

IMPROVING THE KOSOVO SERBIAN BUSINESS COMMUNITY INVOLVEMENT IN ECONOMIC ACTIVITIES IN KOSOVO

supported
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Cooperation
Office in
Kosovo



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IN KOSOVO**

Prishtina, March 2012

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Foreword

In 2012 Switzerland marked its thirteenth year of presence in Kosovo. What initially started out as humanitarian assistance, later also led to Switzerland recognizing Kosovo's independence and establishing diplomatic ties with the young country, as well as establishing developmental cooperation. The overall agenda for the Swiss Cooperation Office in Kosovo has been to support Kosovo's social inclusive transition into a market-based economy and democratic society. As such, Switzerland has taken various initiatives to strengthen economic growth and sustainable employment. The Swiss Cooperation Office in Kosovo has set an ambitious agenda for integrated development in order to achieve sustainable livelihoods, to build a prosperous society through their business activities, and to promote cooperation among all communities.

In order to strengthen the integrated market economy in Kosovo, it is vital to promote socio-economic participation of minorities in their respective communities. The participation of business actors that have a potential for growth and economic development is a must. The support of the Europe, Central Asia, Council of Europe, and OSCE Division is crucial.

The Serbian community is essential for trade, economic growth, and ultimately, for prosperity. As more economic interactions occur, ethnic tensions will lessen, thus contributing to better conditions for doing business in the country on a larger scale.

The vision which includes economic prosperity and a democratic, multiethnic society should be detailed and rely on facts. Therefore, the Swiss Cooperation Office considered it of utmost importance to do a more research on the different businesses in the areas where majority of Serbian community lives.

It is our aim that this document contributes to greater awareness and understanding of the general issues faced and barriers that prevent the integration of Kosovo Serbian business community in the Kosovo market economy. The recommendations presented in the report should assist policy makers, civil society leaders, the donor community and the business community in their efforts to formulate and implement policies and programmes, effectively and efficiently. The study is not intended to present a political argument.

This publication will help the Swiss Cooperation Office to follow through its commitments with consistent and effective action in all domains. This will require long-term commitment and coherent strategies that involve the joint ethnic private sector in order to create opportunities and sustainable livelihoods for all.



Mrs. Krystyna Marty
The Ambassador of Switzerland
1st March, 2012

Executive Summary

This report provides an analysis and evaluation of the current situation and prospects of the Kosovo Serbian business community in Kosovo. It shows that the participation rate of the Serbian community in economic life in Kosovo remains very low. There is a lack of an active approach to mitigate concerns and problems of the Serbian community, to encourage them to participate in the economic system of Kosovo in general. Furthermore, not enough is being done to promote supportive policies for equal access of all citizens to government services and economic opportunities. In this respect, the Riinvest Institute and the Swiss Cooperation Office in Kosovo (SCO-K) identified the need for a study in order to analyse barriers, challenges and options for development on this very sensitive issue, to identify actual circumstances of the participation of the Serbian community in Kosovo's market system, and to analyse whether or not Kosovo's economy is discriminatory, and whether it stimulates further participation of the Serbian community in socio-economic life.

The Methods of analysis included desk research, interviews with key stakeholders, case studies and systems analysis. The report also portrays the results of a survey with 300 businesses (managers) which provided information regarding their perceptions on inter-ethnic businesses interaction, barriers and opportunities for business development, incentives for business cooperation and the current situation of their business. One-hundred survey interviews were conducted with K-Albanian businesses and 200 survey interviews with K-Serbian businesses, whereby 100 businesses were selected from the North¹ of Kosovo and 100 from the rest of the country

The Results of the survey show that the majority of K-Serbian businesses are small. According to data from the survey, around 86 per cent of K-Serbian firms

cooperate with K-Albanian firms at a low or medium level, and only 14 per cent stated that their cooperation with K-Albanian businesses is high. From those firms that reported a high level of cooperation, 80 per cent are from the South of Kosovo, and the size of company is not an influencing factor. The generally low level of cooperation between K-Serbian businesses in the North and companies in the South is also confirmed in the latest ICO opinion poll on the North of Kosovo². K-Serbian firms considered **economic growth in Kosovo** to be the main factor that influences cooperation between the various communities in Kosovo, followed by **increase of potentials for economic benefits through cooperation and establishment of regional and central business networks** between all business communities in Kosovo. For K-Serbian businesses, **language** was ranked as the highest barrier to cooperation, followed by **security**, the black market/organized crime, and trust. The willingness of other businesses communities to cooperate, and peer pressure had the lowest scores. These results show that there is a readiness amongst K-Serbian firms to cooperate, and that peer pressure from society is not significant, as might have been expected. It is interesting to see that language came highest as being a barrier to cooperation, when we bear in mind that Serbian businesses from Serbia and their products are widely available in Kosovo's market (more than EUR 300 million per annum). The greatest barrier according to K-Serbian businesses in general is corruption, followed by tax evasion and the black market.

The report concludes that political intervention to drive socio-economic integration of ethnic communities has resulted in only very limited progress, especially in the North of Kosovo. In contrast, the study shows the possibility of fostering integration by increasing cooperation at the business level. There is willingness to cooperate

¹ By 'North' we mean all the municipalities north of the Ibar river, whereas 'South' refers to the rest of Kosovo.

² More than 65 per cent of K-Serbs felt that there was no need to have any commercial contact with the South.

on both sides if economic development opportunities and benefits exist. Especially in agribusiness, forestry and tourism, there is potential for cooperation. The influence of strong economic growth through improved cooperation is expected to be higher than from cooperation purely in the interests of economic growth. Therefore, measures to foster general economic growth are a dominant part of the recommendations. Business cooperation is a very strong driver towards creating bridges over the current divisions between ethnic groups in Kosovo. Nevertheless, we emphasise that business cooperation cannot be seen in isolation, and social aspects such as trust and political influence, as well as the functioning of government institutions play a similar role in making business relations which provide economic benefits possible in the long-term.

Recommendations are separated into three parts, namely policy recommendations, recommendations for the business community, and recommendations for international donors.

Policy recommendations

- Develop a new integration strategy that will promote activities in the mid-term (three to five years) with the aim of integrating the K-Serbian business community, thereby reducing its isolation.
- Strengthen the business environment and work towards economic growth on a macro-economic level.
- Increase the trust of the K-Serbian community in central and local institutions.
- Actively ensure participation of minority companies in bids for government tenders and ensure the impartial assessment of offers and awarding of contracts.
- Increase business promotion activities specifically targeting K-Serbian businesses, linking them with other businesses in Kosovo through various

events such as fairs and other promotional activities.

- K-Serbian local government (municipalities) should operate in a transparent manner and increase incentives for outside investments, thereby improving the general level of cooperation.
- Treat Serbian businesses from the North the same as other businesses in Kosovo if they are fully registered with the Kosovo administration.
- Trading of goods, assuming that all documentation is in order, should be possible and even encouraged between the North and the rest of Kosovo.
- Ensure security and freedom of movement for people from the North in the whole Kosovo.

Business actors

- Business associations in Kosovo must play a more active role towards the integration of K-Serbian businesses from the South and North of Kosovo.
- Associations should organize joint fairs with a focus on promoting local products, potential business opportunities, and other incentives for cooperation.
- Investment agencies should promote business opportunities in K-Serbian regions, with a special emphasis on the comparative advantages of these regions.

International donors

- Support the Government in implementing the policy recommendations outlined above.
- Establish programmes for the support of micro, small and medium enterprises and for market development, focusing on sectors with a high potential for integration
- Work towards reducing the isolation of the K-Serbian business community. Foster integration in business associations, chambers of commerce, trade and business promotion activities, etc.
- Strengthen the capacities of municipalities in local and regional economic development in line with the on-going decentralisation process with a focus on the new Serbian municipalities.
- In the North, support initiatives that work towards integration on a business level (start-up funds, training courses, linkages to the south), at the level society (reconciliation and trust building) and at the institutional level (business registration, issuing of Kosovo IDs, etc.).
- Launch an information campaign to as impartially as possible inform people about opportunities in Kosovo.
- Develop a common intervention strategy in the North between all donors and coordinate their interventions accordingly in order not to duplicate each other or worse, work against other donors' interventions.

Because of the characteristics of the North, the following principles need to be followed for every intervention:

- The context in the North is different from the rest of the country, as is outlined in this report. Therefore, to simply extend programmes from the South into the North carries an inherent risk that the interventions will not work or might even harm the goal of integration. For the North, separate context analyses need to be done and the solutions and interventions have to be based on these.
- The effects of every intervention need to be closely and continuously monitored. Interventions that support integration should be strengthened; interventions that might be harmful for the integration process have to be changed or stopped quickly. Interventions can quickly turn from one of these types into the other. A consequent "do-no-harm" approach needs to be applied as a minimum.
- Project managers must carry out careful risk assessments when selecting local partners since there is anecdotal evidence of influential people in the North increasingly claiming donor grants and using them for their own benefits. Donors should exchange their experiences with local partners to improve the fair distribution of donor money.
- The consequent application of conflict sensitive project management needs to be ensured for all interventions in the North.

In the report, some options for concrete activities are specified.

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Abbreviations

AMCHAM	American Chamber of Commerce
BEEPS	EBRD-World Bank Business Environment and Enterprise Performance Survey
BRAK	Business Registration Agency of Kosovo
CBK	Central Bank of Kosovo
CIG	Council for Inclusive Governance
GDP	Gross Domestic Product
IBM	International Business Machines Corporation
ICG	International Crisis Group
ICO	International Civilian Office
IMF	International Monetary Fund
K-Albanian	Kosovo Albanian
KCA	Kosovo Cadastral Agency
KCC	Kosovo Chamber of Commerce
KEK	Kosovo Energy Corporation
KFOS	Kosovo Foundation for Open Society
KII	Key Informant Interviews
K-Serbian	Kosovo Serbian
MPT	Municipal Preparatory Team
MTI-SMESA	Ministry of Trade and Industry – SME Support Agency
OSCE	Organization for Security and Co-operation in Europe
PER	Project on Ethnic Relations
SDA	System Dynamics Analysis
SDC	Swiss Agency of Development and Cooperation
SOK	Statistical Office of Kosovo
SWO-K	Swiss Cooperation Office in Kosovo
TAK	Tax Administration in Kosovo
UNDP	United Nations Development Programme
UNMIK	United Nations Administration Mission in Kosovo

PART I

1.1 Introduction

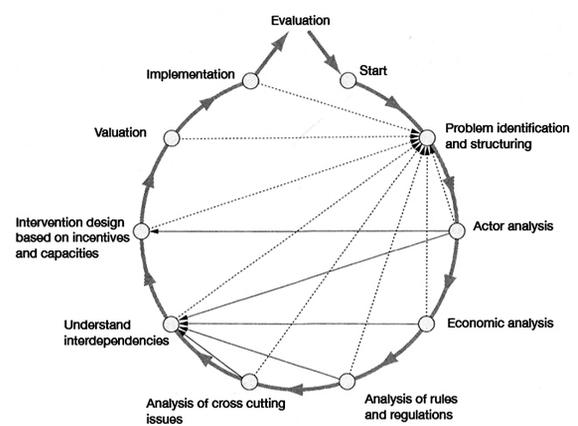
Participation of the many ethnic communities in all aspects of public life in Kosovo remains a key issue for the development of democratic institutions and the promotion of equality. Most importantly, it is a precondition for a future without ethnic tensions or violent conflict. Whilst there has been significant progress regarding the political representation of ethnic communities in Kosovo, much remains to be done to increase the socio-economic participation of the Serbian community. This study, amongst other things, shows that the participation rate of the Serbian community in economic life in Kosovo is still very limited. There is a lack of an active approach to mitigate the concerns and problems of the Serbian community to encourage its people to participate in the economic system of Kosovo in general. There is also little done to promote supportive policies for equal access of all citizens to government services and economic opportunities. In this respect, the Riinvest Institute and the Swiss Cooperation Office in Kosovo (SCO-K) identified the need for a study in order to analyse barriers, challenges and options for development on this very sensitive issue, to identify actual circumstances of the participation of the Serbian community in Kosovo's market system, to analyse whether or not Kosovo's economy is discriminatory, and whether it stimulates further participation of the Serbian community in socio-economic life. The study was funded by the Swiss Agency for Development and Cooperation (SDC) through the SCO-K, and implemented by the Riinvest Institute and Avenjia, a Serbian NGO in Kosovo, with the methodological support of an international consultant.

The following four key questions were defined, to be answered by the study: (1) What is the level of Serbian community involvement in Kosovo economic activity? (2) What are the barriers and obstacles that prevent a more active integration of the Serbian business community? (3) What are the business potential and opportunities for further development? (4) To what extent does the process of business cooperation as a driver of socio-economic integration help the Serbian community to bridge the divisions between ethnic groups in Kosovo?

The study assesses a highly interconnected and complex situation. Therefore, the System Dynamics Analysis (SDA) was chosen as an overarching methodology. The SDA was used to structure the entire process from problem description to data collection, data analysis

and strategy development. Throughout the various steps of the SDA, knowledge of the system is gathered in a comprehensive way using a variety of methods, combining quantitative and qualitative research tools. An overview of all steps of the SDA is given in Figure 1.

Figure 1: The steps of the System Dynamics Analysis



Source: Adapted from Frischknecht and Schmied, 2009³

A combination of desk research, key informant interviews and a survey with 300 businesses in Kosovo (200 K-Serbian, 100 K-Albanian) contributed to the data for the system analysis. These methods, as well as the methodology for the analysis of the system, are described in more detail in Part II.

The report presents the findings of the desk research and key informant interviews, covering the problem description, economic analysis, analysis of rules and regulations, and the analysis of cross cutting issues in section 1.2. The results of the survey of the businesses are presented separately in section 1.3, followed by conclusions and recommendations in sections 1.4 and 1.5, respectively. The analysis of the system is described in section 2.2.

3 P. Frischknecht and B. Schmied (2009): Umgang mit Umweltsystemen. Methodik zum Bearbeiten von Umweltproblemen unter Berücksichtigung des Nachhaltigkeitsgedankens. Aktualisierte und überarbeitete Neuauflage. Oekom Verlag, München.

1.2 Background Analysis

1.2.1 Problem description

In 1999, and after a long inter-ethnic conflict, the international community established a new administration in Kosovo by adopting the UN Resolution 1244, and by setting up the United Nations Administration Mission in Kosovo (UNMIK). The aim was to put a stop to the violent conflict, and to create peace in Kosovo.

Despite this international intervention, Kosovo has been constantly challenged by the legacy of ethnic conflict, and the lack of a realistic approach to reconciliation that could be shared by all communities. The attitude of the Serbian community towards the newly created situation was constrained under the influence of Belgrade and the events of the 1990s. During that time, the (governing?) regime had given preference to the Serbian community in Kosovo, to the detriment of others, and in particular the Albanian community.

The Serbian authorities in Belgrade, but also the Serbian community in Kosovo, have always considered the international intervention in Kosovo as being the occupation of "the territory of Serbia". Since the beginning of the international administration, the Serbian community viewed the situation in the context of their personal security and freedom of movement, whilst the Albanian and other non-Serbian communities perceived the new situation as an opportunity to begin a new political, economic and national era. The process of reconciliation was further aggravated by the new situation created in northern Kosovo, which is still considered to be a source of institutional instability by the Albanian community, whilst the Serbian community views it as a bastion of resistance to the state-building process in Kosovo.

