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**"Kosovo and Bosnia and Herzegovina on the Path to
the EU Internal Market: A Study of Economic
Readiness and EU Support Mechanisms"**

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Chapter 1- Introduction

1.1 Background and motivation

The European Union Internal market is perhaps the most advanced example of regional economic integration in the world (Steinberg, 2023). Membership requires not only legal alignment with the comprehensive EU acquis but, also significant economic and institutional capacity to participate effectively. For countries in the Western Balkans who have aspirations to join the internal market area¹, especially those still in the early stages of the accession process, this presents a formidable challenge. Among these, Kosovo and Bosnia and Herzegovina (BiH) stand out as the two countries considered least prepared for EU membership, not only as they remain the only two yet to have started negotiations, but also with regards to progress in Internal Market integration (European Commission, 2023a), (European Commission, 2023b).

In the wake of the ongoing War in Ukraine, the EU has renewed its focus on the enlargement process to an extent not seen since the Treaty of accession 2005, including through *the New Growth Plan for the Western Balkans* (2023), which aims to accelerate reform and market convergence through targeted financial and policy support. Within this renewed framework, it is crucial to understand how economically ready Western Balkan countries are to participate in the EU internal market, not simply in general terms, but with reference to structural conditions and reform priorities. This thesis aims to assess this preparedness by comparing Kosovo and Bosnia and Herzegovina across two critical economic dimensions: the business environment and trade integration. These two indicators have been selected as they reflect both internal economic health and external alignment with the logic of the EU market.

1.2. Research question

This thesis will aim to answer the following research question:

¹ All are candidates other than Kosovo which is an applicant/potential candidate. Bosnia while being a candidate is not a negotiating candidate like the other 4.

To what extent are Kosovo and Bosnia and Herzegovina economically prepared for integration into the EU Internal Market, based on their business environments and trade integration, and what key reforms or gaps remain in these areas?

A comparative case study approach will be adopted, focusing on the reforms and barriers in each country's path to Internal Market membership in the economic dimensions of business environment and trade integration, both of which are fundamental to an efficient Internal Market and heavily emphasised in European Commission progress reports. The thesis seeks to prepare a diagnostic report of how prepared each country is and outline the areas where reform or EU support is most desperately needed.

1.3. Case Selection Justification

Kosovo and Bosnia and Herzegovina have been selected for comparison for three main reasons. Firstly, the two are the only countries in the Western Balkans region not to have opened formal negotiations for accession with the Commission on accession (Kosovo is an applicant country and BiH a non-negotiating candidate) and furthermore, their economies are widely considered to be the furthest from reaching EU standards. (European Commission, 2023a), (European Commission, 2023b)

Secondly, both share a number of structural and political challenges. In Kosovo this presents itself in the form of contested statehood and lack of ability to print its own currency, since unilaterally adopting the Euro (Uka, Fejza, & Ismajli, 2018). By contrast, BiH suffers from extreme institutional fragmentation, limiting the ability of implementing reform. This will also mean that the thesis will have to consider more unorthodox policy recommendations.

Thirdly, the author of the thesis has prior working experience on economic development and European reform in both countries and connections with members of government, senior international civil servants and diplomats, supporting informed analysis of institutional conditions and external support mechanisms.

The two cases do offer noticeable differences however: Kosovo has a more centralised government and has been able to make progress in fields such as simplification and SME policy since being granted applicant status (Durguti, 2025), while BiH's complex constitutional structure² has led to overlapping jurisdictions unable to implement coherent national economic governance (China-CEE, 2021). BiH however does have the advantage of having its own currency and thus the advantages that a central bank and being a lender of last resort bring, though the BAM (currency of BiH) is pegged to the Euro. Comparing their trajectories may be able to teach us useful lessons on the interplay between political context, external incentives and the ability to effectuate meaningful reform

1.4. Indicator rationale

It is fundamental for internal market participation that the **business environment** of a country is competitive and predictable. Firms must be able to operate independently on a level playing field that possesses access to finance and transparent regulations if they are to successfully integrate into European value chains. A failure to ensure this leads to higher costs of doing business, lower investment and slow innovation, which directly hinder alignment with EU market requirements. For these reasons, institutions such as the World Bank, OECD and EU all devote substantial attention to business environment indicators, in particular with regards to SMEs, quality of regulation and contract enforcement. (World Bank, 2020; OECD, 2022; European Commission, 2023a, 2023b).

Trade integration measures give us a direct measure of how closely a country is linked to the EU economy. For the Western Balkans as a bloc, the EU is already the largest trading partner, but the depth and quality of such integration vary from country to country, from indicators of trade surpluses and deficits, export diversification and compliance with standards and customs procedures. These can all help us to understand how well-prepared an economy is to compete under internal market rules. High import dependence without regulatory alignment can cause structural weaknesses, whereas a

² The 1995 Dayton Peace Accord acts as the nations' constitution, though it was intended as a temporary peace agreement.

diversified and standards-compliant export base indicates progress towards readiness (GIZ, 2023; European Commission, 2023c).

Taken separately, each of these indicators capture important dimension for preparedness. Together, they can help us provide a more comprehensive picture of readiness. Business environment reflects internal capacity, trade integration external connectivity. Analysing the two together allows us to evaluate not just the state of economic structures, but further, how they interact with the EU market and whether they can be competitive.

Chapter 2 – Conceptual Framework and Methodology

2.1 Research Design

This thesis adopts a comparative case study design to assess the extent to which Kosovo and Bosnia and Herzegovina are economically prepared for integration into the EU Internal Market. The comparative approach allows for identification of both common regional challenges and country-specific divergences in reform trajectories. Case study comparison is particularly appropriate in the Western Balkan context, where small economies share similar structural constraints yet differ in political institutions and reform outcomes.

2.2 Conceptual Framework

The analysis is structured around the EU's Internal Market acquis and the Copenhagen economic criteria. Rather than providing a general macroeconomic overview, the thesis focuses on two analytical dimensions most directly linked to market readiness:

1. Business Environment – capturing the internal capacity of firms and institutions to function in a competitive, rules-based economy (drawing on acquis Chapters 4, 6, 8, 9, 20, 23 and 24).
2. Trade Integration – assessing external connectivity and competitiveness, including the degree of alignment with EU trade and customs frameworks (drawing on acquis Chapters 1, 29 and 30).

This dual focus reflects the EU's own assessment practice, where the Commission evaluates both domestic competitiveness and external market linkages as preconditions for accession.

2.3 Indicators and Sources

The study relies on a mix of qualitative and quantitative indicators, selected to align with EU reporting standards and international benchmarks.

- Business Environment: SME share and performance, access to finance, regulatory quality, rule of law, informality, corruption, state-owned enterprises, and alignment with acquis requirements.

- Trade Integration: trade-to-GDP ratios, export diversification, regional trade participation (CEFTA, CRM), and progress on trade facilitation measures.

Primary sources include:

- European Commission annual progress reports (2023–2024) for both countries.
- OECD Competitiveness Outlooks and World Bank/IMF country reports.
- Academic literature on EU enlargement conditionality, Western Balkan political economy, and internal market integration.
- Supplementary interviews and practitioner insights, which inform interpretation of institutional dynamics.

2.4 Analytical Strategy

The analysis proceeds in three steps:

1. Country-level assessments: Kosovo (Chapter 4) and BiH (Chapter 5) are examined individually to establish their economic structures, institutional reforms, and acquis alignment across the two dimensions.
2. Cross-case comparison: Chapter 6 contrasts the two cases to identify areas of convergence, stagnation, or divergence in Internal Market readiness.
3. Policy lessons: Chapter 7 distils comparative findings into targeted recommendations for Kosovo, BiH, and the EU.

The approach is diagnostic rather than predictive: it aims to map current readiness and identify reform gaps rather than forecast accession timelines.

