901	10,9	0,9	-207.397
2010	3.941	1,3	12,5	260.471	12,1	23,5	-256.530
2011	7.198	2,3	82,7	254.917	10,2	-2,1	-247.719
2012	14.968	5,4	107,9	278.388	11,1	9,2	-263.420
2013	14.463	4,9	-3,4	285.356	11,7	2,5	-270.892

Source: Statistical Yearbook of Kosovo 2015

It is remarkable, that imports from Albania are only at roughly at half the level in comparison with imports from Serbia. In 2013, Kosovo imported goods and services worth 285.356.000 Euro from Serbia while imports from Albania were only accounted as 110.595.000 Euro. Likewise, the growth in imports from Albania between the years 2005 and 2013 increased in an average rate of only 3 per cent per annum while exports to Albania from Kosovo increased roughly 12 per cent in the aforementioned time period. (ASK, Statistical Yearbook, 2015, 207) Nevertheless, it should be stated that goods from Italy with a volume slightly less than from Serbia are imported via Albania, furthermore, the relatively low production capacity of Albania has to be taken into consideration.

Kosovo-Albania Trade Volume 2005-2013

TABELA 19.11: FLOW OF GOODS IN TRADE WITH ALBANIA

('000 €)

Period	Exports	%	Difference	Imports	%	Difference	Trade balance
2005	5.784	10,3	222,6	18.093	1,6	-10,6	-12.309
2006	12.645	11,4	118,6	23.108	1,8	27,7	-10.463
2007	20.799	12,6	64,5	35.262	2,2	52,6	-14.463
2008	21.113	10,6	1,5	59.632	3,1	69,1	-38.519
2009	26.182	15,8	24,0	58.385	3,0	-2,1	-32.203
2010	30.841	10,4	17,8	69.714	3,2	19,4	-38.873
2011	34.566	10,8	12,1	96.400	3,9	38,3	-61.834
2012	40.180	14,6	16,2	110.528	4,4	14,7	-70.347
2013	43.774	14,9	8,9	110.597	4,5	0,1	-66.823

Source: Statistical Yearbook of Kosovo 2015

The successor states of the former Yugoslavia are facing similar challenges in their respective economies: unemployment, low levels of economic growth, high public debt, low levels of foreign direct investment and budget deficits. (Gagnon, 2010, 23-39) About 80 per cent of regional trade is being conducted between the successor states of Yugoslavia and the EU. The revival of pre-war institutional and trade links between regional companies as well as shared linguistic and cultural links are having positive effects on the establishment of commercial links. (Tradingfloor, 2016)

SFR Yugoslavia 1989: Foreign and Inter-republic trade

Table 2.3 Foreign sales in 1989 (% of net material product)

	Exports of goods and services	Shipments to other republics	Total
Croatia	23.3	51.8	75.1
Macedonia	17.4	64.4	81.8
B&H	21.1	48.5	69.6
FRY	20.7	47.4	68.1
Slovenia	24.6	56.4	81

Source: The wiiw Balkan Observatory At: <http://www.wiiw.ac.at/federal-republic-yugoslavia-trade-potentials-and-comparative-advantages-dlp-3343.pdf>**Conclusion**

Trade data as well as general indicators included in the three sector model are clearly showing a remarkable continuance of relations between trading partners in the former Yugoslav Republics if compared to pre-war data. While countries as Italy, Germany and Turkey used to be important trading partners for Yugoslavia, a comparison between pre-war intra-republic commerce and post-war trade activities show similar patterns for all the successor states of Yugoslavia. (Jovic/Zdravkovic/Dragutinovic-Mitrovic, 2001,10) While volume and product diversity should not be compared on a total basis, a revival of regional trade links will contribute positively towards

development perspectives for Kosovo and the region as a whole. Therefore, a revival of regional supply and production chains coupled with greater integration into global trade and international institutions are likely to contribute to positive economic growth as well as political stability. Neither the area of Kosovo nor the neighbouring states are likely to register any significant sustainable growth factors without re-establishing durable trade links on all levels. Summarized, Adam Smith's classical theorem that mutual trade activities do benefit all parties can be clearly shown on the example of Kosovo and other former Yugoslav Republics.

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