Given that UN Resolution 1244 did not refer decisively to a final political status for Kosovo (i.e., independence), the Serbian community south of the Ibar River agreed to take part in local and national elections, taking their seats in the Parliament of Kosovo and the assemblies of several municipalities, as well as a number of leading positions at the central Government level. Although this participation was challenged by the strong influence of Belgrade, by building "parallel" Serbian structures (in Kosovo) and also in light

of the Declaration of Independence of Kosovo in 2008, the political representation of the Serbian minority should be considered a significant result. Much remains to be done, however, in order to provide support for its socio-economic participation. Previous studies conducted by the Riinvest Institute show that the participation rate of the Serbian community in economic life is minimal.

In this regard, there is a need to undertake research to identify barriers, opportunities and channels for developments in this sensitive field, to define the actual circumstances surrounding the issue of participation of the Serbian community in Kosovo's market, and to determine whether the market is non-discriminatory and promotes greater participation of the Serbian community in economic and social infrastructures. There is also a need for concrete guidance at a policy level, as well as at the level of business actors and the international community, in order to foster the economic integration of the Kosovo Serbian community.

1.2.2 Economic analysis

Kosovo is one of the poorest countries in Europe with extreme poverty affecting 12 per cent of the population, which survives on EUR 1.02 per person per day, whilst 34 per cent of the population lives below the poverty line, living from EUR 1.55 per person per day (UNDP, 2012).

Unemployment is one of the major challenges facing the country's economy and affects between 40 and 45 per cent of the population (SOK, 2009). The employment ratio for youth from all ethnicities in Kosovo stands at 28 per cent. The Roma, Ashkali and Egyptian (RAE) community is the most disadvantaged with an employment ratio of 17 per cent, K-Serbian with 23 per cent, and K-Albanian with 29 per cent (Corbanese and Rosas, 2007). Recent figures for ethnically disaggregated unemployment are not available but given Kosovo's macro nature, these figures are expected to still be indicative for the current situation.

Given that GDP growth in Kosovo is driven mainly by government consumption, public expenditure, remittances and foreign aid, it cannot remain sustainable in the long term. Kosovo continues to have a GDP of EUR 4.7 billion (IMF, 2011). The real GDP growth deceler-

Case Study 1

Kllkot is a region very well known for its mineral water resources. One of these sources, rich in minerals, is found in the backyard of a land owner's family. The land owner started his mineral water production business in 2002 and currently employs 12 people. His company is the only K-Serbian industrial production company, but not the only company producing water. There are two K-Albanian businesses in the same region that produce mineral water and he enjoys productive cooperation with one of them exchanging supply materials when needed. Today, the company runs at only 30 per cent of its capacity owing to the difficulties involved in gaining access to markets outside the region. Although the owner has some contacts outside of Kosovo, administrative barriers also present challenges to the export of his water. The company currently sells 30 per cent of its output to regions inhabited by K-Albanians and 70 per cent to regions inhabited by the K-Serbian community. The company owner doesn't believe that his being Serbian is the main reason for him not being able to sell outside the local market. Rather he thinks that there are systemic issues within the market, which is still not well organized. He used to cooperate with companies in the North of Kosovo but this cooperation has evaporated as companies there now have better conditions in terms of choice of products and links from Serbia.

ated from 5.4 per cent in 2008 to 4.0 per cent in 2009, and continued to fall to 4.6 per cent in 2010 with an increase to 5.1 per cent in 2011 (EC Progress Report, 2010; Progress Report made in Kosovo, 2011).

Between 2002 and 2007, Kosovo frequently experienced budget surpluses which reached a peak in 2007 with a roughly two per cent budget surplus as a percentage of GDP. However, from 2008, the country continuously experienced budget deficit, reaching its lowest point in 2011 at roughly 1.5 per cent of GDP (IMF, 2011).

Kosovo suffers from a current account deficit in its balance of payments which is due mainly to a negative trade balance, with imports significantly higher than exports. In September 2010, the current account deficit amounted to 16.9 per cent of GDP (CBK, 2010).

The private sector in Kosovo continuously underperforms and is failing to reach its full potential. Out of 105,000 companies registered with the Business Registration Agency of Kosovo (BRAK), according to the Tax Administration of Kosovo (TAK), around half of these are inactive (UNDP, 2012). Furthermore, Kosovo's domestic production continues to be low. Out of all registered SMEs, only 50 per cent were operating in the trade sector (SME Agency, 2011).

1.2.3 Business environment

During the past few years, the Government of Kosovo has realised several improvements in the *business environment*. They include reforms for the creation of new businesses, labour market legislation, tax regulations, and competition laws (UNDP, 2012). However, these reforms alone are insufficient for significant business growth and job creation.

In 2011, the Riinvest Institute conducted a study with 600 businesses (published by UNDP in 2012). Kosovan businesses were asked to rank 22 categories of barriers, as defined in BEEPS⁴ surveys. Categories of 'unfair competition' and 'anti-competitive practices of other competitors' showed the highest intensities, followed by electricity, corruption, contract violations, political stability and cost and access to finance.

The World Bank's "*Doing Business 2011*" report ranks Kosovo in the category of 'ease of doing business', at 119 out of a total of 183 economies. Starting a business and dealing with construction permits is a complex process, and this was also highlighted in the same report. Kosovo ranks very poorly when compared to neighbouring countries such as Macedonia, and in the categories of the 'enforcement of contracts', and 'trading across borders', Kosovo was placed at positions 155 and 130 respectively (World Bank, 2011). Recent trade conflicts between Kosovo and Serbia, and respective reciprocity measures may further hamper the current levels of cooperation between K-Albanians and K-Serbians.

A study conducted at the request of the American Chamber of Commerce in Kosovo highlights that K-Serbian businesses believe that the most problematic institutions that hinder business development are the Kosovo Energy Corporation (KEK), the Kosovo Cadastral Agency (KCA), and local government. K-Serbian businesses, according to this report, display a relatively low level of discontent with Kosovo institutions, probably due to the lack of Kosovo institutions being present in those areas (K. Shaipi, 2008).

Tax evasion fosters unfair competition, providing an advantage to businesses that dodge paying their taxes. Data shows that the level of tax evasion in Kosovo is around 39 per cent. To date, out of 65,000 registered businesses with fiscal numbers, only 13,000 busi-

⁴ EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS)

nesses have been equipped with cash registers. Their use is specifically aimed at reducing the level of tax evasion in Kosovo (UNDP, 2012).

According to TAK, registered businesses are composed of 96 per cent micro enterprises, 2.3 per cent small enterprises, 0.9 per cent medium enterprises, and 0.8 per cent large enterprises.

In the key informant interviews it was found that most K-Serbian businesses are small enterprises and family businesses, with very few employees. They lack managerial and technical skills and productivity is very low. Nevertheless, they may act as an important input supplier, mainly in the agriculture sector which accounts for over 25 per cent of Kosovo's GDP (UNDP, 2012).

The role of K-Serbian businesses in the Kosovo economy is considered to be small owing to their low participation rate in the market. However, the participation rate of K-Serbian businesses in the South is higher than in the North⁵. A very successful but informal cooperation exists within an established Albanian-Serbian network that allegedly smuggles goods free of duty and tax from Serbia via the North to southern Kosovo (ICG, 2011).

The exchange of business information between the two communities remains very low due to a lack of participation of K-Serbian businesses in business fairs and other events organized by the K-Albanian business community, and vice versa. On the other hand, support provided by international organizations has improved the Serbian language television network which now covers 80 per cent of the K-Serbian population, allowing the promotion of their products within the K-Serbian community, in all regions of Kosovo (EC Progress Report, 2011). The Kosovo Media Association radio network also broadcasts throughout Kosovo in the Serbian language.

An accelerated private sector development in Kosovo is necessary for higher levels of economic growth and job creation (UNDP, 2012). In order to see economic development throughout all regions of Kosovo, an improved business environment is essential. Part of this reformed business environment must also include establishing cooperation between K-Albanian and K-Serbian businesses.

⁵ By North we mean municipalities of Leposavic, Zvečan, Zubin Potok and Mitrovica north of the Ibar River

Case Study 2

The company has been established in a region famous for potato production thus it is primarily engaged in potato production and processing, sale of potato seedlings, and machinery. The company cultivates 130 hectares of its own land and has subcontracted an additional 130 hectares to other farmers, out of which 10 per cent are K-Serbian farmers located in the North.

The company currently exports to Albania, Macedonia, Montenegro, and Croatia. It used to export its products to Romania, but this was interrupted after Romania joined the EU. Nowadays the company is seeking to re-establish those channels, following improvements to its processes and quality assurance as required to meet EU standards. Before independence, the company also exported to Serbia and Bosnia and Herzegovina, which at the time made up 30 per cent of its business. Now, the restrictions imposed by Serbia do not allow for the transport of its products through Serbia with Kosovo vehicle plates.

Differences in ethnicity does not concern the owner thinks when it comes to doing business and he would like to expand seed production in the North because of its favourable climate, as well as increasing the market share.

1.2.4 Rules and regulations

Fiscal Policies – In 2009 the Government of Kosovo adopted some important measures to improve the business environment by creating favourable fiscal policies. Previous research by Riinvest showed that after those fiscal policy changes had been implemented, the issue of tax had slipped to a lower rating in the list of difficulties in doing business, indicating that these changes have had a positive effect.

Trade Policies – Kosovo has an open trade policy and in 2006 signed the CEFTA agreement with the intention of opening its borders to neighbouring countries and vice-versa. However, trade liberalization did not increase competitiveness in the market, thus leaving Kosovo with an enormous trade deficit (EUR 1.85 billion) (CBK, 2010). The CEFTA agreement was not fully implemented due to trade blockages imposed by Serbia and Bosnia and Herzegovina for Kosovo products. Such disputes hamper economic progress and continue to be a major challenge for the development of the Kosovo economy.

Property Rights – Although changes in the legal framework regarding property rights have been made (the law on cadastre, amendments in the law of immovable property, the tax law on immovable property, amendment to the law of expropriation), implementation has been difficult and a mixed level of progress has been achieved (EC Progress Report, 2011). In Mitrovica, the implementation of deportation orders and property administration has been a challenge, thus interethnic property disputes are prolonged in the local courts (EC Progress Report, 2011). Property rights disputes

Case Study 3

The Sharr Mountains are a mountain range in south-western Kosovo which are home to almost 2,000 plant species, including blueberries, raspberries, cherries and strawberries. Currently, raspberries are only cultivated in the municipality of Strpce, over an area of ca. 22 hectares. Raspberry production has proven to be one of the economically viable activities that can provide income for families in this area. The berry production business has functioned very well in the last couple of years in the Strpce municipality, characterizing a business in which Serbs and Albanians are equally involved. The berry production association is a registered association with 45 members, of which 11 are K-Albanians, two are K-Bosnians and 32 are K-Serbs.

Producers, regardless of ethnicity, have the possibility to keep their fruits in cold storage which also serves as a collection point for raspberries and is owned by a K-Serbian. Currently, 90 per cent of products are sold to Serbia whereas the sale of frozen merchandize abroad in cooperation with K-Albanian business stagnated because of market changes on a global level.

The raspberry business is very new for the owner, and he has not been able to establish channels with major supermarkets in Kosovo on account of the fact that he could not provide the necessary packaging for his products. Starting in 2012, he will invest in the design of packaging and marketing, which will allow him to trade with the supermarkets.

With technological support, such as irrigation and the introduction of new varieties, production in the region could be further strengthened and increased.

and uncertain situations over ownership are hampering the development of the business environment and limiting investment opportunities.

The *judiciary system* in Kosovo remains very weak. There is still a backlog of unsolved cases within the judiciary system including corruption and nepotism (EC Progress Report, 2011), and loopholes in the legislative system make corrupt business practices possible. Continuing with this issue, there are still numerous reports of threats and intimidation against judges, especially for sensitive cases such as those dealing with property rights. Moreover, rule of law continues to be a concern for northern Kosovo since the Mitrovica courts still only consist of EULEX judges and prosecutors, and operate with limited capacity (EC Progress Report, 2011). The Serbian parallel structures instilled in the North of Kosovo are very dominant and thus their integration into of the rest of the Kosovo network is a great challenge (EC Progress Report, 2011).

Although these problems persist and affect the whole population of Kosovo, the K-Serbian community have, by law, many *guaranteed rights*. Serbian political representatives hold 20 reserved seats out of a total of 120 in the main legislative body of Kosovo. The same law applies to the participation in executive decisions and the appointment of judges and prosecutors (Djukanovic, 2008). However, the implementation of these laws remains unsatisfactory, and the principles of good governance are not readily apparent within Kos-

ovo institutions. Decisions are often taken based upon who is connected to whom. Specifically, one's own community will always receive preference, and other ethnicities that are not well integrated will always be discriminated against (KII, 2011).

However, many K-Serbians still utilize parallel institutions, especially in the North of Mitrovica. They can apply for and receive personal documents, receive healthcare, education, salaries and most goods and services locally, or from Serbia (ICG, 2011). Some of those interviewed underlined the important role that the Serbian parallel institutions still have in K-Serbian communities, and they are afraid that if the support from Serbia ends, their situation will worsen. They still see the parallel institutions as providing better quality services, especially in the sectors of education and health care, and they do not trust the institutions of Kosovo to fill the gap.

Efforts to create a business friendly environment are still hindered by the inability to implement rules and regulations throughout the whole of Kosovo. In order to increase the level of cooperation, inter-ethnic trust, and the country's business infrastructure, rules and regulations must be strictly implemented according to the law.

1.2.5 Cross-cutting issues

There is a lack of research and information regarding the current level of business ownership by women, as well as their inclusion in management, types of employment, salary levels, and participation in political and social decision-making. No information could be gathered showing the differences of business involvement between K-Albanian and K-Serbian women.

According to research conducted by Ann Androsik (2007), the number of businesses registered in North Mitrovica as of September 2002 was 375. Out of these businesses, 33 per cent were owned by women. This research pointed out that these were women who in the main used to work for companies which ceased operations after the war, and then opened their own small private trade businesses. Since that report, no other study appears to have been conducted examining the number of K-Serbian women in business in the North or other regions.

Recent changes in the employment law have included improved benefits for women in the workforce, some

of which have backfired. Today the cost of hiring women is very high, in part due to a long maternity leave allowance, which discourages companies to hire women, and thus can be considered discriminating. According to the law (Law No. 03/L-21), women are entitled to 12 months of maternity leave, whereby the employer is obliged to pay 70 per cent of the salary for the first six months. Data reveals that women are more likely to be unemployed than men in Kosovo. The UNDP 2012 report reveals that the unemployment rate for women stands at 57 per cent, whereas the level of men is 41 per cent. Furthermore, the participation rate of women in the labour market is 29 per cent compared to 67 per cent of men.

The existence of parallel structures has a considerable impact on Kosovo society. However, following Kosovo's Declaration of Independence, K-Serbian have elected local governments (councils) in those municipalities populated by a majority of K-Serbians in the South, during elections organised by legitimate Kosovo institutions. This has led to a weakening of the influence of parallel structures which, according to the OSCE (2007), operate under *de facto* the authority of the Serbian Government.