2.5 Limitations

Several methodological limitations must be acknowledged. First, reliance on secondary data (EU, OECD, World Bank) means findings are constrained by the quality and coverage of those sources, particularly as Kosovo is sometimes excluded from global indices. Second, the political sensitivity of

reforms means that official assessments may understate informality or corruption. Finally, the scope is limited to business environment and trade integration; other accession dimensions (e.g. environment, energy, agriculture) are not addressed.

Chapter 3- EU Internal Market and economic integration

criteria

3.1. Introduction

In this chapter we will outline the features of the European Union's Internal market for Western Balkans countries, from the chapters of the Acquis Communautaire to the regional frameworks that set the path for membership. Also commonly referred to as the Single Market, the internal market has at its core the fundamental principle of the free movement of goods, services, capital and persons (European Commission, (n.d.)). For Western Balkans nations aspiring to join, internal market integration is both the main goal and primary challenge of the accession process. Membership requires not only legal alignment with the EU Acquis Communautaire (the cumulative body of EU laws and obligations developed over time starting from the 1957 treaty of Rome), but also practical readiness- that is, the institutional and economic ability to participate, implement and enforce under acquis-based rules in a competitive transnational market setting (Craig & Búrca, 2020). There are also additional institutions and agreements that Western Balkans nations must participate in as part of the integration process that will be described in the chapter.

3.2. The internal market: Structure and requirements

As already mentioned, the internal market is governed by a dense and evolving legal framework underpinned by the fundamental principle of free movement of goods, services, capital and persons across member states, supported by harmonised standards, mutual recognition and regulatory coherence. To ensure full regulatory alignment, candidate countries must demonstrate that their domestic institutions and firms can function effectively under the competitive, rules based-conditions set out in the acquis. This is done through the opening and closing of acquis chapters, of which there are currently 35.

Eight main chapters have been chosen that are particularly relevant when it comes to business environment and trade integration.

On business environment:

- **Chapter 4- Free movement of capital**
Requires the removal of all restrictions of movement of capital between Member states and Third Countries, with some exceptions.
- **Chapter 6- Company law**
Includes rules on the formation, registration, merger and divisions of companies.
- **Chapter 9- Financial Services**
Includes the rules for authorisation, operation and supervision of financial institutions in the areas of banking, insurance, supplementary pensions, investment services and securities markets.
- **Chapter 20 – Enterprise and Industrial Policy**
Seeks to promote industrial strategies enhancing competitiveness by speeding up adjustment to structural change, encouraging an environment favourable to business creation and growth throughout the EU as well as domestic and foreign investments.
- **Chapters 23 and 24**, relating to the judiciary and justice will also be analysed, while strictly economic, they will be considered in so far as corruption and the informal economy affect business and trade (Bieber, 2018)

(European Commission, n.d.)

For trade integration:

- **Chapter 1 – Free Movement of Goods**
Implies that products must be traded freely from one part of the Union to another and adopting EU standards and certification systems, and aligning product safety rules.

- ***Chapter 29 – Customs Union***

Requires modernisation of customs procedures and alignment with the EU Customs Code.

- ***Chapter 30 – External Relations / Trade Policy***

Covers trade agreements, WTO obligations, and compatibility with the EU's common commercial policy. In the case of the Western Balkans, also covers regional initiatives such as CEFTA (Central European Free Trade Agreement) and the CRM (Common Regional Market) (See Chapter 2.6.).

(European Commission, n.d.)

Candidate countries are expected to progressively bring their laws in line with these chapters.

However, alignment alone is insufficient. The Commission emphasizes that countries, alongside adopting adequate legislation, must also develop the capacity to implement and enforce it, including in areas that affect trade and business operation (European Commission, 2023).

3.3. The Copenhagen Economic criteria

In addition to legal alignment, countries must meet the Copenhagen Criteria set out by the European Council in 1993, which require in the economic sphere:

1. A functioning market economy
2. The capacity to cope with competitive pressure and market forces within the Union

These are not assessed by quantitative metrics but rather through a qualitative evaluation of economic performance, institutional quality and structural reforms. The European commission evaluates whether economies:

- Are open and liberalised
- Have a stable macroeconomic framework
- Protect property rights and enforce contracts
- Support entrepreneurship and innovation
- Have competitive sectors able to withstand EU-level competition

(European Council, 1993)

3.4. Stabilisation and Association Agreements

Stabilisation and Association Agreements (SAAs) form the legal and institutional backbone of EU relations with potential future members. Through them, a contractual framework is established that grants preferential trade access and progressively eliminates trade barriers with time. Immediate duty-free access for almost all potential members is granted and subsequently, usually over a period of 5-10 years, the partner country will itself commit to tariff reductions on EU imports, with transactional periods for sensitive products (Jusufi & Qorraj). The agreements also set the binding timetables for the approximation of non-directly trade related national laws with the EU acquis (European Commission, n.d). These include areas of competition policy, state aid, public procurement and intellectual property. The SAAs also create the space for political dialogue, cooperation on issues of justice, security and home affairs and joint bodies that monitor national progress levels (SAA councils and parliamentary committees). Essentially, they act as the framework that guides each country EU accession path, offering a step-by-step path towards eventual Internal Market membership and serving as a key benchmark for reform progress.

3.5. The EU Enlargement Logic and Conditionality

The process of EU enlargement is based on conditionality. That is, Candidate countries continue to receive financial assistance, political engagement and eventually membership in return for meaningful progress on reforms. With time, this logic has shifted from broad aspirational promises on political alignment and good faith commitment to a more performance-based framework. The Commission has increasingly emphasised sectoral benchmarks, annual assessments and nation-state reform roadmaps (Becker, 2025).

Two recent developments are particularly relevant to this thesis

- IPA III (2021-2027): The third generation of the Instrument for Pre-Accession assistance. It is what ties funding to progress made in topics of governance, rule of law and competitiveness.

Resources are allocated based on sectoral performance, including trade facilitation and business reform (European Commission, 2021).

- New Growth Plan for Western Balkans (2023): A major shift in enlargement policy, developed after the Russian invasion of Ukraine (Regional School of Public Administration, 2024). The plan offers €6 billion in grants and loans for countries that adopt and implement detailed, country-specific reform agendas aligned with EU-recommendations. Crucially, progress in these reforms allows for gradual access to parts of the Internal Market before full membership, thus creating both a direct but also conditional connection between economic readiness and market participation (European Commission, 2023).

Within this updated framework, Kosovo and Bosnia and Herzegovina are both engaged, but at different stages. The full implementation of the Growth Plan will depend on whether reform can be demonstrated in key fields such as custom integration, regulatory quality, investment conditions and private sector development.

3.6. CEFTA and Regional Market Integration

Both Kosovo and BiH are also part of the CEFTA, a regional trade bloc, comprised of the Western Balkan countries and Moldova, designed to facilitate pre-accession integration. CEFTA mirrors key elements of the EU's Internal market between the seven Member States, including trade liberalisation, harmonisation of standards and mutual recognition; to attempt to create a region that has fair, predictable and stable trade rules that attract investment (CEFTA, n.d.). Originally only concentrated on goods, in 2006 it expanded to services, though not persons or capital. CEFTA is supposed to act as a stepping stone to EU integration, though effectiveness varies.

The Common Regional Market (CRM) initiative was launched in 2020 as part of the Berlin Process, and subsequently renewed through CRM 2.0 (2025-2028) with the aim of deepening the pre-accession economic space set out by the CEFTA³ and expanding the regional framework to all four freedoms of

³ Unlike CEFTA, Moldova is not a member of the CRM, solely the 6 Western Balkans countries

goods, addressing the economic fragmentation in the region. Reforms it has implemented include (RCC, 2023):

- Removal of non-tariff barriers
- Digital market harmonisation
- Labour mobility agreements (travel between countries with only ID card)
- Mutual recognition of professional qualifications
- Smoother border crossings

Kosovo has thus far shown some leadership in some CRM reforms (e.g., mutual recognition of ID travel, business licencing agreements) (European Commission, 2023a), Bosnia and Herzegovina on the other hand has lagged behind, often due to internal political disputes (European Commission, 2023b). The CRM reflects the EU's push for regional convergence as a precondition for Internal Market readiness.

3.7. Limits of EU Instruments in Preparing Candidate States

Now that we have understood the mechanisms at play, it is important to state that this study does is not simply aim at assessing how close each country is to achieving the integration goals set out by the various programs, otherwise one could simply look at the EU reports to assess the progress made under each EU chapter. What we must also do is assess whether the programmes the EU has put in place will be enough to prepare Kosovo and Bosnia and Herzegovina to compete effectively in the Internal Market once all the chapters are closed, something that has been criticised in the cases of the 2007 expansion, when Bulgaria and Romania closed all the chapters but many felt were not at an adequate level to compete with the other members of the Internal Market.

A growing body of scholarship in fact has raised the question of whether these instruments are sufficient to prepare Western Balkan economies for the challenges of the Internal Market or whether they are merely necessary and further support should be provided. Scholars and policy groups have highlighted that while SAAs, IPA funding and trade frameworks provide a stepping stone to

accession, often the underlying fundamental issues are left unaddressed, leaving governance weakness in place.

Bieber and Kmezić (2017) discuss the concept of Stabilitocracy in their paper “The crisis of Democracy in the Western Balkans. An anatomy of Stabilitocracy and the limits of EU democracy promotion.” This is where EU conditionality rewards stability and formal compliance but brushes aside the entrenched governance problems (corruption, weak rule of law, informality.) The landmark report characterises this as the EU’s incentive structure producing democratic backsliding beneath a veneer of reforms, questioning the transformative power of current tool and not increasing standards of living. As they put it “*Moving closer towards the EU, negotiating accession, receiving endless reports and recommendations – none of these steps delivered the promised progress towards democracy (and higher living standards) (p.93)*”

Connected is what Vachudova (2019) describes as the problem of “State capture”. In her paper, she notes that “*[Western Balkans] states in the membership queue are hobbled by the capture of the state by elites who [favour] rent-seeking and ethno-nationalist appeals over economic reform, media freedom, and the rule of law (P.64)*” Instead of making entrenched elites weaker, EU instruments have often actually helped reinforce them, as financial assistance (e.g. IPA) is typically channelled through state institutions controlled by dominant parties. This has not been so much the case in Kosovo, where there have been frequent transfers of power between the main parties; however in BiH, particularly on the Serb side dominated by the Alliance of Independent Social Democrats (SNSD), rent-seeking behaviour is common.

Looking from an economic perspective, Uvalic (2019) has commented that while trade liberalisation under the SAA and CEFTA has increased the volume of EU and regional trade respectively, this has not driven industrial upgrading or competitiveness. She notes that imports have risen much faster than exports, as we will see in more detail in the next chapters.

Criticisms have also been directed towards focus on EU conditionality. The Clingendael Institute argues that “*Brussels has predominantly provided financial and technical assistance to the WB6*

governments to transpose (on paper) the EU acquis. Instead of contributing to deep political and societal transformations, this has led to thin-surface norm adoption which does not alter the political realities of the region (2022, p. 13)”. This may explain why despite years of reforms and billions in IPA funding, governance indicators have barely shifted, if not declined, in most of the region. The Growth plan attempts to solve this by replacing formal benchmarks with direct, performance-based financial initiatives, but results are yet to be seen.

All-in-all, the literature suggests that there are issues with the EU tools and that perhaps the constant focus on reaching EU goals can itself be a hinderance to competitiveness, something we will consider carefully when shaping our policy recommendations.

3.8. Relevance of Business Environment and Trade Integration

Considering these frameworks and debates, this thesis now turns to the analysis of readiness based on the two selected indicators: business environment and trade integration. As outlined earlier, these indicators can capture both the internal and external dimensions of market preparedness. Both feature heavily in EU assessments. The next chapter will assess these and apply them to Kosovo and BiH.

Chapter 4- Kosovo analysis

4.1 Overview of Kosovo's economic structure and reform context

4.1.1 Macroeconomic performance

Since independence in 2008, Kosovo has recorded consistently higher growth than most Western Balkans peers. Real GDP grew by 4.4% in 2024, driven by household consumption and investment, with an abnormally large amount of consumption underpinned by large remittance flows from the diaspora (remittances account for around 14.6% of GDP, highest in the WB) (International Monetary Fund [IMF], 2025a). Forecasts have projected a continued expansion of around 3.8-4.0% in 2025-2026, amongst the fastest growing in the region. (IMF, 2025a; World Bank, 2023).

4.1.2. Fiscal Stability and Monetary constraints

Kosovo currently has one of the lowest public debt levels in Europe ($\approx 20\%$ of GDP), far below the Maastricht treaty maximum of 60% and has usually run deficits below 2%. In 2023 the deficit was narrowed to 0.2% with a slight increase to 0.3% in 2024, though this year's is expected to rise as concessional finance has pushed the government to pursue a looser fiscal policy (IMF, 2025a). This is not as much because of fiscal prudence as it is due to structural necessity. As a unilaterally "Euroised" economy, Kosovo's Central Bank does not issue currency or conduct monetary policy that goes along with it and furthermore cannot rely on the European Central Bank's support in times of crisis, including the backstop of not being a lender of last resort. This means it must maintain economic stability through tight fiscal rules and precautionary cash buffers (Kapsoli & Mohona, 2025; Magnin, 2022).

4.1.3 External balances: Trade and remittances

Despite macroeconomic stability, external balances remain a large vulnerability. Kosovo currently has one of the largest trade deficits in the world, estimated at 48% of GDP (Berisha, 2025). Imports in machinery, fuels and various other consumer goods hugely outweigh Kosovo's meagre exports, which remain concentrated in metals, construction materials and a nascent wine sector. This is only partly

cushioned by large inflows of remittances, equating to 14.6% of GDP (Arapi-Gjini, Möllers, & Herzfeld, 2024; International Monetary Fund [IMF], 2025a). While these have benefits, including that of reducing poverty, they can also create dependence and potentially discourage labour market participation, something we will see in the next section.

In 2024, the current account deficit stood at near 9% of GDP (IMF, 2025a). As well as the high level of remittances, service exports, in particular diaspora-linked tourism, have helped offset some of the imbalance, but goods exports still remain far too undiversified (Hadergjonaj, Asllani, Shala, & Grima, 2024).

4.1.4. Labour market dynamics

Labour force participation is one of the lowest in the entire continent at 43% overall, with a staggering 22% level for women, below regional average of 50% (Gashi, Rizvanolli, & Adnett, 2019; Kapsoli & Mohona, 2025). Youth inactivity is particularly high too, with a third of those between age 15-24 neither in employment, education or training. Black market work accounts for roughly 30-35% of total employment. Overall, factors such as these weaken the product capacity and growth of Kosovo, constraining convergence with EU standards.

4.1.5 Energy and Infrastructure constraints

Energy dependence demonstrates further structural vulnerabilities. Kosovo still depends on two ageing lignite plants for 90% of its electricity, of which it has one of the largest reserves in the planet, circa 14.7 billion tonnes (Arifi & Späth, 2018; Di Bella et al., 2023). Coal guarantees supply for now, but the ageing plants along with environmental costs and EU decarbonisation pressures render the model unsustainable. Renewable potential exists in solar and wind, but for utilisation remains in the low single digits (Lajqi, Hamidi, Kabashi, & Disha, 2020). The EU climate acquis will require huge structural adjustment in Kosovo's energy sector.