According to the ICG (International Crisis Group, 2011) the situation in the North is different. The Kosovo Government's reference to the northern municipalities being "parallel" authorities is misleading due to the fact that the Serbian municipalities have their own authorities. However, although the UNMIK administration has drawn down its operations throughout most of Kosovo, UNMIK Administration Mitrovica (UAM) still functions, and overlaps with Serbian municipal administration (ICG, 2011).

According to research performed by the Kosovar Stability Initiative (KSI), when asking people living in the North of Mitrovica about who is in charge, a wide variety of answers was received. Around 22 per cent believed that the Government of Serbia was in charge, 19 per cent considered the local politicians to be in charge, 19 per cent believed that organized crime was influencing the governance of the municipality where they lived, 12 per cent considered UNMIK to have competence, 8 per cent believed that the international community held responsibility, and 21 per cent were not aware of who was actually in charge of governing their municipality. This confusion has been caused by the great number of stakeholders involved, who claim responsibility without taking concrete actions (KSI, 2009).

Case Study 4

Mogilla is a town in the municipality of Klllokot, a region which benefits from fertile agricultural land, and where communities from both Albanian and Serb ethnic backgrounds live and work together. In Klllokot, the municipality population is made up of 72 per cent Serbian, 27 per cent Albanian and two per cent Roma. The ethnically mixed Mogilla Farmers' Association has received development programme funding on several occasions to help increase their production. One of the beneficiaries was a company that cultivates 12 hectares of its own land and now also serves as a collection point for the products of all farmers, regardless of ethnicity. The core products are peppers, tomatoes, potatoes, cabbages and onions. The collection point is equipped with a cool storage facility which prevents the vegetables from decaying. The owner has also invested in a greenhouse and is constructing greenhouses for other farmers which will extend the production period. He is also planning to pre-supply the farmers with seedlings and to provide a payback guarantee for products.

The company's main market is Kosovo but it exports to Albania as well, and last year also exported to Serbia. K-Serbian farmers previously sold their products mainly in the open markets of the Klllokot and Gjilan regions, but they are now able to sell their products in other regions of Kosovo, populated mainly by K-Albanians, thanks to the initiative of this company.

The ICG notes that although in the past K-Serbian participation in Kosovo political life might have seemed impossible, the local elections of November 2009 and national polls of December 2010 showed the opposite. K-Serbians living in the south voted in large numbers. However, the drawback was that the same reaction could not be expected from K-Serbians living in the North. K-Serbians living in other regions of Kosovo voted because they were surrounded by areas ruled by the Kosovo state authority and had few alternatives. The turnout in the 2009 elections for the whole of Kosovo was 45 per cent, whilst in the three municipalities with a majority K-Serbian population it ranged from between 23 and 27 per cent, in Ranilug 12 per cent, whilst in the North, participation was minimal (KFOS, 2010).

The lack of communication between political parties and the perception that Serbia decides about everything have contributed to a feeling of helplessness amongst the K-Serbian population, and it has consequently discouraged serious initiatives (CIG, 2010). The current political situation and the debates about territorial division, or special status for the North, make inclusion initiatives not only less appealing for the K-Serbian community, but also more difficult to implement.

In addition, Serbia spends around EUR 200 million in the North of Kosovo, which helps sustain its influence. This is a strong factor hindering K-Serbian integration. Due to investments from Serbia, which go mainly to the North, that region is urbane and full of life, even

Case Study 5

A professional cleaning and maintenance company, based in Gracanica, is a business partnership between a K-Serbian and K-Albanian owner. It deals with the professional cleaning and maintenance for all aspects of commercial or residential buildings, such as the cleaning of upholstery, carpets, car interiors, facades, tiles, and marble, to name but a few. Its sales are mostly achieved through the process of tenders and when requested by buyers. Sales are spread throughout the Kosovo market and the company's main buyers are from both K-Serbian and K-Albanian communities, with similar amounts of sales. It is anticipated that sales to the K-Albanian and K-Serbian communities will increase by some 10 per cent in the short- to mid-term.

In general, the business considers all Kosovo to be a potential market in the future. The firm is supplied with raw materials and products from K-Albanian owned companies mostly located in Prishtina. The company believes that this trend will continue. It welcomes customers from a variety of ethnic structures, such as K-Albanians, K-Serbian and Roma, meaning that no ethnicity is particularly under-represented when it comes to using its services. There have not been any kind of problems or obstacles in doing business with K-Albanians, and cooperation is at a normal level. Clients themselves are not judgmental of the fact that the company is co-owned and works with K-Albanians as getting the job done professionally is what matters the most.

in its small towns and villages. Small and rural areas are filled with new buildings, sports halls, and a university campus equivalent with the best in Belgrade. The hospital in the North of Kosovo is large and well-staffed, where a large number of citizens from all over Kosovo obtain medical services (ICG, 2010).

Data revealed through secondary research provides information related to *local governance* and how it has affected life in general, but does not provide information on how it has affected businesses. The creation of new municipalities has helped businesses indirectly. New municipalities are donor babies and receive

funds from a variety of sources, a portion of which end up in businesses (KII 2011). In addition, many interview respondents answered that parallel structures might have a greater influence in the North of Kosovo than in the other areas populated by K-Serbians.

The American Chamber of Commerce in Kosovo (2008) conducted a study trying to explain the impact of *corruption* on businesses. From the respondents, 40 per cent of K-Albanian and 18 per cent of K-Serbian businesses stated that they had been faced with corruption on various occasions. K-Serbians highlighted that they had experienced greater corruption at the local level, whilst a significant portion of K-Albanians indicated serious corruption at the central level.

The EC Progress Report (2011) on Kosovo pointed out that limited progress had been made with regards to the promotion and enforcement of *human rights*, despite the fact that Kosovo continued to implement the strategy and action plan for human rights. The same report stated that human rights mechanisms were not efficiently coordinated at either the central and municipal level (EC, Progress Report, 2011). Regarding the protection of minorities, the progress report noted that there had been limited progress, but that the decentralisation process provided a good framework for future improvements. According to the OSCE, the absence of a fully functioning justice system in Mitrovica has led to violations of human rights such as the right to access to justice, and the right to trial within a reasonable period of time (OSCE, 2011).

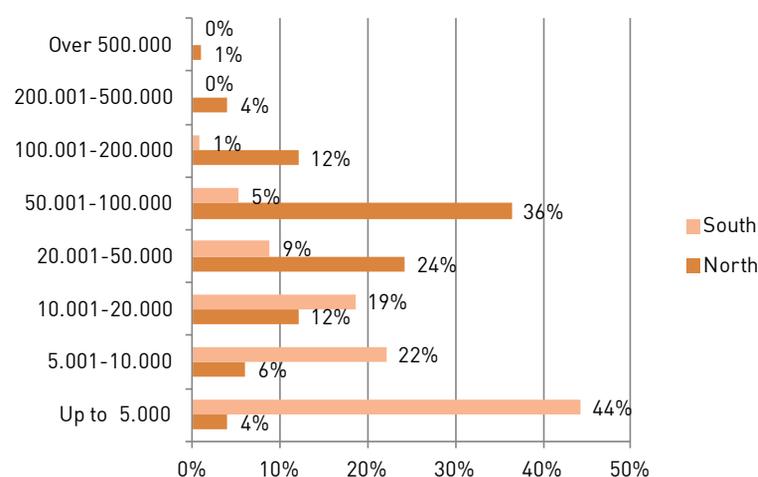
1.3 Survey Results and Analysis

As we have described in the part of the study on methodology, the team interviewed 300 businesses all over Kosovo, specifically 200 K-Serbian and 100 K-Albanian businesses. The main aim of the survey was to gain a clearer picture about the level of Serbian business community involvement in Kosovo's economic activity. Answers were sought to the following questions: What are the main barriers that prevent a more active integration of the Serbian community in to economic activities? What are the business potential and opportunities for further development? And, to what extent does the process of business cooperation help them to integrate?

As expected, the majority of K-Serbian businesses are small. Of the K-Serbian businesses interviewed, around 93 per cent stated that they are individually owned businesses. K-Serbian businesses are mainly engaged in providing services and trading (around 76 per cent), whilst a smaller portion is engaged in production and processing (24 per cent). These results are compatible with the findings from other sources, such as secondary research and interviews with stakeholders. According to key stakeholders, the main sectors identified in locations populated by K-Serbians are trade, tourism, agribusiness and forestry, and this was also supported by the survey data. Moreover, some of the stakeholders think that K-Serbian businesses may act as intermediaries for the export of Kosovo products to Serbia and other countries in the region on account of language and cultural relations.

The size of K-Serbian businesses is also an expression of their vision for the future. Around 70 per cent of K-Serbian businesses see their local area (localities where they live) as their potential market for the future. Around 20 per cent of them see the Kosovo market as their target, whereas only 10 per cent view other countries in the region as future market potential to export to. K-Serbian businesses are also small in terms of annual turnover. Around 27 per cent had a turnover rate of up to EUR 5,000 per annum, whilst over 60 per cent managed a turnover up of to EUR 50,000. The rest are businesses with more than EUR 100,000 annual turnover. We also checked for the differences in turnover between K-Serbian businesses in the North and South of Kosovo. The results show that 94 per cent of businesses in the South had turnover rates of up to EUR 50,000 in 2010. Around

Figure 2: Turnover rate of K-Serbian businesses in North and South in 2010

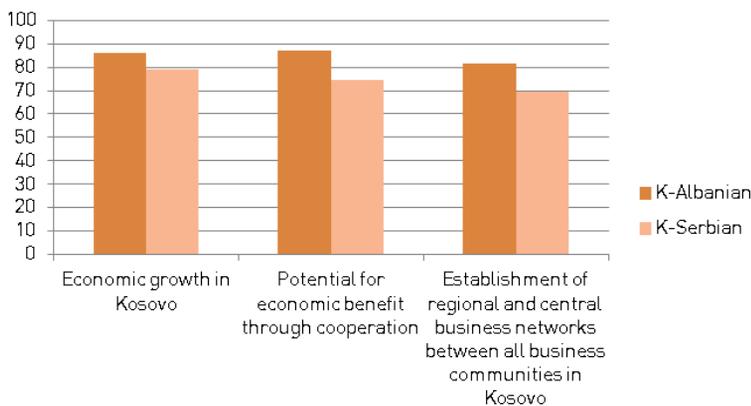


Source: Survey with K-Serbian businesses

46 per cent of businesses in the North have a significantly lower turnover rate. A great difference is also noted in the turnover rate of more than EUR 100,000. A considerable number of K-Serbian businesses in the North (52 per cent) reported to have had such turnover, whilst only five per cent of the K-Serbian businesses in the South of Kosovo declared such turnover. From the data and figure below we can conclude that K-Serbian businesses operating in the North are larger than K-Serbian businesses operating in the South of Kosovo. This may be due to access to a larger market in the North of Kosovo, and the fact that some of them have existed longer, established prior to 1999 (for more details see figure 2).

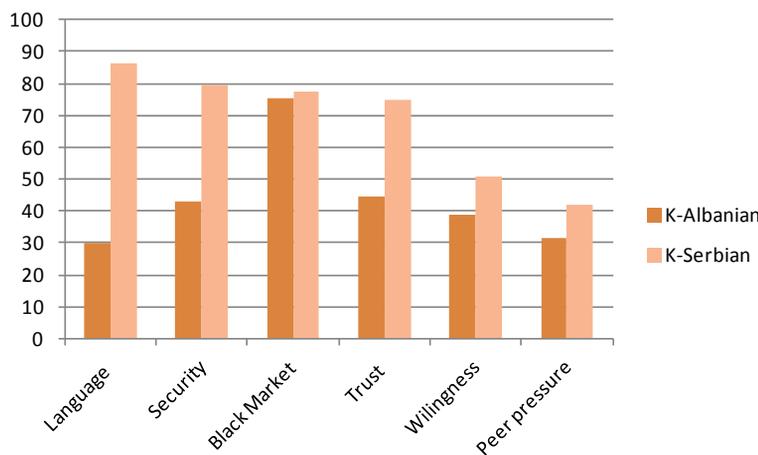
We asked businesses about their level of cooperation with other businesses, i.e. with K-Serbian businesses, K-Albanian businesses and others in Kosovo. The respondents were asked to rate their cooperation with businesses from other ethnicities as high, medium or low in relation to the scale of their overall business cooperation. According to data from the survey, around 86 per cent of K-Serbian businesses cooperate at a low or medium level with K-Albanian businesses, and only 14 per cent stated that their cooperation is high. From those businesses that stated a high level of cooperation, 80 per cent are from the South of Kosovo, and the size of company does not have an impact on this result. The

Figure 3: Factors that increase cooperation between communities according to K-Serbian businesses and K-Albanian businesses



Source: Survey with businesses

Figure 4: Barriers to cooperation according to K-Serbian businesses and K-Albanian businesses



Source: Survey

generally low level of cooperation between K-Serbian businesses in the North with companies in the South is also confirmed in the latest ICO opinion poll in North of Kosovo⁶. We must also emphasize that K-Serbian businesses cooperate at a higher level with non-K-Albanian businesses (56 per cent), and that 44 per cent cooperate at medium or low levels. The results are also supported by the K-Albanian response, whereby around 86 per cent of K-Albanian businesses stated that they cooperate at a low or medium level with K-Serbian businesses,

⁶ More than 65 per cent of K-Serbs felt there was no need to have any commercial contact with South.

and that around 14 per cent of them engage in a high level of cooperation.

In addition, businesses were asked whether cooperation was formal or informal. From K-Serbian businesses, 87 per cent stated that they cooperated on a formal basis, whilst only 13 per cent stated that their cooperation was informal. The same questions to K-Albanian businesses produced similar findings whereby around 88 per cent of them stated that cooperation was formal, whilst around 12 per cent stated that they cooperate on an informal basis. This is a very important and encouraging result which supports the idea that peer pressure from society is not a significant problem.

K-Serbian and K-Albanian businesses were asked which factors they thought would increase cooperation between different business communities in Kosovo. K-Serbian businesses considered **economic growth in Kosovo** (economic growth creates new opportunities for businesses, and hence creates new ways of cooperation) as the main factor influencing cooperation between the different communities of Kosovo, followed by **potential for increase of economic benefits through cooperation** and **establishment of regional and central business networks** between all business communities in Kosovo. For K-Albanian businesses, the most important factor was **potential for increase of economic benefits through cooperation**. **Economic growth in Kosovo** is also considered very important with almost the same intensity, as is **the establishment of regional and central business networks** between all business communities in Kosovo.

The aim of the study was also to identify and analyze the barriers to cooperation between K-Serbian and K-Albanian businesses. In the questionnaire, barriers to cooperation had to be ranked from 1 to 5 (1 standing for no barrier and 5 standing for a very high barrier). We asked businesses to rank, based on their experience, the following barriers: 1. peer pressure from your own community, 2. willingness from other business communities to cooperate, 3. trust, 4. security, 5. language, and 6. black market/organized crime.