4.1.6 Political Challenges

As is the case for much of the European integration of Kosovo (though less so on the economic side), political complexities relating to disputed independence have also created direct costs. The most

notorious example is that of electricity consumption in northern Kosovo. For nearly two decades, households in four municipalities⁴ received electricity without payment (Bami, 2024), imposing tens of millions of annual fiscal losses until in 2022 an EU-facilitated agreement licenced a Serb incorporated company, *Elektroserver*, to act as local supplier, though in mid-2024 only 25% of households had signed contracts, meaning a large amount of electricity in the north remains unbilled (Prishtina Insight, 2024). While this has shifted the burden away from the state, it continues to represent a hidden quasi-fiscal cost and a visible gap in regulatory enforcement.

This episode demonstrates the challenge of political fragmentation, be that for political implementation or access for business. Kosovo may be able to align its legal framework with the EU acquis, but consistent implementation can still be impeded, a fundamental weakness in regards to preparation for the Single Market.

4.2. Business Environment

4.2.1. Regulatory framework and reforms

Improvements have been made over the last years in Kosovo's regulatory framework for businesses, however there is still much progress to be made. The government has been pursuing more efficient economic reforms on business regulations and strengthening institutional capacity. In 2022, a dedicated commercial court was established (LAW NO. 08/L-015, 2022) to accelerate the resolution of commercial disputes, expecting to improve contract enforcement and investor confidence. The government has also passed initiatives to reduce administrative burdens, such as expanding the digital e-Kosova platform from 21 services offered in 2021 to 140 services in 2023, including new features for companies to apply for grants and subsidies (OECD, 2024), download business certificates (Gazeta, 2025) and enable users to view and pay waste collection invoices through the platform (Insajderi, 2025). In early 2025, the platform reached one million users, a significant benchmark for a

⁴ . Kosovo has a 5% Serb minority, strongly backed by Aleksander Vucic, President of Serbia. In total there are 9 majority Serba municipalities. 5 are enclaves surrounded by Albanian majority population, however in the Mitrovica district there are 4 contiguous municipalities on the border with Serbia, allowing for greater control by Serbian government and business

country of 1.6 million (Telegrafi, 2025). New laws have also been passed to align with EU standards, such as the Law on General Product Safety (2022) which harmonises Kosovo's product safety and market surveillance rules with the EU Directive 2001/95.EC, aiming to make it simpler to open and run businesses.

Despite these steps forwards, the regulatory environment is still evolving. Many reforms are still at an early stage of implementation, if at all, and institutions face capacity constraints. Kosovo's national standards agency, for example is not yet a full member of either European or international standardisation bodies (European Commission, 2024), thus slowing the adoption of EU standards. Furthermore, a fully functioning state-aid control framework is yet to be developed and the creation of a state-aid commission has been delayed (European Commission, 2024), thus suggesting that oversight of fair market competition is weak.

Overall, Kosovo's regulatory framework has improved, at least on paper, with new laws on inspections, investments and business registration. Effective enforcement and institutional capacity do remain key problems however. The European Commission (2024) assesses that the country remains at an *early stage* of preparation, pushing for further legislation and efforts to build administrative capacity for implementation. The continued modernisation is a positive trend, but EU reports demonstrate that Kosovo must go further in order to meet the standards of the internal market.

4.2.3. SMEs

Chapter 20 of the acquis covers policies intended to boost industrial competitiveness and support SMEs. With its foundations in the EU Small Business Act, the chapter requires candidate countries to provide a predictable business framework that strengthens innovation and sectoral policies whilst ensuring SME access to finance and services.

The Commission has said that "*Kosovo is moderately prepared in the area, and the government made some progress by continuing to implement the 2030 strategy for industrial development and business support.*" (2024, p.15). Adding that the recommendations from the previous year were partially implemented and remain largely valid. These reforms include the Law on Sustainable Investments

(Law No. 08/L-209, in force from September 2024). This replaced earlier legislation on foreign and strategic investment, introducing a new unified, EU-aligned framework for sustainable investment promotion. It has been hailed as a significant step in aligning the investment regime with acquisition requirements

The private sector in Kosovo is near-universally made up of small and medium-size enterprises. SMEs account for 99.9% of firms, 76% of the employment and 81% of value added of the country (EBRD, 2019). The vast majority of businesses (93%) are micro-enterprises and small family run businesses of less than 10 people that contribute only 13% to value creation. Medium firms account for 48% of the value added, despite accounting for less than 1% of the business population (*ibid*). Large firms are very few in number and even the largest in the country are very small by European standards; for context the three highest employers in the country are the Ministry of the Interior, the main university hospital and the Police Force (HitHorizons, 2025). As a result, economic activity is spread across many small-scale operations, limiting productivity and most of all hindering the ability of firms to compete on the international stage. Kosovo has seen a rise in the number of registered businesses over the last few years (for instance, 5.3% year-on-year growth in new enterprises in Q1 2024) (CBK/KAS). However, the main obstacle remains scaling up, especially from micro to small or small to medium size.

One of the biggest problems in this regard is general access to finance. Kosovo's banking sector is in a healthy state with solid liquidity. Banks are well capitalised, non-performing loans are among the best in the region at 2% and lending has been expanding with bank credit to the private sector growing by 18.3% in 2024 and continuing in the early months of 2025 (Central Bank of Kosovo, 2024; CEIC, 2025).

Despite this expansion, many structural barriers to firms accessing finance remain. Commercial banks impose stringent collateral requirements, often demanding collateral values far above the requested loan amount, which limits access for SMEs, particularly micro and small enterprises lacking in sufficient assets (European Commission, 2023), indeed banks have tended to favour established clients and lower-risk loans. Average interest rates on loans rose from 6.3% to 6.5% in 2024, with

early data from 2025 suggesting only a moderate easing to 6.0% (Central bank of Kosovo, 2024).

These rising borrowing costs in an environment of relatively slow profit margins exacerbate financial difficulties.

A large share of bank lending does go to SMEs however- over 60% of total corporate loans benefit SMEs, higher than EU average (European Commission, 2023). Furthermore, SME policy has been boosted by the expansion of the Kosovo Credit Guarantee Fund, providing partial risk guarantees that encourage banks to lend to SMEs. Together with other related SME support schemes, by 2022-23, support for SMEs was equivalent to 3.7%, the highest in the Western Balkans (OECD, 2025), addressing one of the main concerns of the acquis: improving access to finance for SMEs. Even with the guarantee, however, banks remain wary and the high collaterals have stayed in place. Other modes of finance are also underdeveloped; the capital market is nascent (Kosovo does not have a stock exchange and there is limited venture capital activity), and although microfinance institutions exist, their loans carry abnormally high interest rates in the region of 18% annually (World Bank, 2025).

Institutionalisation of SME support services and innovation policy is also required. Here Kosovo is significantly behind. The SME agency remains under-resourced and limited in scope, while donor-driven projects fill up much of the gap in enterprise support. According to the **OECD**

Competitiveness Outlook 2024, Kosovo underperforms regional peers in dimensions closely tied to Chapter 20 — particularly in innovation support, enterprise policy implementation, and cluster development — even as it scores relatively well on SME finance (OECD, 2024). These weaknesses illustrate the Commission's assessment that Kosovo's policy framework is still too fragmented and lacks the instruments needed to shift from a survival-oriented SME economy to a competitive enterprise sector (European Commission, 2023).

In summary, Kosovo's SME-driven economy brings with it a spirit of entrepreneurship and flexible small businesses that can adapt quickly. However, access to finance and difficulties in scaling up hold back investment and innovation in this rapidly growing economy. The World Bank (2025), has said that further financial sector development and inclusion efforts are needed for Kosovo's private sector to create more jobs and increase competitiveness. Strengthening credit channels (whether it be

through credit guarantees, improved collateral frameworks or possibly developing non-bank financing) is fundamental. The Kurti government's new *Law on Sustainable Investments*, passed in late 2024, aims to promote and protect investments, including foreign ones, and to reorganise the investment promotion agency. This could have tangible benefits for both domestic and foreign investors. According to the OECD 2024 report, Kosovo has made good progress in investment policy and promotion, which led to a tripling of FDI inflows from 2019 to 2022. However, it also highlights that much of this FDI has gone into non-export sectors (most of all, real estate and construction), limiting its impact on productivity and trade competitiveness (OECD, 2024). The SME-centric environment in Kosovo is slowly improving, but the issues highlighted continue to impede the emergence of a more competitive, investment driven private sector fit for the Internal Market.