For K-Serbian businesses, **language** was ranked as the highest barrier to cooperation, followed by **security**, black market/organized crime, and trust. Willingness from other business communities and peer pressure were ranked at the lower end of the scale (see figure 4). These results show that there is a willingness amongst K-Serbian businesses to cooperate, and that there is no peer pressure from society, as might have been expected. It is interesting to see that language is seen as the

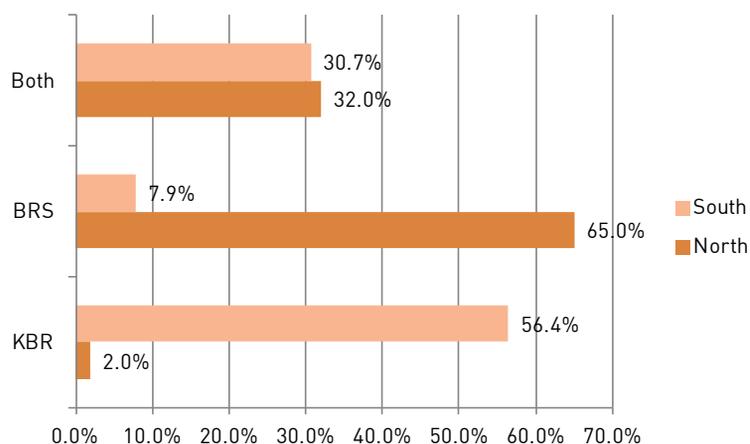
highest barrier to cooperation, when we bear in mind that Serbian businesses (from Serbia) and their products are widely available in the Kosovan market (more than EUR 300 million per annum).

K-Albanian businesses reported that **black market/organized crime** represent the highest barriers to cooperation, followed by **trust**, security, willingness from other business communities to cooperate, and finally language

K-Serbian businesses were also asked whether they their businesses were registered. According to the survey results, 30 per cent of those asked stated that they were registered with the Kosovo Business Registry, 38 per cent were registered with the Business Registry of Serbia, and 32 per cent stated that they were registered with both. When analyzing the differences between answers between businesses in the North and South, one can see large differences. Around 65 per cent of businesses in the North are registered with the Business Registry of Serbia, 32 per cent with both registries, and only two per cent with the Kosovo Business Registry. In the South, the situation is almost the opposite, where eight per cent of businesses are registered with the Business Registry of Serbia, 56 per cent with the Kosovo Business registry, and 31 per cent with both.

The next question in the questionnaire focused on the payment of taxes. Sixty per cent of K-Serbian business-

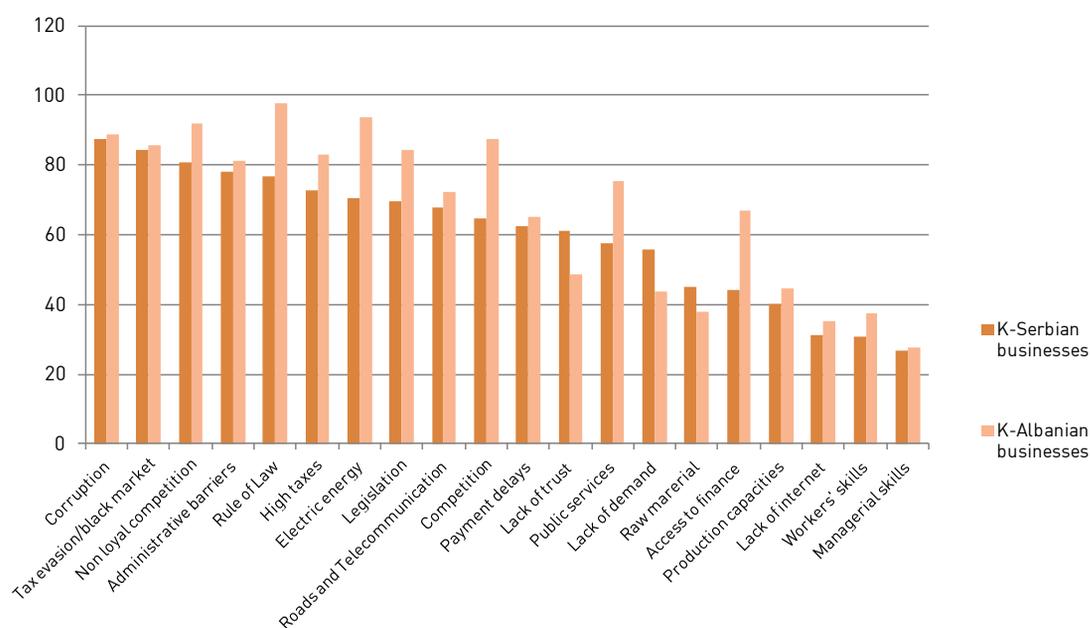
Figure 5: Registration of K-Serbian businesses in North and South



Source: Survey with businesses

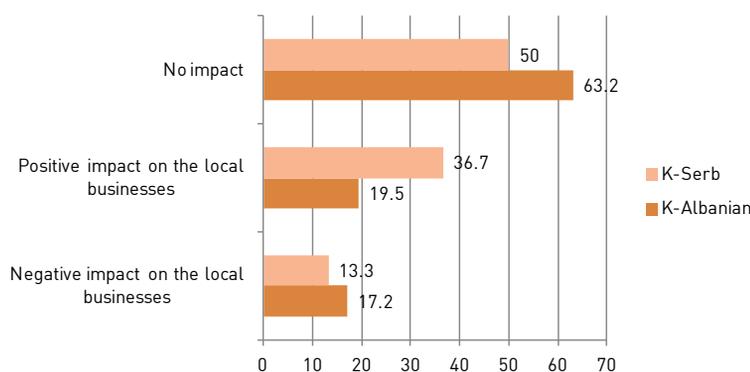
es stated that they pay taxes to the Kosovo Tax Administration, whereas 40 per cent said that they do not. Out of those who do not pay, around 60 per cent gave the reason as being that they were not registered as formal businesses, but the remainder answered that there was no tax administration office to get the forms, or to make payments. We used this question to also validate our registration data, and the results clearly show that around 25 per cent of all K-Serbian businesses are not

Figure 6: Barriers for K-Serbian and K-Albanian businesses on doing business in Kosovo



Source: Survey with businesses

Figure 7: Impact of the establishment of new local governments in the decentralized Kosovo municipalities for K-Albanian and K-Serbian businesses



Source: Survey with businesses

registered at all, the majority of them being in North of Kosovo. Another difference is evident when comparing the North with the South with respect to paying taxes. From businesses interviewed in the South, 86 per cent declared that they pay taxes to the Kosovo Tax Administration on a regular basis, whereas in the North the percentage was 34 per cent.

We had already asked about barriers to cooperation, and another important part of the questionnaire was regarding the general barriers of *doing business* in Kosovo. K-Serbian businesses ranked the barriers to doing business differently than K-Albanian businesses. In the questionnaire, we asked respondents to rank barriers from 1 to 5, 1 representing no barrier, and 5 representing a very serious constraint. The greatest barrier according to K-Serbian businesses in general is corruption. Corruption is followed by fiscal evasion and the black market. K-Serbian businesses ranked non-loyal competition third. Administrative barriers also pose problems to K-Serbian businesses and rank fourth. Rule of law is perceived as another business barrier, and ranked top amongst K-Albanian businesses. Electric power supply, which ranked second with K-Albanian businesses, ranked seventh with K-Serbian businesses. Similar to K-Albanian businesses, the last set of barriers that followed were internal issues such as a lack of access to the internet, employee level of expertise and managerial skills.

We analyzed and compared the data of K-Serbian businesses with regards to general barriers in terms of

northern and southern Kosovo. The leading barrier perceived by the northern part highlighted tax evasion and the black market. This barrier was ranked fifth in the South. Corruption was ranked as being the highest barrier to doing business in the southern part of Kosovo, whereas in the northern part it was ranked second. Non-loyal competition was the third highest barrier for those in the northern part of Kosovo, although the southern enclaves labelled it as the sixth most important barrier. Rule of law for the northern part was ranked sixth; however, in the southern part it was ranked second. Furthermore, electric power supply was considered a high barrier (fourth) in the southern enclaves, whereas in the northern community it was placed much lower, at number 11. The K-Serbian population in the North of Kosovo does not pay for electricity provided by the Kosovo Energy Corporation; nevertheless, the area is not prone to blackouts and this is probably why the business community there does not consider the lack of electric energy as a barrier to doing business.

When asked about the impact of the establishment of new local governments in the decentralised Kosovo municipalities, 37 per cent of K-Serbian businesses stated that the creation of new municipalities had had a positive impact on local business, 13 per cent stated that it had had a negative impact, whereas 50 per cent stated that it had had no impact whatsoever. However, it is important to mention that around 40 per cent of K-Serbian businesses did not answer this question. Figure 7 represents data on the impact of the establishment of new local governments in the decentralized Kosovo municipalities according to K-Albanian and K-Serbian businesses.

We also wanted to see if there were differences in opinion between businesses in the North and South regarding the impact of the decentralisation process on business development. From the businesses in the South, 54 per cent stated that the establishment of new local governments had had no impact, 16 per cent believed that it had had a negative impact and 28 per cent believed that it had had a positive effect on local business. When businesses in the North were asked the same question, almost 80 per cent did not respond, hence we do not have sufficient data to interpret a result.

All survey results can be found on the following website: www.riinvestinstitute.org.

1.4 Conclusions

As is all too obvious, political intervention to drive socio-economic integration of ethnic communities leads to progress being very slow, especially with respect to the North of Kosovo. In contrast, this study shows that there are significant opportunities to foster integration by increasing cooperation at the business level, as willingness to cooperate is evident on both sides if the potential exists to improve economic benefits and development.

When looking at the current structure of K-Serbian businesses, they are generally small with limited access to the market, limited or no access to finance, lack of linkages with K-Albanian business networks, and poor access to information. Their focus is mainly on local markets and they are active in trading and services, which promise neither high growth rates nor strong growth for employment opportunities.

Currently, the level of inter-ethnic cooperation is very low, whilst cooperation within the own community is significantly higher. The main barriers that prevent more active cooperation between K-Serbian and K-Albanian businesses are a lack of trust, isolation, low level of freedom of movement, language, poor performance of the economy, lack of rule of law and unfair competition. It is not clear why K-Serbian businesses mentioned language as a decisive barrier for cooperation, bearing in mind that businesses from Serbia are doing well selling their products to the Kosovo market.

In agribusiness, forestry and tourism, there is potential for cooperation, and through that to a limited extent, increased growth and job creation. Influence in the other direction, i.e., strong economic growth leads towards improved cooperation, is expected to be higher, given that K-Serbian businesses represent only a small fraction of the market. Therefore, measures to foster economic growth in general are central to the recommendations.

'Pure' business cooperation is a very strong driver towards building bridges over the current divisions between ethnic groups in Kosovo. Many people that were interviewed or otherwise participated in the study strongly suggested that business activities should not be linked to political problems. Nevertheless, we emphasise that business cooperation cannot be seen in isolation, and that social aspects such as trust, and political aspects such as functioning government institutions, play a similar role in ensuring that business relations do what they are supposed to do, namely to provide economic benefits in the long-term.

In the next chapter, recommendations are given as to how to positively strengthen sustainable cooperation between K-Serbian and K-Albanian businesses.

1.5 Recommendations

1.5.1 Policy recommendations

The following recommendations are targeted at the policy level and, hence, towards the Government of Kosovo. The basic premise of the recommendations is that the Government of Kosovo should follow its integration politics as laid out by the Ahtisaari Plan and included in current legislation. But it also needs to be proactive in building trust between ethnic communities, as well as engaging in activities that foster communication and linkages between all its citizens. Furthermore, it must ensure that ethnic impartiality is assured within all institutions and decision-making processes.

- Develop a new integration strategy that will give emphasis to mid-term (three to five years) activities towards the integration of the K-Serbian business community and will reduce its isolation. Businesses need to be involved in the process of developing and expanding this integration strategy.
- Strengthen the business environment and work towards economic growth on a macro-economic level through reducing barriers for doing business (such as corruption, unfair competition and administrative barriers), strengthen the enforcement of the rule of law (for example, functioning courts, security and police, and freedom of movement) and functioning institutions (such as customs, tax administration, health, and education).
- Increase the trust of the K-Serbian community in central and local institutions by providing effective public services in infrastructure, health and education, an impartial court system and freedom of movement.
- Actively ensure participation of minority-owned companies in bids for government tenders and ensure impartial assessment of offers and awarding of contracts. This will further contribute towards building trust in government institutions.
- Increase business promotion activities specifically targeting K-Serbian businesses, linking them with other businesses in Kosovo through various

events, such as fairs and other promotional activities. A creative and intensive approach is required by the Government in order to convince K-Serbian businesses to participate in such events and potential joint ventures. General business integration requires facilitation of linkages between different ethnic actors.

- K-Serbian local government (municipalities) should operate in a transparent manner and increase incentives for outside investments, thereby improving the general level of cooperation. The employment of K-Serbians in K-Albanian owned businesses could be a first step towards other business integration practices, and could instigate a change in attitude towards trusting each other.

In general, these recommendations are valid for the whole of Kosovo, including the North. In the North, however, implementation is hampered by the fact that institutional structures do not exist. Introducing measures to build trust are especially important. As the feedback loop analysis shows, in order to build trust, government institutions need to be functioning and the population needs to feel that the institutions are working in the population's interest. Hence, government services should be extended to the North as far as possible. The following policy related recommendations specifically target the North of Kosovo:

- Treat Serbian businesses from the North the same as other businesses in Kosovo if they are legally registered with the Kosovo administration. Consider them in government tenders and encourage them to apply for these.
- If the relevant paperwork is as it should be, the trading of goods should be possible and even encouraged between the North and the rest of Kosovo. Anecdotal evidence suggests that businesses from the North are having difficulties transporting their products into the South, even with valid paperwork.
- Ensure security and freedom of movement for people of the North in the whole of Kosovo.

1.5.2 Recommendations for Business Actors

The recommendations for business actors are mainly targeted towards business associations, chambers of commerce and investment agencies. However, individual businesses can also play an active role in improving relations between the business communities of the two ethnic groups.

- Business associations in Kosovo must play a more active role towards the integration of K-Serbian businesses from the South and North of Kosovo. Currently, the membership of K-Serbian businesses in these associations is at an absolute minimum. In order to improve participation rates, inclusion of a K-Serbian representative in the management structures of such associations is advisable. This will increase the trust of K-Serbian businesses in the associations.
- Associations should organize joint business fairs with a focus on promoting local products, as well as highlighting potential and other incentives for cooperation.
- Investment agencies should promote business opportunities in K-Serbian regions, with a special emphasis on the comparative advantages of these regions.

1.5.3 Recommendations for international donors

In the following pages a number of recommendations for international donors are outlined. Specific interventions can be planned either as individual projects or as separate components of bigger projects. The recommendations are targeted towards the whole of Kosovo, including the North to the extent possible. For the North, specific strategic considerations and recommendations are given below.

- Support the Government in the implementation of the policy recommendations outlined above.
- Establish programmes for the support of micro, small and medium enterprises and for market development, focusing on sectors with a high potential for integration (predominantly agribusiness, forestry and tourism). Use a

systemic approach (e.g. the Making Markets Work for the Poor Approach), including affirmative actions to increase cooperation between ethnic communities, for example through the support of joint ventures.

- Work towards reducing the isolation of the K-Serbian business community. Foster integration in business associations, chambers of commerce, trade and business promotion activities, etc.
- Strengthen the capacities of municipalities in local and regional economic development in line with the on-going decentralisation process, with a focus on the new Serbian municipalities.