4.2.3. State-Owned enterprises

State-owned enterprises play a smaller role in Kosovo's economy than other Western Balkans countries. The private sector accounts for the vast majority of the employment and value added (U.S. Department of State, 2024). SOEs do remain present in utilities, energy and some transport or service sectors, but overall they do not dominate market structure. The European Commission (2024), does note however, that Kosovo is yet to establish a state-aid authority and state-aid control system, a core requirement under chapter 8 (competition policy) of the acquis. While the scale of SOEs-related distortions is not at the same level of neighbours including BiH, issues of weak oversight, limited transparency, and delayed institutional reforms block progress towards the creation of a fully level playing field. Both the IMF and World Bank have highlighted that strengthening state aid control and governance of public enterprises will be important to improve competition and attract private investment.

4.2.4. Access to Finance and FDI

Alignment with the acquis under Chapter 4 (Free Movement of Capital) and Chapter 9 (Financial Services) is assessed to be at *an early stage of preparation* in Kosovo (European Commission, 2024). Capital movements are largely liberalised in line with the obligations set out in the SAA and Kosovo

has an open regime for FDI with equal treatment of foreign and domestic investors (U.S. Department of State, 2024). Nonetheless, issues of institutional weakness, fragmented promotion system but also the absence of a strong investment agency have limited Kosovo's capacity to attract better quality FDI. Banks dominate the financial sector, at around 90% of total financial assets. It is largely foreign-owned, which has helped with alignment to EU prudential standards and preserved stability and capitalisation (Central Bank of Kosovo, 2024). As mentioned, non-performing loans remain low and lending has expanded strongly in recent years, but collateral requirements are excessive, maturities remain short and other financing options are severely under-developed.

FDI inflows are modest compared to other Western Balkans states, averaging at around 3-4% of GDP in recent years, though volatile (World Bank, 2025). As alluded to earlier, inflows are concentrated in non-tradeable sectors such as real estate or construction which do not drive productivity growth (OECD, 2024). Kosovo has made progress, notably, in investment policy and promotion, with FDI inflows tripling between 2019 and 2022 (OECD, 2024). The Law on Sustainable Investments, passed last year aims to improve investor protection and reorganise the investment promotion agency, thus enhancing Kosovo's international visibility.

Overall, the financial system remains stable, even when compared to EU standards. But FDI inflows remain low and concentrated in unproductive sectors. Both chapters thus remain at an early stage of preparation. It will be necessary for Kosovo to strengthen investment promotion and diversify financial options beyond banking to prepare for integration into the internal market.

4.2.5 Informality and corruption

“Alignment with the acquis under Chapter 23 (Judiciary and Fundamental Rights) is assessed for Kosovo to be at some level of preparation, with limited or slow progress in strengthening the rule of law, judicial independence, anti-corruption enforcement, and ensuring effective oversight.” (European Commission 2024). Chapter 24 on the other hand has some level of preparation and recent progress (ibid).

European Commission estimates place the informal work sector at around 30% of GDP (OECD, 2024), indicating widespread unregistered businesses activity and undeclared unemployment. Both are significant drags on both the business climate and institutional development. High informality undermines fair competition and reduces the tax base, putting firms that comply with regulations at a disadvantage (European Commission, 2023). There have been measures passed in recent years to try and deal with this issue that is notorious in the region. Targeted inspections and audits by the Tax Administration of Kosovo (TAK), more stringent border and declaration checks by customs and the introduction of risk-based auditing systems are all positive steps in the fight against informality (European Commission, 2023). Moreover, the linking of government COVID-19 recover subsidies to employee registration in this period led to formalisation gains that accounted for a rough 35% of increase in tax revenues from 2020 until 2022 (European Commission, 2023).

Under its national strategy, the Kurti government has adopted a new action plan (2022-2023) that built upon a similar action plan passed in 2019, but with a greater focus on informality. However, by mid-2022 only around half of planned anti-informality actions had been executed (European Commission, 2023). This has led for a further push and as of late 2024 the government announced that *“a new strategy on preventing and combating the informal economy, AML/CFT and financial crime 2024–2028 is being drafted, with an accompanying action plan 2024–2026.”* (OECD, 2024). Despite the slow progress, these efforts demonstrate both an acknowledgement of the magnitude of the problem and significant political will to tackle it.

Similarly, corruption remains a problem in Kosovo. There have been improvement on indicators, but Kosovo still ranks a meagre 73th out of 180 countries on the Transparency International Corruptions Perceptions Index, though this does represent an increase of 11 spots over the last two years (Transparency International, 2023). In 2022, a new package of anti-corruption laws was passed with the aim of strengthening criminal prosecution of corruption by empowering the anti-corruption agency and tightening systems of asset declaration for officials (European Commission, 2023). While these reforms are a positive step forwards, enforcement remains key and the institutional capacity to detect, investigate and sanction corruption is still developing in Kosovo. This is not assisted by a

judicial system that has historically been slow to act and vulnerable to political interference. As a result an environment prevails where businesses are sceptical on relying on courts to settle disputes fairly (European Commission, 2024).

The OECD *Competitiveness Outlook* has put Kosovo behind its Western Balkan neighbours when it comes to anti-corruption efforts, finding that limited resources for enforcement and a lack of a stringent national strategy - which was only updated in 2023 after having expired in 2017 had hampered progress. Many firms have indeed continued to report corruption and informal competition as major barriers to doing business in the country, and EBRD survey on business indicates that unfair competition from unregistered firms is one of the top barriers to an efficient business environment (EBRD, 2023). Similarly, both the World Bank and EBRD highlight corruption as lagging behind regional partners in their enterprise surveys (World Bank, 2023; EBRD, 2023).

Overall, both informality and corruption represent structural weaknesses in Kosovo's business environment and while there are some positive signals on both the legislative side and improving international perceptions of corruption, tangible impact on tackling the problem is thus far limited. Both the EU and OECD call for stronger political will and more robust enforcement to reduce the informal work sector presence and ensure a culture of integrity in the private and public sectors (European Commission, 2024; OECD, 2024).

4.2.4 Institutional Assessments and reforms

Since applicant status was granted in 2022, European Commission reports have constantly stressed that Kosovo has to go further in consolidating the fundamentals of a functioning market economy. Progress has been made in improving the business environment and reducing informality according to the Commission, but it remains at an early stage of preparation for dealing with the competitive pressures of the EU internal market (European Commission, 2023, 2024). The 2023 report highlights positive steps such as the operationalisation of the Commercial Court as well as initiatives to digitalise

government services, but at the same time points out long-standing problems such as those of informality and weakness in rule of law in the public administration.

The OECD, in its *Competitiveness Outlook 2024* comes to similar conclusions. The report analyses 15 competitiveness indicators between 2021 and 2024 and highlights improvements in 12 of these, particularly when it comes to investment policy and certain sectoral supports (e.g. agriculture), indicating reform momentum. Such progress means that Kosovo now outperforms the Western Balkan average in areas such as trade policy and management of state-owned enterprises. On the other hand, Kosovo is below average when it comes to anti-corruption, access to finance and employment skills/employment policies (OECD, 2024). As already highlighted, governance and human capital issues are the main problems holding back convergence with EU standards.