Taking into account the chaotic situation in the North of Kosovo, the following recommendations are proposed specifically for the North:

- Support initiatives that work towards integration, at the business level (start-up funds, training courses, linkages to the south), at the level of society (reconciliation and trust building) and at the institutional level (business registration, issuing of Kosovo IDs, etc.). Concepts which are beneficial for integration in the North need to be identified and strengthened; concepts that work against integration need to be amended or stopped. Since ideas frequently change according to the chaotic and turbulent circumstances that prevail, no specific and concrete options can be given here; indeed, interventions need to be based on current realities through thorough analyses on the ground.
- Launch an information campaign, that should be impartial to the greatest extent possible, to inform people about business opportunities in Kosovo.
- Develop a common intervention strategy in the North between all current donors and coordinate their interventions accordingly in order not to duplicate each other or worse, work against other donors' interventions. The strategy needs to take into account the principles for taking decisions in 'chaotic systems' as outlined in the methodology section of this report.

Because of the clear characteristics of a chaotic system in the North, the following principles need to be followed for every intervention:

- The context in the North is different to the rest of the country, as has been outlined in this report. Therefore, to simply extend programmes from the South into the North carries an inherent risk that those interventions will not work or might even harm the goal of successful integration. For the North, separate context analyses need to be carried out, and the solutions and interventions have to be based on their results.
- The effects of every intervention need to be closely and continuously monitored. Interventions that support integration should be strengthened; interventions that might be harmful for the integration process have to be changed or stopped quickly. Interventions can quickly turn from one type into the other. A “do-no-harm” approach needs to be applied.
- Project managers need to undertake careful risk assessments when selecting local partners since there is anecdotal evidence of influential people in the North increasingly claiming donor grants and using them for their own benefits. Donors should exchange their experiences with local partners to improve the fair distribution of donor money.
- The subsequent application of conflict sensitive project management needs to be ensured for all interventions in the North.
- The Government of Kosovo, with the help of donors, could create a fund for economic integration and cooperation of business communities with the purpose of supporting:
 - Promotion of investment opportunities for K-Serbian businesses through, for example, the creation of agencies for inter-ethnic business cooperation, creation of business alliances, participation in campaigns to promote investments, trade and investment missions of Kosovo on an international level
 - Ensuring support for fiscal incentives for K-Serbian production businesses which are registered in the Kosovo Business Register, and businesses which operate as a result of joint investments with K-Albanian business partners
 - Encouraging involvement of K-Serbian business in applying for governmental tenders either alone, or in cooperation with K-Albanian businesses, especially with regards to participating in the privatization process of SOEs and POEs.

1.5.4 Options for concrete activities

In this section, a number of concrete activities will be proposed that are in line with the recommendations above.

- The Government of Kosovo, with the help of donors, could establish information centres, one-stop shops and other service centres in order to stimulate the formalisation of current K-Serbian businesses and facilitate new business registrations and operations. These centres would provide relevant services and information with regards to laws, operational requirements, as well as state benefits as a result of registration (application for government tenders, government subsidies, bank loans, etc.).
- Despite the participation of the K-Serbian community in key governmental positions, it is necessary to ensure adequate participation in governmental positions further down the hierarchy. This would demonstrate administrative integration, thereby assuring greater impartiality in decision making processes. In this sense it is especially necessary to ensure the participation of K-Serbian representatives in agencies relevant to trade and business development, as well as security and freedom of movement, such as the tax administration, customs service, police, etc.
- Provide fiscal amnesty to those businesses not yet registered, but which are ready to take the necessary steps to register, in order to encourage the transformation and formalisation of other businesses.

PART II

2.1 Methodology

2.1.1 Desk Research

Desk research comprised the identification and review of key existing literature on legal and policy frameworks, a review of analyses and research already undertaken on this issue, and other printed, electronic, published and unpublished documents, as well as international, regional and local research documents from international and local institutions, and international and local NGOs.

Desk research analyses were used as a basis for background information (chapter 3 of the report), description of the system, and development of the questionnaires for the survey and key informant interviews. Information gathered during the desk research was also used for stakeholder identification and selection of key informants. The criteria for key informant selection were based mainly on the interests and knowledge of stakeholders, as well as the past and future involvement of the K-Serbian community in Kosovo in various types of initiatives for economic integration.

2.1.2 Key informant interviews

Interviews with stakeholders were based upon the exchange of information on the current situation in terms of policies, regulation, market development, best practices and lessons learned. In order to gain a realistic picture of their views, 19 semi-structured interviews were performed with representatives of Kosovo institutions, international bodies, Serbian bodies, civil society organizations, business associations, as well as K-Albanian and K-Serbian business representatives (for the full list of interviewees please see annex 1). However, it was obvious that responses were based mainly upon the personal perceptions of individual respondents, and there is an evident lack of research done on this issue. In particular there was a lack of information on the actual structure of K-Serbian businesses and their economic potential.

In order to ensure the maximum level of legitimacy, interviews with K-Serbian business representatives were conducted by an international consultant in cooperation with Avenija. Bearing in mind the sensi-

tive nature of the subject, the conversations were not recorded and we opted to take notes which were later transcribed for systematic qualitative data analyses.

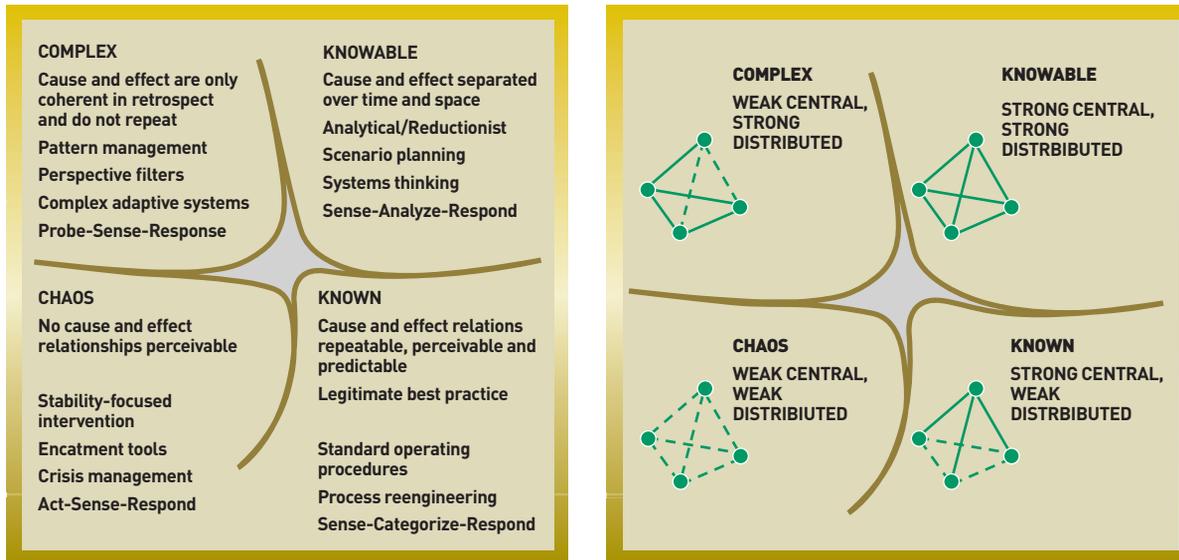
2.1.3 Survey

This report portrays the results from a survey with 300 businesses (managers), who shared information regarding their perceptions about inter-ethnic businesses interaction, barriers and opportunities for business development, incentives for business cooperation, and the current situation of their business. Comments needed to be assessed both from K-Serbian and K-Albanian businesses in Kosovo. To meet this requirement, 100 survey interviews were conducted with K-Albanian businesses and 200 survey interviews with K-Serbian businesses.

In order to be able to differentiate between businesses in the North of Kosovo and in other areas, a stratified sampling was done considering 100 businesses from each region. Due to parallel Kosovo and Serbian institutions being active in the same areas, a double system of business registration process exists. As a consequence, K-Serbian businesses are only partially registered with the Kosovo Business Registry. Unfortunately, the true number of companies registered with the Serbian Business Registry could not be obtained from the relevant authorities. As a result, the actual number of K-Serbian businesses in Kosovo is unknown. Therefore, the TAK database, in combination with the identification of businesses in the field by Avenija, was chosen to make the selection of businesses.

Although we acknowledge that a selection of 100 companies is not a representative sample for K-Albanian businesses in Kosovo, the choice was made with the intention of getting a feeling for the K-Albanian perspective. This sample was drawn therefore from the group of businesses with a higher probability of cooperating with K-Serbian businesses, generally comprising larger production and trade companies. The sample of 100 businesses for survey interviews with K-Albanian businesses was taken from the 600 largest production and trade businesses on the TAK database.

Figure 8: *The Cynefin framework. The known and knowable domains also stand for simple and complicated, respectively. The left illustration describes the four domains, the right illustrates the influence of the interconnections and the degree of centrality.*



Source: Kurtz and Snowden, 2003

To the extent possible, businesses were selected at random from the available lists. The survey target was active businesses, operating in Kosovo (ensuring a proportional balance amongst different regions). The sample size allows the disaggregation of data based on the following groupings: K-Albanian businesses, K-Serbian businesses in the North of Kosovo, K-Serbian businesses in other regions of Kosovo.

2.1.4 Case study analysis

Information from interviews and surveys was used to identify potential case studies, based on successful cooperation between K-Serbian and K-Albanian businesses in Kosovo. Five case studies from different regions were identified to represent a model of interethnic business cooperation for other businesses in Kosovo. In-depth interviews were used as a methodology for data gathering from four business representatives and one focus group which was organized in cooperation with the Strpce Municipality. The focus group was comprised of berry production businesses, being the best representatives of inter-ethnic cooperation where K-Serbian and K-Albanian businesses are equally involved.

Case study methodology was not based on questionnaires or survey instruments in order to not prede-

termine primary issues or factors. Instead, interviews were open-ended and conducted according to case study guidelines, developed in advance by the team, with a list of categorized questions of relevance.

2.1.5 Systems analysis

2.1.5.1 Introduction: from simple to complex

The methodology used for the System Analysis is based on the work of Peter Frischknecht and Barbara Schmied (2009) from the Department of Environmental Sciences at the Swiss Federal Institute of Technology, Zurich. It has been combined with a concept of sense making and strategy development in complex and complicated environments called the Cynefin Framework, developed by Cynthia F. Kurtz and Dave J. Snowden (2003) at IBM Global Services⁷.

Both publications differentiate between situations that are simple, complicated, or complex. Kurtz and Snowden furthermore add 'chaotic' situations. The main differentiations between the domains are the

⁷ IBM - International Business Machines Corporation

number of elements in the system under consideration as well as their connectedness. Generally, more elements in a system and more connections lead to a greater difficulty to determine cause and effect and, therefore, to predict the behaviour of the system. Another defining aspect is the degree of centrality, i.e., whether there is a central power that controls the system. The relationship between cause and effect becomes unpredictable in complex systems and in chaotic systems it breaks down completely. In every domain, different decision models are needed. The Cynefin Framework is shown in Figure 8.

The two domains that are most relevant for the systems that are assessed in this report are the complex and the chaotic domains.

Complex domain: Cause and effect relationships are often not assessable because of the high number of agents and the high number of relationships. Patterns that emerge are only coherently assessable in retrospect but are not predictable. To base a strategy on retrospectively coherent patterns will only cause new and different patterns for which given procedures are ill prepared. Hence, categorization or analytic techniques are not useful. The decision model here is to create probes to make patterns or potential patterns more visible before taking any action. Once the patterns can be gauged, the response is to stabilize those patterns that are found desirable, to destabilize those that are not desirable and to create space so that desirable patterns are more likely to emerge.

Chaotic domain: In the chaotic domain, there are no perceivable relations between cause and effect and the system is turbulent. There is no time to investigate change. The decision model in this domain is to act, quickly and decisively, to reduce the turbulence; and then to gauge immediately the reaction to that intervention so that we can respond accordingly. Authoritarian interventions might be used to control the space, or alternatively multiple interventions can be used to create new patterns and thereby move the situation into the complex space.

2.1.5.2 Overview of the systems analysis

Whilst the Cynefin framework supplies the basis to characterize a given situation, the system dynamics analysis (SDA) introduced by Frischknecht and Schmied provides a comprehensive approach to assess a system and make sense of its dynamics. Thereby, it can take on different shapes to support the decision models for the different types of systems.

In complicated systems, the aim is to develop an exact model of the system, able to simulate and, hence, predict the behaviour of the system. In complex systems, as the one at hand, systems dynamics analysis is used to identify and explain existing patterns and mechanisms that keep the patterns stabilized. In this context, it is not the aim of the analysis to present a comprehensive model of the system but to reduce the complexity in a way that the visible patterns and their rationale in the system are more accessible and useful, without negating the overall dynamics of the system.

Since interventions in chaotic systems are guided by direct and decisive action, an analysis framework such as the system dynamics analysis is of little help. In this case it is important to have a sensitive monitoring system in place to gauge the reaction of the system to the interventions. Only when the interventions have pushed the system into the complex domain, can the analysis methodologies as the one presented here be used.

All steps of the SDA are presented in Figure 1. From a methodological point of view, the problem identification and structuring is done in a team workshop where areas requiring additional information are identified. The data to fill these gaps are collected by the methods previously described, in order to undertake the stakeholder analysis, economic analysis, analysis of rules and regulations, as well as the analysis of cross cutting issues.

The step to understanding the interdependencies is separated into two main analyses; the sensitivity analysis and the feedback loop analysis, presented in more detail below.

Since the aim of this study is to present recommendations, the steps of intervention design, valuation and implementation are not considered at this time.

2.1.5.3 The Sensitivity Analysis

Based on the information gathered in the previous steps, a set of impact factors is defined to describe the system. As previously mentioned, it is not the aim of this analysis to comprehensively cover all possible factors and dynamics, but to show the most important patterns. Therefore, and for reasons of practicality, the number of impact factors should be kept as small as possible, but still large enough as to present a meaningful picture.

In order to understand the interdependencies, the impact of every factor on every other factor is assessed on a relative scale of 0 (none), 1 (weak), 2 (medium), and 3 (strong) and presented in the so-called 'impact matrix'. The sum of all impacts on one specific factor determines its activity and passivity levels, i.e., how much it influences the system, or not. The impact factors or variables, as they are also called because of their variable nature, can then be plotted on a so-called 'impact diagram', a graph with passivity on the x-axis and activity on the y-axis. By using the average activity and passivity to divide the impact diagram into four quadrants, the variables can be characterized as active, critical, passive, or buffering, depending on the quadrant they are located in.

Active factors: These factors have a strong influence on the system, and the system's influence is weak. They can be used as leverage points.

Passive factors: These factors have a weak influence on the system but are strongly influenced by it. They can be seen as indicators.

Critical factors: These factors have a strong influence on the system and are strongly influenced by it. They are drivers and catalysts of the system. When influencing them, one has to be aware of the danger of overheating the system.

Buffering factors: These factors have a weak influence on the system, and the system's influence on them is also weak. They are usually seen as stabilizers of the system.