The World Bank (2025), has emphasized that Kosovo needs to “*unleash productivity gains and create more quality jobs*” by addressing infrastructure bottlenecks and creating a better business environment to allow for stronger private sector development. In summary, it affirms that Kosovo’s growth model, heavily reliant on diaspora-driven consumption and public investment, needs to be complemented by a much stronger domestic business sector (World Bank, 2025). Likewise, The IMF’s Article IV consultation stresses that “*addressing infrastructure and governance gaps is essential to support new growth engines* for Kosovo’s economy. This means that Kosovo, in order to meet EU goals, must strengthen key institutions that serve to boost fair market competition (such as courts, regulatory agencies and anti-monopoly bodies) and invest in public goods such as reliable energy, transport and education that underpin a healthy business environment (IMF, 2024).

Looking at quantitative benchmarks, performance on various indices reflects these challenges. In the World Bank’s worldwide governance indicators, Kosovo scores relatively low on *control of corruption and rule of law* in comparison to EU countries, in spite of gradual improvements with time (World Bank, 2023). In *competitiveness*, while many global indices do not include Kosovo, due to international dispute over recognition, its regional standing suggests it trails most Western Balkan countries in business sophistication and innovation capacity (WEF, 2019; OECD, 2024). The institutional assessments all call for sustained reforms.

The Commission (2023) has recommended explicitly that Kosovo *intensify efforts against the informal economy, improve the enforcement of contracts and property rights, and upgrade the quality of public services to businesses*. In response, strategies such as the Public Administration Reform Strategy, which modernises how government functions, delivers services and manages civil servants, and the Justice Strategy, which strengthens Kosovo's judiciary and rule of law institutions, have been adopted to help deal with some of these issues. The period since applicant status was granted has seen Kosovo align a number of economic laws with the EU acquis (e.g. on competition, public procurement and intellectual property), reflecting on the commitments made under the EU Stabilisation and Association Agreement (SAA). *De facto* however, effective implementation and institutional capacity remain key obstacles. Law enforcement that allows for consistent regulatory outcomes is still hindered by human resource constraints and political interference in institutions (European Commission, 2024).

To conclude, Kosovo's business environment is on a positive trend thanks to reform pressure and international guidance and institutional quality is not yet at the level required for seamless integration into the EU Internal Market, but there is good reason to be optimistic given some of the legislation passed and it seems that the government in power since 2021 is acting with goodwill on these challenges. Various international organisations: The World Bank - EU, OECD and IMF all converge on the point that Kosovo must deepen structural reforms to fight corruption and informality, strengthen rule of law and invest in skills. Only when these reforms are implemented effectively will it be possible to foster a business climate that is able to withstand the forces of the EU market. The next sections will explore Kosovo's trade integration and how these business factors translate into external competitiveness.

4.3. Trade integration

4.3.1. Trade structure and Performance

Kosovo's trade balance is marked by a persistent and rather enormous trade deficit. This reflects a very limited export base as well as high import dependence. Goods exports have loitered around the 10% level, staggeringly low even for Western Balkans economies. On the other hand, imports are roughly equivalent to 50-60% of GDP, resulting in a huge trade gap (European Commission, 2024d). In absolute terms this equated to around €1.0 billion of merchandise exports against €6.2 billion of imports, yielding a trade deficit of approximately €5.2 billion. This has grown over time, in 2001 for example it stood at €0.67 billion, which at the time accounted for roughly a sixth of GDP, demonstrating how import growth has vastly outpaced export growth since the end of the war. Kosovo covers barely 15% of its import bill through export earning, a very low ratio that indicates a structural imbalance (Trade.gov, 2024).

Composition of exports is limited not only in the range of products, but furthermore markets.

Traditional export commodities include base metals (mainly nickel and lead), mineral products, scrap metals, some agricultural goods (like vegetables and wine) and a couple of niche products (for example, mattresses have become a notable export to the United States) (World Bank, 2025; OECD, 2024). Export destinations are concentrated in a handful of countries, mainly CEFTA partners and European nations where Kosovar diaspora has a strong presence, such as Switzerland, Germany or Italy (European Commission, 2023). This lack of diversification not only makes Kosovo extremely vulnerable to external shocks but limits its integration into EU value chains, which are driven by high value intermediate goods and strict compliance with technical standards. Unlike countries such as North Macedonia, which was able to leverage FDI to integrate into the European automotive sector, Kosovo has been unable to attract investment for tradeable industries and its SME-dominated economy lacks the scale and certification capacity that is required to supply EU manufacturers (OECD, 2024; European Commission, 2023). All this combined with high logistical costs and incomplete quality infrastructure leaves Kosovo positioned at the margins of EU production networks

Service exports, in particular travel services linked to Kosovo's large diaspora visiting Kosovo, are also significant, in fact exports in services are larger than those in goods, partially explaining why Kosovo's current account deficit is only at 9% despite such an enormous goods trade deficit, though the large inflow of remittances account for even more (World Bank, 2025). Still, the goods deficit remains a significant weakness and Kosovo's industrial base too remains underdeveloped with the economy highly reliant on imports that outweigh industrial exports by a ratio of 7:1, meaning that local manufacturing and value added production is insufficient to meet domestic demand, let alone penetrate foreign markets (European Commission, 2023).

We have briefly mentioned Kosovo's largest trading partners, but to break it down further: the EU and CEFTA account for roughly two thirds of Kosovo's total trade volume. The EU is the largest trading partner with 33.8% of exports and 42.3% of imports going to and coming from the bloc in 2022 (Ministry of Industry, Entrepreneurship and Trade. 2023). The CEFTA block accounts for an extra 36.2% of Kosovar exports (larger than the EU) with Albania and North Macedonia being by far the two largest partners. This is unsurprising given that Bosnia and Herzegovina and Serbia do not recognise Kosovo and Montenegro's population is a mere 600,000. Furthermore, North Macedonia also has a significant Albanian population of around a quarter of its population, facilitating trade when it comes to services or packaging of goods. Nevertheless, Serbia and Montenegro both account for around 5-10% of exports each (Ministry of Industry, Entrepreneurship and Trade. 2023). Interestingly in 2022, the United States emerged as the single biggest export destination at around 15% due to a one off surge in exports in mattresses, as of 2024 however, exports to the US only accounted for 4% (OECD, 2024). On the import side, besides the EU, Turkey and China account for 25%, reflecting their role as global suppliers for goods such as machinery, chemicals and textiles. CEFTA only makes up for 17.7% of imports, signifying that large trade deficits are not only a Kosovar phenomenon in the region (Ministry of Industry, Entrepreneurship and Trade. 2023).

Access to the EU market is duty free for nearly all Kosovar goods under the SAA, presenting a huge opportunity for export growth if firms are able to significantly exploit this access which they have so far been unable to due to limited export capacity and standard compliance issues (European

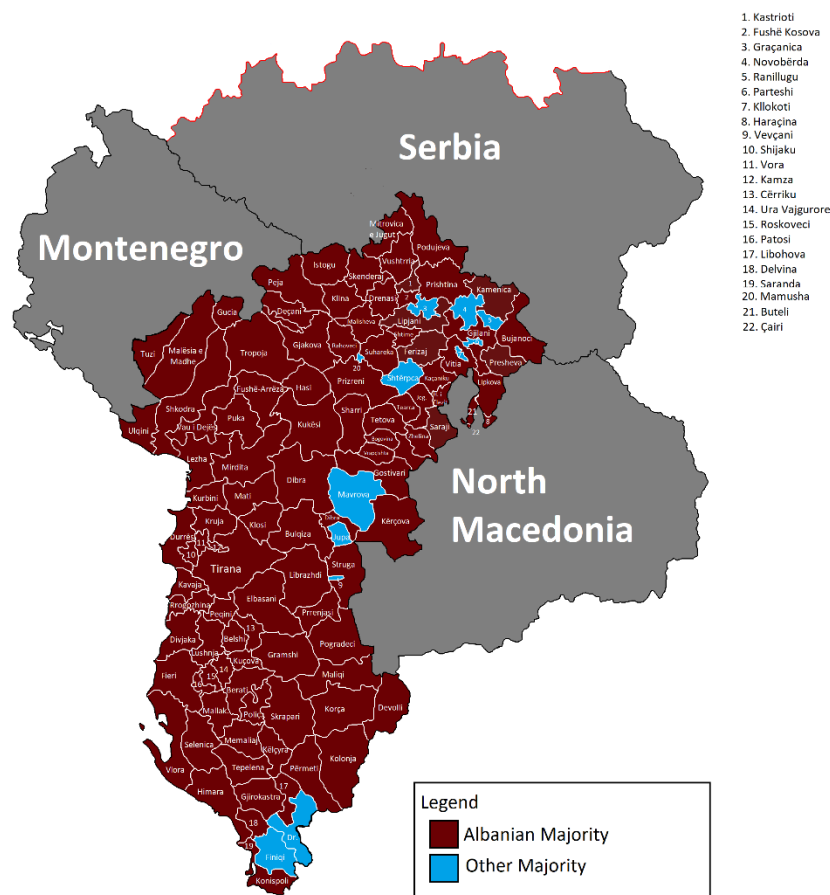
Commission, 2024). Heavy reliance on a few commodity exports means that Kosovo is exposed to international price fluctuations and has limited presence in higher-value product segments. Additionally, the dominance of diaspora-driven demand (e.g., construction booms fuelled by remittances, which drive imports of materials and appliances) means that external inflows often fund Kosovo's consumption, rather than domestic activity (World Bank, 2025).

A narrow export base however, is a rather slim diagnosis for Kosovo's export troubles. Kosovo's competitiveness challenges also stem from labour market dynamics. Average wages, while low in absolute terms (around €550-600/month) are high relative to output, while at the same time productivity levels remain far below both EU and CEFTA averages. As the European Commission (2023) notes, this results in *elevated unit labour costs*, that weaken price competitiveness of firms in international markets. Combined with energy supply constraints from an aging coal-based electricity system, this limits the ability for industry to expand exports (IMF, 2024).

On the positive side, export volumes have hugely increased since Covid and there are new export-oriented firms emerging in wood processing, IT and food processing sectors, as well as services. The government has also begun initiatives to support exporters, such as establishing an Export Credit guarantee window and organising trade fairs. This is promising, but these efforts are nascent and more will need to be done to tackle raising concerns for long-term sustainability which require urgent strengthening of Kosovo's production and export capacities (OECD, 2024).

4.3.2. Regional trade integration: CEFTA and Common Regional Market

Since 2007, Kosovo (represented by the UNMIK mission at the time) has been a party to CEFTA. This has effectively eliminated tariffs in all industrial and agricultural goods traded among the six Western Balkans states as well as EU negotiating candidate Moldova. CEFTA has thus provided duty free access to neighbouring markets that are not only valuable for geographical proximity but also diaspora and linguistic links (European Commission, 2024)., especially in Albania and North Macedonia and to a lesser extent in Serbia and Montenegro (see image).



As noted, the CEFTA region now accounts for 45% of Kosovo’s exports, up from 36% just 2 years earlier, thanks in large part to Kosovar products (such as food and plastics) that have found niches in Albania and North Macedonia (Ministry of Industry, Entrepreneurship and Trade, 2023).

However, non-tariff barriers and political issues have blocked the full potential of CEFTA for Kosovo. The largest problem is unsurprisingly the fact that neither Serbia, nor Bosnia and Herzegovina recognise Kosovo. Recurrent trade frictions have arisen from this, from differences over custom stamps and phytosanitary certificates to lack of recognition of documents, all impeding the flow of goods (European Commission, 2023). Most notably, in mid-2023 Kosovo imposed a temporary ban on imports of all goods coming in from Serbia, citing political and security reasons. This move led to criticisms from the EU which declared that Kosovo was contravening Kosovo’s commitments under CEFTA and the spirit of the SAA with the EU. On October 7, 2024, after 16 months, Kosovo lifted the import ban under enhanced customs oversight (Balkan insight, 2024, October 8). The move was welcomed by the EU as “vital to restoring CEFTA-compliant free trade” (European Western Balkans,

2024). Moreover, for some time, the Kosovar government has blocked formal decision making within CEFTA's joint structures which rely on unanimity - over a disagreement on Kosovo's representation (the Kurti government insists on being treated as an equal sovereign party to the others rather than under the UNSCR 1244/UNMIK designation). This has led to CEFTA rules, such as *Additional Protocol 5 on trade facilitation and Additional Protocol 6 on trade in services*, not being fully implemented by Kosovo. These two bills respectively aim to make goods trade faster and cheaper and open and integrate services markets (particularly law, IT, finance and tourism) across CEFTA. As part of its 2025 CEFTA chairmanship, Kosovo has promised to advance the implementation of these protocols, however this has not been done yet and arguments over political differences continue, all to the detriment of Kosovo's economy (OECD, 2024).

The Common Regional Market (CRM) was established by the Berlin Process, a diplomatic initiative launched by Germany in 2014 to re-energise regional cooperation and EU integration for the Western Balkans. It seeks to deepen integration by allowing freer movement of goods, services, capital and people within the region, building upon the progress made on goods under CEFTA. Crucially, its non-treaty nature allows Kosovo to sit on the table as an equal, avoiding certain problems with the CEFTA. It has led to many positive developments that Kosovo has been able to ratify, including; mutual recognition of qualifications for engineers, architects and doctors, something the EU has not yet achieved; automatic recognition of higher-education qualifications; abolishment of roaming charges and freedom of movement with only ID cards (European Commission, 2024). These so-called *Berlin agreements* are hugely significant as they allow for citizens and professionals to move and access labour across the region without additional bureaucracy, particularly useful in this bloc of six minor economies that only share three languages between them, all of whom have substantial minorities of either one of the other ethnicities or languages.

Other regional initiatives Kosovo has partaken in recently to boost trade performance include: CEFTA Green corridors/Green Lanes which ensure priority passage for trucks at certain borders, including transit routes to EU member states Bulgaria and Greece via North Macedonia; cooperation on SEED+ system (Systematic Electronic exchange of Data) to exchange customs data with neighbours, with EU

support; finally closer economic ties with Albania, with which it has taken steps towards a closer bilateral economic area (discussions include a customs union or port cooperation), which complements regional integration efforts that are already underway (OECD, 2024) (Sanfey & Milatovic, 2021).

To conclude, regional trade integration has seen many successes, driven by both the EU and Kosovo's willingness. Tariffs have been essentially eliminated from nearly all trade with the continent and regional trade is rapidly growing, but political disputes and remaining non-tariff barriers prevent full realisation of the benefits. The blockage within CEFTAs joint committee is of particular concern, holding back consensus requiring improvements in regional trade. The hope is that sooner rather than later Kosovo will drop its case and in the long run that political issues with Serbia can be solved in order to allow Kosovo to reap the full benefits of the CEFTA. Nevertheless, the commitment to the CRM and alignment of regional agreements to EU norms bode well not just for Kosovo but the entire trade bloc. Improved relations and trade logistics with neighbours is a stepping stone towards Internal Market integration, as it helps Kosovar firms become more competitive in a larger market.