2.1.5.4 The Feedback Loop Analysis

In the feedback loop analysis, a diagram is drawn that contains only the most significant impacts identified in the sensitivity analysis described above. These impacts are drawn as arrows between the impact factors. The impact can be either protagonistic, i.e., both factors change in the same direction, or antagonistic, i.e., the variables change in the opposite direction. This is indicated by a plus or a minus sign next to the arrowhead.

Based on this impact diagram, feedback loops can be identified. There are two basic types of feedback loops, the reinforcing loops and the dampening loops. To determine whether a loop is reinforcing or dampening one has to count the number of negative arrows. Is this number even, then the loop is reinforcing, is it odd, then it is dampening.

Reinforcing loops can be both virtuous and vicious circles, depending on the dynamic of the system. One possible goal of an intervention could be to invert the dynamics of such a loop from a vicious to a virtuous circle or to enforce the virtuous circle compared with the rest of the system. But reinforcing loops can also destabilize a system if they get out of control.

Dampening loops stabilize the system. They counteract any extreme reaction, both in the positive and in the negative. Usually these loops are important if we ask why a system is not reacting to our interventions. There is usually a feedback loop that dampens the reaction of the system to the intervention and keeps it in its present state.

2.2 Systems Analysis

2.2.1 Characterization of the system

The system that was analysed in this study looks into the economic cooperation between K-Serbian and K-Albanian communities in Kosovo. This cooperation is influenced by various factors outside the economic domain, specifically from the realms of society, politics, institutions, and the informal sector. Furthermore, the system is heavily influenced by very recent historic events such as the war in Kosovo in 1999, the ethnic tensions in Kosovo in the spring of 2004, or the barricades put up by the Serbian minority in northern Kosovo in July 2011. These different realms are populated by a variety of actors with very heterogeneous agendas ranging from politics and commerce, to personal interests. Systems exhibiting such characteristics – a high number of actors with different interests and other influencing factors as well as the high interconnectedness of all factors – are categorised as complex systems; hence, they are inherently unpredictable and cannot be condensed to produce a simple model.

A clear differentiation has to be made between the situation in the South, where clear patterns of cooperation and more or less obvious disincentives for cooperation can be identified, and the North, which exhibits only a very limited degree of coherent patterns and where the only patterns that are coherently reported by different sources are the ones of organised crime, strongmen-politics and violence. The recurring uprisings and political and administrative interventions from the Government of Kosovo, the Serbian Government as well as the international community, further destabilise the situation. Thus, the North of Kosovo exhibits clear characteristics of a chaotic system where cause and effect relationships are obsolete, the situation is turbulent and all emerging patterns are frequently disrupted by political, often violent events.

Small events can trigger great disruption which in turn can completely change intervention priorities. Based on these considerations, different decision models and strategies have to be applied to develop recommendations and interventions for the North and the South.

Due to the characteristics of chaotic systems, deeper analysis in the North will not lead to any usable findings, since patterns are disbursed quickly and any insight established through analysis or probing will be useless within short time due to the high turbulence in the system. Hence, the SDA has been focused on the South. Nevertheless, considerations for possible interventions in the North have been made based on the decision model given by the Cynefin framework and will be expressed in the recommendations chapter.

2.2.2 Defining the system model

The first step of the SDA is to define the variables that shape the system. When working in complex systems, it is the aim of the SDA to discover patterns and make the dynamics and influences that build these patterns visible and accessible, not to build a representative model that reflects every aspect of the system. Therefore, it was our aim to use only a small number of the most important variables to describe the system. A number of variables that are strongly connected were combined into one to increase clarity. For example, the performance of the sectors where cooperation is most common and the performance of the individual businesses, since they are correlating in any case, are taken together into a variable of economic performance. A total of 16 variables were defined. They are presented and described in Table 1.

Table 1: *Description of the variables used for the system dynamics analysis*

No	Variable	Description/Indicator
1	Trust in Kosovo institutions	Share of businesses and of the general community that expresses trust in institutions of the Republic of Kosovo such as ministries, government organizations, courts, freedom of the market, etc.
2	Acceptance of the political status	Share of K-Serbian that accept the political status of the independence of the Republic of Kosovo.
3	Rule of law enforcement	Degree of enforcement of the rule of law, especially contract enforcement, property rights, tax collection, business registration, security of assets and personal security.
4	Peer pressure	The degree to which businesses perceive they are pressured by peers not to do business with companies owned by people of other ethnicities.
5	Anti-integration politics	Degree of influence of interest groups promoting anti-integration politics and nationalism based on patriotism or because they benefit from the current situation. Combining both political and business influence groups.
6	Pro-integration politics	Degree of influence of political activities and interest groups that foster integration of minorities.
7	Economic performance	Economic performance of individual businesses (turnover) reflected in the growth of the sectors where cooperation is most common (e.g. agriculture, tourism).
8	Isolation of the K-Serbian community	Isolation of the K-Serbian community through limited media coverage in the Serbian language, low security and limited freedom of movement, lack of access to business networks and trade fairs, lack of information about market opportunities in the Serbian language, perceptions of the quality of K-Serbian products, etc.
9	Level of cooperation	Number of K-Albanian and K-Serbian businesses that are cooperating in a business relationship that provides economic benefits for both sides.
10	Unfair competition	Lost business through informal economy, tax evasion, cartels/monopolies, and organized crime
11	Barriers for business	Lost business through non-functioning institutions, lack of infrastructure, limited access to finance, limited availability of skills, low production standards, lack of quality assurance practices, etc., as determined by the survey.
12	Competitiveness of Serbian businesses	Competitiveness of Serbian businesses in the general economy of Kosovo compared with Albanian businesses
13	Integration into the Kosovo market	Degree of participation of K-Serbian businesses in the overall market of Kosovo, accepting the market related institutions of Kosovo
14	Functioning of government institutions	Existence, effectiveness and efficiency of institutions of the Government of Kosovo
15	Trust between ethnic groups	Level of trust between ethnic groups on a community level.
16	Influence of Serbian parallel structures	Level of influence the Serbian parallel structures can exercise on the population and businesses.

In order to determine whether the chosen variables cover the whole system in an even way, a relevance assessment of the variable set was performed. Thereby, five domains were considered: society, politics, business/economy, institutions, and the informal sector. All variables were assessed regarding their coverage of the domains. The result of the relevance assessment is presented in Table 2. In addition, it is shown which variables have effects outside the system and which variables are affected from by external influences. It can be seen that the variables are well spread, covering all domains to an even extent. Effects *from* the outside are higher than effects *to* the outside. The outside effects must be considered when interpreting the results of the analysis.

Table 2: **Relevance assessment of the set of variables**

1		Society	Politics	Business/ Economy	Institutions	Informal sector	Effect to outside	Affected from outside
1	Trust in Kosovo institutions	x	X		x			
2	Acceptance of the political status	x	X		x		x	X
3	Rule of law enforcement			X	x	x		X
4	Peer pressure	x	X			x		
5	Anti-integration politics	x	X				x	X
6	Pro-integration politics	x	X				x	X
7	Economic performance			X	x	x		X
8	Isolation of Serbian community	x	X					
9	Level of cooperation	x		X		x		
10	Unfair competition			X	x	x		
11	Barriers for business			X	x	x		
12	Competitiveness of Serbian businesses			X	x			
13	Integration in Kosovo market		X	X	x			
14	Functioning of government institutions		X		x			
15	Trust between ethnic groups	x	X					
16	Influence of Serbian parallel structures		X		x	x		X
	Sum	8	10	7	10	7	3	6

2.2.3 Sensitivity analysis

In the sensitivity analysis, the impact of every variable on every other variable was determined in a team discussion. The aim was to do this to the extent possible in an objective way, based on the collected data. It is important to mention that these influences still remain subjective to a certain extent, and that other assessments would likely produce different results. This is, however, inherent to complex systems.

The sum of all impacts of one specific factor on all other factors determines its activity level, i.e., how much it influences the system, and the sum of all impacts on one specific factor its passivity level, i.e., how much it is influenced by the system. Based on their activity and passivity, variables can be characterized as active, critical, passive, or buffering.

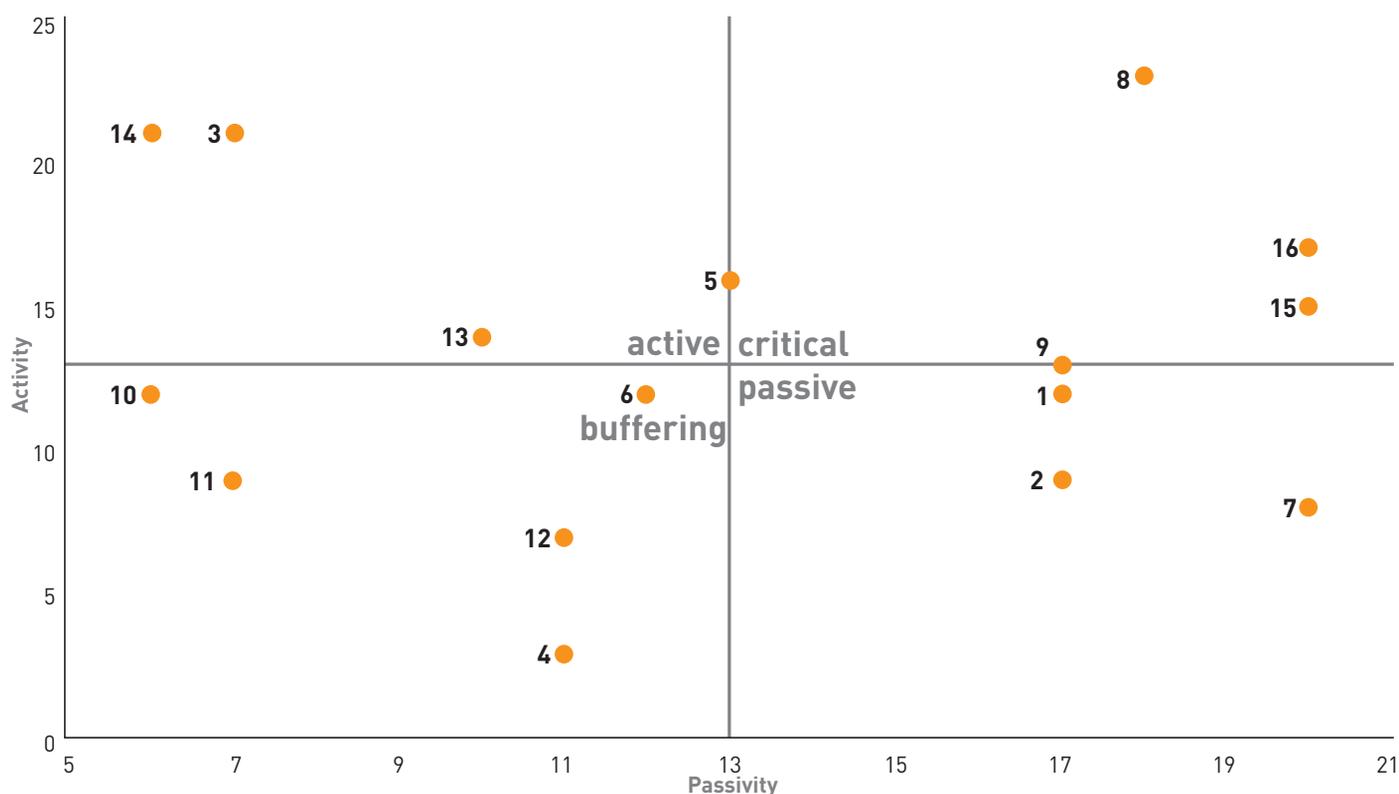
The results of the sensitivity analysis can be used to give a sense of the relative importance of the different variables. The impact matrix that is reflecting all impacts is shown in Table 3.

Table 3: *Impact matrix*

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	
	Variable	Trust in Kosovo institutions	Acceptance of the political status	Rule of law enforcement	Peer pressure	Anti-integration politics	Pro-integration politics	Economic performance	Isolation of Serbian community	Level of cooperation	Unfair competition	Barriers for business	Competitiveness of Serbian businesses	Integration in Kosovo market	Functioning of Government institutions	Trust between ethnic groups	Influence of Serbian parallel structures	Activity
1	Trust in Kosovo institutions	3	1	0	0	0	0	0	0	0	0	0	0	3	0	2	3	12
2	Acceptance of the political status	0	3	1	3	0	0	0	0	0	0	0	0	0	2	0	3	9
3	Rule of law enforcement	3	0	0	0	0	3	3	0	3	3	2	0	2	0	2	2	21
4	Peer pressure	0	0	0	0	0	0	0	3	0	0	0	0	0	0	0	0	3
5	Anti-integration politics	2	3	0	3	0	0	2	0	0	0	0	0	0	0	3	3	16
6	Pro-integration politics	1	3	0	0	0	0	3	0	0	0	0	0	0	0	3	2	12
7	Economic performance	3	0	0	0	0	2	0	3	0	0	0	0	0	0	0	0	8
8	Isolation of Serbian community	2	2	0	2	2	2	1	0	3	0	1	3	1	0	2	2	23
9	Level of cooperation	0	0	0	0	2	2	3	0	0	0	1	3	0	2	0	0	13
10	Unfair competition	3	0	0	0	2	0	3	0	0	0	2	0	0	2	0	0	12
11	Barriers for business	0	0	0	0	0	0	3	0	3	0	3	0	0	0	0	0	9
12	Competitiveness of Serbian businesses	0	0	0	0	0	0	2	0	2	0	0	3	0	0	0	0	7
13	Integration in Kosovo market	0	0	0	2	3	2	3	2	0	0	0	0	0	3	1	1	16
14	Functioning of Government institutions	3	0	3	0	0	2	2	2	0	3	3	0	0	1	2	2	21
15	Trust between ethnic groups	0	3	0	3	1	0	0	3	2	0	0	0	0	0	2	2	14
16	Influence of Serbian parallel structures	0	3	2	0	3	2	0	3	0	0	0	0	0	2	2	0	17
	Passivity	17	17	7	13	13	12	20	18	16	6	7	11	10	6	20	20	213

Based on the activities and passivities calculated in the impact matrix, an impact diagram was drawn. In the impact diagram (Figure 9), every variable is plotted with the activity on the y-axis and the passivity on the x-axis.

Figure 9: Impact diagram



Source: systems analysis

The impact diagram is divided into four quadrants by using the average activity and passivity, respectively. Variables are characterised as active, critical, buffering, or passive depending on their location in the diagram. Table 4 ranks the most active and most passive variables, respectively. Not all variables are, however, possible to influence by system actors. Table 5 interprets the characteristics of the variable and determines whether it is possible to influence them.

Table 4: Ranking of the variables according to their activity and passivity, respectively

55	Rank	56 Activity		57 Passivity	
		No	Variable	No	Variable
1		8	Isolation of the Serbian community	15	Trust between ethnic groups
				16	Influence of Serbian parallel structures
				7	Economic performance
2		14	Functioning of government institutions		
2		3	Rule of law enforcement		
4		16	Influence of Serbian parallel structures	8	Isolation of the Serbian community

Table 5: *Interpretation of the impact diagram and possibility to influence the variables*

No	Variable	Interpretation
Active		
Active variables have a strong influence on the system but the system's influence is weak. They are critical leverages that can be used to influence the system.		
3	Rule of law enforcement	A functioning and enforced rule of law clearly has a strong influence on the system. Rule of law is the precondition for functioning markets and preventing market failure by providing contract security and the possibility to go to a court to enforce laws; it provides the security to invest in future business ventures and expansion. It is also the basis for freedom of movement and security for all people. A functioning rule of law is not strongly influenced by the rest of the system since it is something that has to be enforced by the Government, through institutions such as the courts or the police. <i>This variable can be influenced by policy measures.</i>
5	Anti-integration politics	Anti-integration politics are strongly driven by a part of the Serbian community that is oriented towards Serbia. The influence of this variable is great since it shapes the Serbian community. It has to be taken into consideration when wanting to change the system since it is a variable that can contribute to the resistance of the system to change, as can also be seen in the loop analysis below. This variable is on the edge of the critical quadrant. Hence, it runs the risk of contributing to uncontrolled behaviour of the system. <i>This variable is difficult to influence both from a policy perspective as well as from the point of view of an international donor.</i>
13	Integration into the Kosovo market	The integration of businesses into the market in Kosovo can have a strong influence on the whole system. Integration can, however, not directly be influenced and is an emerging property of the system. In our system it is closest to what we would call the target variable, i.e., the variable that is targeted to increase by project interventions. <i>No direct influence possible.</i>
14	Functioning government institutions	With an activity such as the rule of law ⁸ , the functioning of government institutions is an active element of the system. Only with functioning and credible institutions can the Government of Kosovo gain the trust of the Serbian communities to involve their companies in the Kosovo market. Furthermore, functioning institutions mean less bureaucracy, less red tape, leaner procedures, etc. <i>This variable can be influenced by policy measures.</i>
Critical		
These factors have a strong influence on the system and are also strongly influenced by it. They are drivers and catalysts of the system. One central characteristic of critical variables is that changes in these variables will most probably reflect back on the variables themselves. How that might happen has to be determined by the feedback loop analysis. When influencing them, one has to be aware of the danger of overheating the system by tapping into positive feedback loops.		
8	Isolation of the Serbian community	The isolation of the Serbian community has a passivity that is above average, i.e., it is disproportionately influenced by the system. At the same time, it is the most active variable of all, i.e., it also has a strong influence on the system. This is one variable with much potential as an entry point. <i>The variable is composed of many factors, most of which can be influenced by both policy measures as well as donor led projects.</i>
9	Level of cooperation	The level of cooperation is a variable at the edges between critical and passive. It is influenced by the system relatively strongly, but does not influence the system as much as other critical or active variables. This suggests that an indirect approach to increase cooperation will be more successful in the long term. <i>The variable can be either directly targeted by interventions or indirectly and in a more systemic way by influencing the system, so that the level of cooperation increases in a sustainable way.</i>

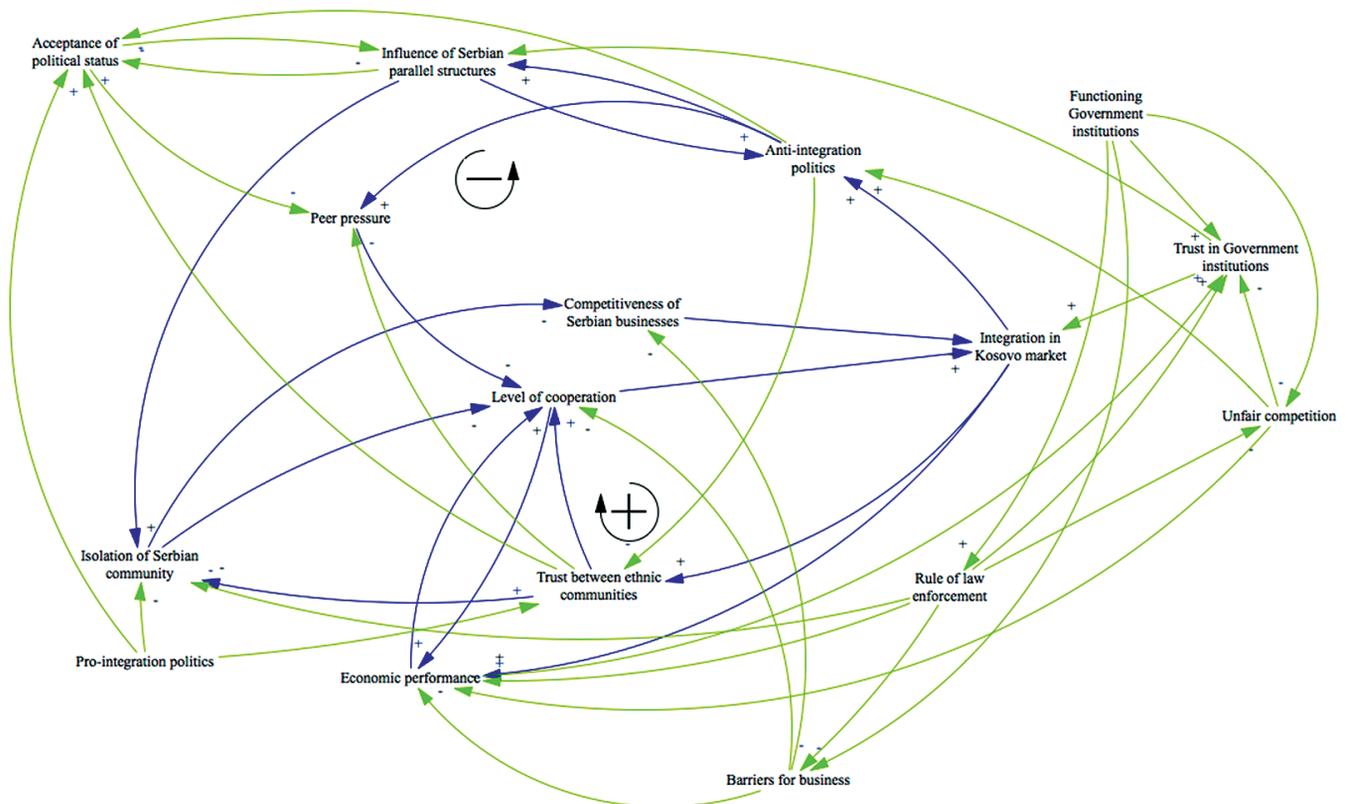
⁸ Technically, rule of law is also an institution. But since it has been mentioned separately many times in this analysis, it was taken as a separate variable.

15	Trust between ethnic groups	Trust between ethnic groups is amongst the most passive variables of the system, though still exhibits activity above the average. It is less active where the Serbian community is more isolated, i.e., it exhibits a less relevant role in changing the system. <i>Trust is an emergent aspect of a social system and is difficult to influence through policy changes or donor interventions. Some projects have tried to establish trust-building platforms, which could be seen as a possible approach.</i>
16	Influence of Serbian parallel structures	Interestingly, the influence of the Serbian parallel structures also shows critical characteristics. This is mainly because its influence is strongly dependent upon the performance and acceptability of the Government and institutions of Kosovo, as well as the level of isolation and influence of anti-integration politics. At the same time, parallel structures have a considerable influence on the system mainly because they pay salaries to a significant number of Serbian people, and also influence anti-integration politics. <i>The influence of the Serbian parallel structures can hardly be changed by policy measures or donor interventions without risking a significant and unpredictable change in the system, for example as was witnessed in the North of Kosovo in 2011.</i>
Passive		
These factors have a weak influence on the system but are strongly influenced by it. They can be seen as indicators. We have to take into account, however, that our set of variables is only a selection of the most relevant and, hence, a set of variables that generally express high activity in the overall system. What is determined by this analysis is merely their status relative to the other variables of the set. For this reason, by the very nature of their selection, all variables express a certain influence on the overall system, and therefore passive variables should not be dismissed as possible entry points.		
1	Trust in Kosovo institutions	The significance of this variable lies in the discussion about the acceptance of the State of Kosovo by the Kosovo Serbian population. Only if they have enough trust in the institutions of Kosovo will they be ready to accept the political status of Kosovo, and to reduce and eventually eliminate the influence of the parallel structures. <i>This variable is a good indicator to assess the willingness of K-Serbs to integrate into the new structures. Active trust-building can support this.</i>
2	Acceptance of political status	The acceptance of the political status is seen by many as a precondition for fully working institutions and enforced rule of law, especially because of the current lack of clarity as to which legal framework and which institutions the people accept. <i>This is an emergent property of the system and cannot directly be influenced.</i>
7	Economic performance	The economic performance has earned its passive characterisation in this system because its activity is predominantly directed towards the level of cooperation. There, however, it exerts a strong influence. <i>If this variable is to be used as an indicator, it needs to be separated from the influence of cooperation and external influences on the economy.</i>
Buffering		
These factors have a weak influence on the system and are weakly influenced by it. They are usually seen as stabilisers of the system.		
4	Peer pressure	Buffering variables have neither a strong influence on the system nor do they strongly influence the system. From the set of variables, the unfair competition is the most active, together with the pro-integration politics. They exhibit, however, a lower activity compared with other variables and are therefore not the first choice as intervention targets. Although peer pressure is named by many as a decisive factor, both the survey as well as various discussions with a number of business managers showed that its influence is very limited, if any. In addition, the competitiveness of Serbian businesses does not seem to be a major concern, primarily because of the small number of Serbian businesses; it would not be very influential on the overall system.
6	Pro-integration politics	
10	Unfair competition	
11	Barriers for business	
12	Competitiveness of Serbian businesses	

2.2.4 Loop analysis

In the loop analysis, the impact matrix is visualised, i.e., the impacts between the variables are shown as arrows. Since the display of all impacts in this complex system would not lead to much clarity, only strong impacts (value 3) are shown in Figure 10.

Figure 10: Feedback loop diagram



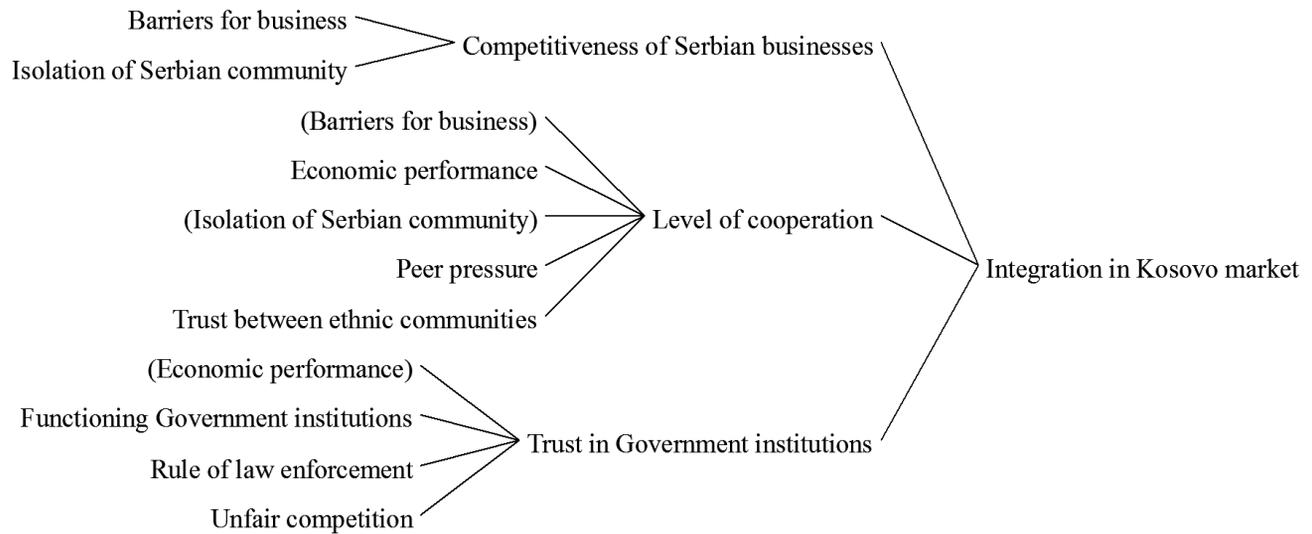
Source: systems analysis

Finding ways to foster the integration of K-Serbian businesses in the Kosovo market is the main purpose of the study. Figure 11 shows the cause tree for this variable, i.e., how this variable is influenced. There are three ways. The first is to encourage K-Serbian businesses to be more competitive in the Kosovo market (with other companies). As seen above, the competitiveness of Serbian businesses is only a buffering variable with little influence on the system.

The second way is to promote increased cooperation with K-Albanian businesses. This could be done directly by encouraging cooperation, for example with conditional grants or loans. A more systemic solution would be, however, to achieve this goal indirectly, for example by reducing the 'Isolation of the Serbian community', a critical variable that is directly influencing the level of cooperation.

A third factor influencing integration is the trust in government institutions. Two active variables can be influenced in the cause tree to improve the trust in government institutions. These are the 'rule of law enforcement' as well as the 'functioning of government institutions'. These two variables are, therefore, prime entry points for policy interventions.

Figure 11: Cause tree for integration in the Kosovo market

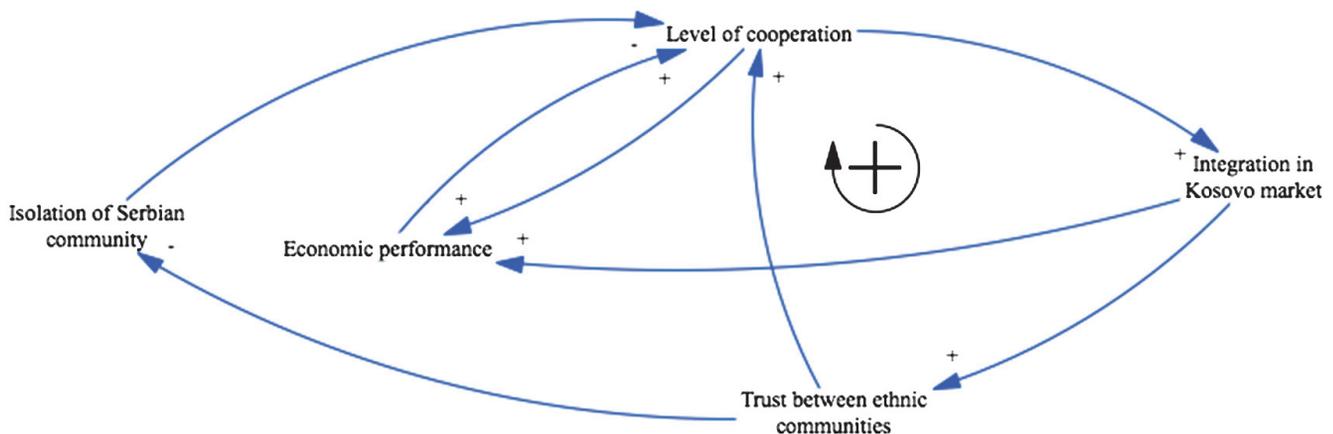


Source: systems analysis

There are two feedback loops that are connected to the first two impact pathways, one is a reinforcing loop, the other one a dampening loop, illustrated by blue arrows in Figure 10. The dynamics of these two loops predict that the system is relatively stable without much change. If the reinforcing loop increases integration in Kosovo market, the other loop buffers this movement.

A total of nine variables are directly involved in the loop. The other eight variables of the model are influencing the loop from the outside, illustrated by green arrows. Some of those variables are again interconnected.

Figure 12: Reinforcing loops



Source: Systems analysis

Figure 12 shows the reinforcing feedback loops. To further simplify the illustration, the pathway via 'Competitiveness of Serbian businesses' is not shown since it is not considered to be decisive.

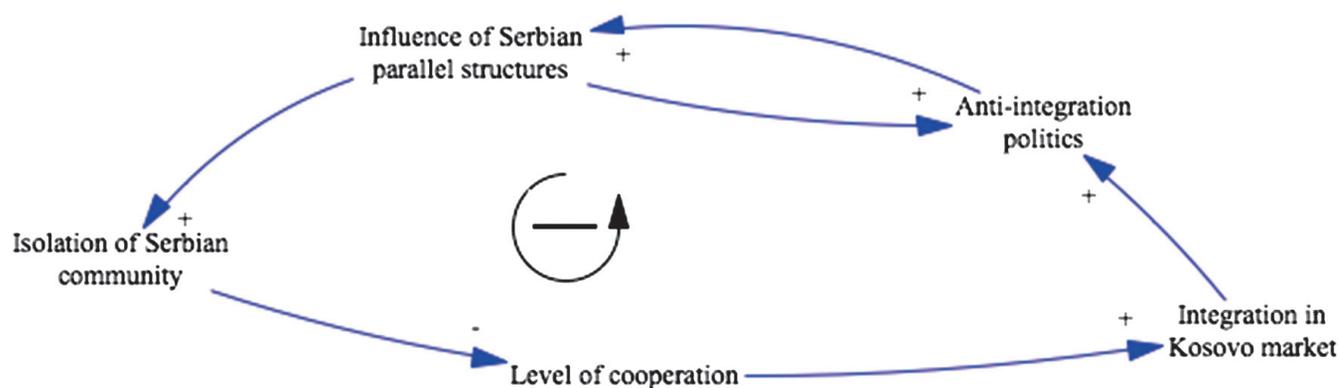
This loop shows us that an *increased level of cooperation* leads to increased integration in the Kosovo market. Higher integration into the Kosovo market leads to increased economic performance, leading again to *increased levels of cooperation*. Furthermore, greater integration into the Kosovo market also leads to increased trust between ethnic communities, which in turn leads directly to the reduction of isolation of the Serbian community and *increased levels of cooperation*.

Figure 13 shows the dampening feedback loops, again not considering the pathway via competitiveness of Serbian businesses. Peer pressure is also not shown as it has been assessed as a buffering variable and therefore as being less influential.

In this case, *increased integration* into the Kosovo market leads to increased efforts of anti-integration politics to counteract this development. This, in turn, leads to an increased influence of Serbian parallel structures, which again increases the isolation of the Serbian community, decreasing the level of cooperation and eventually leading to a *decreased level of integration*.

Note that there is a small reinforcing loop in this constellation, i.e., the reinforcement of anti-integration politics and the influence of the Serbian parallel structures.

Figure 13: Dampening feedback loops

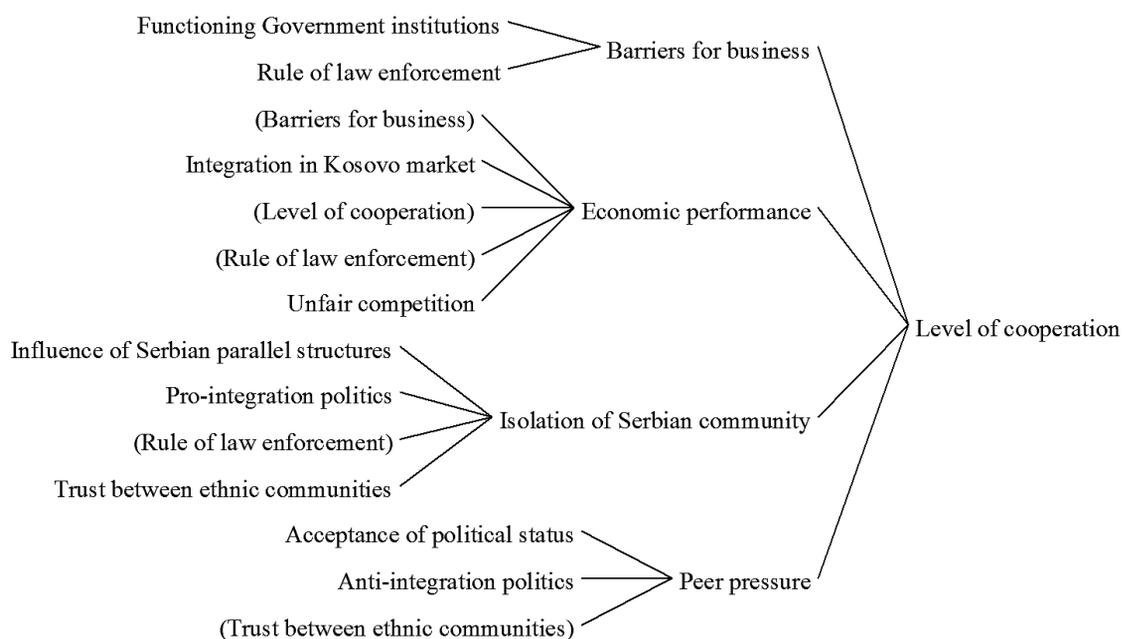


Source: systems analysis

2.2.5 Selection of variables for intervention

As could be shown through the sensitivity and the loop analyses, the variables that have the highest likelihood of leading to the desired changes are (1) the 'level of cooperation', (2) the 'functioning of government institutions' and (3) the 'rule of law enforcement'. Changes to the latter two are best achieved on a policy level, the level of cooperation is, as previously mentioned, best increased indirectly.

Figure 14: Cause tree for the level of cooperation



Source: Systems analysis

Figure 14 shows the cause tree for the variable 'level of cooperation'. Considering the sensitivity analysis, prime entry points are the isolation of the Serbian community as well as 'economic performance'. 'Barriers for business' is a buffering variable but still with a relatively high activity and could additionally be taken into consideration. 'Peer pressure' on the other hand is not seen as influential enough to make any change and would furthermore be difficult to influence.

The isolation of the Serbian community, as seen above, is a critical variable, as well as the variable with the highest activity of the system. It is therefore a very logical and obvious entry point for interventions. All priority variables for interventions are listed in Table 6.

Table 6: Priority variables for interventions identified by the SDA

No	Variable	Type
9	Level of cooperation	Critical
14	Functioning of government institutions	Active
3	Rule of law enforcement	Active
8	Isolation of the Serbian community	Critical
7	Economic performance	Passive
11	Barriers for business	Buffering

By improving the three variables 'isolation of the Serbian community', 'economic performance', and 'barriers for business', the reinforcing loop is strengthened. But in order to make the interventions sustainable and effective, the dampening loop too has to be taken into account. The main variables in the dampening loop are the 'anti-integration politics' as well as the 'influence of Serbian parallel structures'. Both variables have a high activity and are therefore able to influence the system to a large extent. The influence of Serbian parallel structures also has a relatively high passivity, which makes it a critical variable. If we go back to the impact matrix, we can see that the variables that influence one or both of these variables are the trust in Kosovo institutions, as also shown in Figure 9, as well as the acceptance of status, rule of law, and the isolation of the Serbian community. This again confirms the necessity to also try to influence the variables 'rule of law enforcement' and 'isolation of the Serbian community'.

2.2.6 Perspectives

An additional aspect that must be considered when looking at complex systems is the different perspectives of the actors. This is an important part of the SDA actor analysis. The two most frequently cited aspects i.e., the Serbian and Albanian sides, are mentioned here, and analysed based upon insights from the systems analysis.

The two perspectives can easily be expressed with two catch phrases, although in reality they are of course expressed in a more nuanced way:

K-Serbian perspective: "Albanians don't want to do business with us although our products are competitive both in price and quality. They don't want economic growth for Serbs."

K-Albanians: "Ethnicity is not a problem, we treat all people the same when it comes to business."

Obviously these statements do not express the observed reality. These perspectives can, however, give us important insights as to how the communities perceive each other, and based upon those perspectives, a rationale for the behaviour exhibited by the communities can be suggested. The K-Serbian perspective for example resonates with the aspect of isolation and even turns it into a deliberate isolation caused by the Albanians. In turn, on the K-Albanian side, cooperation is mentioned as being something very normal, which is evidently not true when looking at the situation on the ground. Many K-Serbian businesses struggle to sell their products on the market in Kosovo for a variety of reasons.

One key principle of all strategies for achieving sustainable change in complex systems is the facilitation of change from within. This can, for example, be achieved by strengthening relationships between change makers on both sides or between those working towards a complementary goal and allowing them to come up with their own solutions for cooperation.

One key principle for negotiating change is an appreciation of each others' positions and perspectives. This has to be taken into account when designing intervention strategies.

2.2.7 Patterns and possible interventions

As explained earlier, the strategy to bring change to complex systems is based on sensing patterns in the system and discovering their underlying causes. Patterns that are favourable shall be strengthened and patterns that work against the envisioned change shall be weakened.

The goal of the SDA is to describe the system in a way to make patterns visible and accessible. Some patterns, however, are better expressed through narrative approaches, for example one-on-one interviews with a variety of people. A number of patterns based on the stories told by the interviews are presented in Table 7 together with their relationship to our goal, possible interventions, and an explanation as to how they resonate with our system model.

Table 7: *Patterns that became visible during the analysis and how they can be used.*

Pattern	Relationship to our goal	Possible interventions	System perspective
Successful cooperation between K-Serbian and K-Albanian businesses.	Favourable	Programme that systemically strengthens business models in which cooperation is frequently seen, i.e., in sectors where K-Serbian businesses are active. Existing cooperation should be strengthened and new cooperation should be fostered.	This intervention would have an impact on the variables 'level of cooperation', 'competitiveness of Serbian businesses' and eventually on the variable 'economic performance'. All these variables are part of the reinforcing feedback loop and two of them have been identified above as priority variables for interventions.
Well-organised producer groups and well-established companies on K-Serbian side are waiting to start collaborations but are not well connected with K-Albanian businesses.	Favourable	Strengthen networking of K-Serbian and K-Albanian companies. Establishment of common business associations, platforms where businesses can meet, trade fairs, etc. This intervention line would be especially important to test the statements of the two communities that were described in the section on perspectives, above.	This intervention would have an impact on the variable 'isolation of the Serbian community' from a business perspective which leads both to an increased level of cooperation as well as improved competitiveness of Serbian businesses, strengthening the reinforcing loop. The isolation of the Serbian community has been identified as a priority variable for interventions.
Economic development activities of the Municipality of Strpce.	Favourable	Strengthen the capacities of municipalities in local economic development both in terms of skills as well as resources.	This intervention would have an impact on the variable 'competitiveness of Serbian businesses' if implemented mainly in Serbian municipalities and 'performance of the economy' if all municipalities were included, again strengthening the reinforcing loop. More importantly, it would improve the variable 'trust in Kosovo institutions', since the Municipality of Strpce is an institution of the Government of Kosovo. Trust in Kosovo institutions is important to reduce the influence of the dampening feedback loop.
Isolation of the K-Serbian (business) community, difficulties to access markets, lack of networks, perceived low quality of produce.	Unfavourable	Specifically target the isolation of the Serbian community by supporting communication between ethnic communities and strengthen the integration politics of the Government.	This intervention would have an impact on the priority variable 'isolation of the Serbian community' from both a social and business perspective.

<p>Low competitiveness of Serbian businesses and low attractiveness as business partners or suppliers due to small size, traditional practices, etc. Bad business management skills and nepotism in the whole country is making companies less efficient.</p>	<p>Unfavourable</p>	<p>SME upgrade interventions systemically for the whole of Kosovo with affirmative actions for K-Serbian businesses targeting both the competitiveness of K-Serbian businesses as well as economic performance in general.</p>	<p>This intervention would have an impact on the variables 'level of cooperation' and on the priority variable 'performance of the economy'. Both variables are part of the reinforcing feedback loop.</p>
<p>Interviews showed that there are instances of government institutions discriminating against K-Serbians by not accepting documents and forms in the Serbian language or refusing to speak Serbian in personal communications. A lack of open and transparent governance leads to decisions that are given preference to one's own community and, therefore, leads to discrimination of other ethnicities.</p>	<p>Unfavourable</p>	<p>Implement policies to improve good governance and transparency of decision making in government institutions.</p>	<p>This intervention would have an impact on the variable 'functioning of government institutions', 'trust in government institutions' as well as 'rule of law enforcement', all working towards an increased integration of Serbian businesses into the Kosovo market, two being priority variables. The variable 'trust in government institutions' as well as indirectly the other two variables are important variables to reduce the influence of the Serbian parallel structures and in this way reduce the influence of the dampening feedback loop.</p>
<p>No contract security, many property rights disputes not resolved, etc. Organized crime and unfair competition are making business difficult.</p>	<p>Unfavourable</p>	<p>Implement policies to improve rule of law and functioning of police and judiciary institutions such as the courts.</p>	<p>This intervention would have an impact on the variable 'trust in government institutions' as well as 'rule of law enforcement', both working towards an increased integration of Serbian businesses into the Kosovo market. The variable 'trust in government institutions' as well as indirectly the rule of law are important variables to reduce the influence of the Serbian parallel structures and in this way reduce the influence of the dampening feedback loop.</p>

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Appendices

Annex 1 – List of Key Informant Interviews (KII)

Date	Institution/Organization	Role	Name and Surname
9/5/2011	SME Support Agency / Ministry of Trade and Industry	Head of the Business Support Division	Xhemajl Syla
9/5/2011	Avenija	Director	Gordana Đorić
9/6/2011	Intercooperation	Project Manager of Horticulture Promotion in Kosovo	Heini Conrad
9/7/2011	Fractal	Project Manager	Milos Milovanovic
9/7/2011	Municipal Assembly Strpce	Director of Economic Development Division	Radoljub Mladenovic
9/7/2011	European Commission	European Commission Team Leader - Economic Development	Sirje Poder
9/7/2011	Intercooperation	Project Manager - Local Governance and Decentralisation Support (LOGOS)	Norbert Pijls
9/8/2011	Care	Programme Director	Dragan Peric
9/8/2011	Kosovo Business Association	Executive Director	Lumnije Hajdini
9/13/2011	American Chamber of Commerce	Policy Manager	Arian Zeka
9/16/2011	Kosovo Private Enterprise Programme	Business Development and CFW Programme Manager	Burim Korqa
9/19/2011	K-Albanian Businessman	Pestova	Bedri Kasumi
9/20/2011	K-Serbian Businessman		Mr. Nesovic
9/20/2011	K-Serbian Businessman	LOLA FOT Company Owner	Vukoje Vukojević
9/21/2011	K-Serbian Businessman	Aqua Sana Company Owner	Srećko Spasić
9/21/2011	K-Serbian Business	ROK (Motel-Restaurant owner)	Jovanovic Orli
9/23/2011	Kosovo Chamber of Commerce	Director of Economic Analysis and Policies Department	Ardiana Gashi
12/6/2011	K-Albanian Businessman	Agro-Produkti Company owner	Naim Fejza
12/9/2011	Municipal Preparatory Team	Head of MPT	Adrijana Hodzic
12/9/2011	UNDP	Project Manager – Area Based Development	Boban Simić