4.3.3. Alignment with EU Acquis and Trade facilitation

Internal market preparation requires not only trade liberalisation, but also alignment of laws, standards and institutions to fit the EU acquis in relevant chapters. Alignment with these is crucial to the removal of non-tariff barriers that will ensure goods and service are able to flow between Kosovo and EU countries freely in the future. Kosovo has undertaken efforts to align with several trade-related chapters of the acquis (European Commission, 2023, 2024):

- *Free Movement of Goods (Chapter 1)*: Kosovo has begun to adopt the legislative framework mandated for EU-fit product regulation. Earlier we mentioned the law on Product safety, in addition to this, Kosovo has been able to align laws on market surveillance and metrology and is working on the harmonisation of technical regulations for industrial products (European Commission, 2023). Another important factor of this chapter is the establishment of institutions for quality infrastructure: standardisation, accreditation, conformity assessment

and market surveillance. Kosovo has established a national accreditation body and is improving the capacity of its market inspectorates. Gaps remain however, Kosovo's standardisation agency is still not a member of CEN/CENELEC (the European standards organisation) which means that it cannot meaningfully adopt European standards with ease (European Commission, 2024). There are also practices that go against the single market's values in place such as requiring certain imports to be labelled with the country of origin flags, supermarkets too put the flag of origin next to the price symbol at the store (the generally accepted theory amongst Kosovars is that this is done to discourage the purchase of Serbian goods) (European Commission, 2023). The EU has warned Kosovo that this must be abolished. The overall Commission assessment is that Kosovo has some level of preparation in free movement of goods, but must sustainably build up administrative capacity and complete the alignment of its technical legislation (European Commission, 2024).

- *Customs and Trade facilitation (Chapter 29)*: As a customs territory, Kosovo's tariff schedule is largely in alignment with the EU's common external tariff for industrial and some agricultural goods (a commitment under the SAA). Additionally, customs operations have been modernised via electronic systems for declarations. Kosovo customs is generally regarded among the more effective agencies in the region and it has been able to cooperate with EU instruments like the use of compatible customs code classifications more successfully than others (European Commission, 2023). However, the EU customs code has not yet been fully adopted and full interconnectivity with EU customs IT systems will be a task for the future. Progress has been limited mainly as a result of the political disputes in CEFTA mentioned above. Some border procedures have been simplified such as the one with North Macedonia that has been effective in reducing waiting times, though businesses still complain about administrative delays and compliance costs at the border. To address these barriers, Kosovo will need to implement regional trade facilitation agreements like CEFTA Protocol 5 as soon as possible. The European Commission (2023) noted that “*while customs legislation is moderately aligned, Kosovo should ratify the pending regional agreements and improve coordination to fully meet the trade facilitation standards expected by the EU.*”

Structural weaknesses remain, in particular in border infrastructure. The World Bank (2022) has highlighted deficiencies in modern facilities, scanners and one-stop posts, which drive high transaction costs. A World Bank-supported project is working on a national “single-window” system to streamline import–export procedures, but according to World Bank logistics indicators, Kosovo’s time and cost of border compliance remain significantly above EU levels (World Bank, 2022).

- *External relations (Chapter 30)*: Chapter 30 requires candidates to align their external economic relations with the EU’s Common Commercial Policy (CCP). Within this lies adopting the EU common external tariffs, participating in trade defence mechanisms, implementing WTO obligations and aligning with sanctions that have been imposed by the EU (European Commission, 2023). Kosovar progress is limited though not inexistent. It has notably joined the EU in implementing sanction regimes, including those imposed upon Russia following the invasion of Ukraine in 2022. Kosovo also applies a tariff regime broadly aligned with the EU through its SAA and CEFTA membership. Nearly all barriers to trade have been removed from EU goods. However, the European Commission continues to stress that Kosovo must build institutional capacity for *managing trade defence, external tariff policy, and international trade negotiations*, all of which are currently minimal. Moreover, Kosovo’s WTO membership application remains unsolved and, as trade defence and many elements of the EU’s CCP are rooted in WTO rules, this leaves a major structural gap. Entrance is reliant on Serbian approval (OECD, 2024). Overall Kosovo’s performance in Chapter 30 is described as “*politically aligned but constitutionally weak*” (European Commission, 2024). For Kosovo, further progress on this chapter relies less on economic policy and more on overcoming political obstacles in order to obtain WTO membership, the lack of which means Kosovar trade policy remains embryonic.

There is much work to be done in order to align Kosovo with the *acquis*. The most recent EU report has said that Kosovo has made some progress in the Internal Market cluster, but still faces structural weaknesses in enforcement and institutional capacity. Within the chapters analysed; free movement,

customs and external relations - many reforms remain at the early stage with much progress, both political and socio-economic, needed. How well the acquis is enforced will be a hugely important factor in meeting EU expectations.

Encouragingly, trade liberalisation has been largely implemented, under the SAA obligations. Kosovo has virtually eliminated all tariffs with the EU and refrained from introducing any new barriers (with the exception of the skit with Serbia). Its trade measures are generally aligned with the EU, including foreign sanctions. This is a great show of political will and is viewed positively by the EU. Kosovo will however- need to invest in trade-related infrastructure, including physical infrastructure at borders and digital ones such as a national “single window” system that can streamline import-export procedures in order to reduce the time and cost of moving goods.

4.4 Summary of Economic readiness

Kosovo has undergone some positive developments in economic reform and alignment with EU standard. In spite of this, its readiness for the Internal Market remains limited. The European Commission’s 2023 and 2024 reports have said that the country is at the stage of having *some level of preparation* in developing a functioning market economy, though stress that enforcement capacity and competitiveness remain weak

Key strengths

Kosovo has the benefit of a very stable macroeconomic environment. Public debt stands at an incredibly low 20% of GDP, the banking sector is strong and sufficiently capitalised and inflationary pressures from the 2022 global shocks have essentially disappeared, restoring economic stability. The government has also passed reforms in favour of digitalisation and simplification, such as the expansion of e-governance services and the establishment of the specialised commercial court. Openness to trade and investment is another key positive factors. There are very little restrictions on foreign investors and under the SAA, Kosovo has been able to maintain a liberal trade regime. While dependence on them remains an issue, diaspora ties remain a key asset, with remittances equivalent to

roughly 15% of GDP, sustaining consumption and support investment in services and construction, helped further by the lengthy periods of time spent in Kosovo in the festive periods. Kosovo has also shown strong willingness to integrate into the CRM (which unlike the CEFTA treats them as equals to the other member states) by ratifying agreements on freedom of movement and recognition of qualifications amongst others. The adoption of EU-aligned laws on product safety, public procurement and financial services demonstrate closer acquis alignment which will hopefully be accelerated in the coming years. Institutions such as the Central Bank and Ministry of Finance have demonstrated economic discipline as well as resilience, helping maintain economic stability through recent checks in an economy that cannot afford to spiral out of control given its absence of traditional monetary policy tools.

Main constraints

At the same time, Kosovo also faces deep structural weaknesses. The export base remains extremely narrow, with exports accounting for only 10% of GDP against the 60% level of imports, leaving a trade deficit half the size of GDP. This is a sign that Kosovo's industries are yet no match for the Internal Market. Low productivity and high unit Labour costs, combined with underdeveloped industry undermine competitiveness. The business environment, like many others in the region, is also constrained by issues of informality, estimated at over 30% of GDP, which diminishes the tax base and traps firms and workers in low productivity activities. Weaknesses in governance and rule of law are also a hinderance in a country still riddled with corruption, leading to discouragement of investment. Institutional capacity is under sourced, which creates challenges for agencies responsible for implementing EU rules in sectors such as competition, food safety or inspection, and the judiciary is overburdened. Skills mismatches in the labour market, high unemployment (particularly youth and female), and emigration of skilled workers also limit Kosovo's productive potential. Infrastructure bottlenecks — notably in energy reliability and trade logistics — compound these barriers, even as donor support is beginning to address them.

Overall assessment

To paraphrase the EU, Kosovo's readiness for Internal Market can be described as partial yet evolving. The country's finances are in shape and successive governments have displayed commitment towards reform. But this has not yet built the institutional, productive and governance foundations needed to meet EU standards. In EU terminology this puts them at *some level of preparation*, short of the *moderately prepared* status achieved by other Western Balkan countries. The path forwards will require tackling informality and corruption, strengthening rule of law and creating export-led growth. The young population, diaspora connections and growing digital and renewable energy sectors represent untapped potential. With sustained reforms and EU support, Kosovo can close the gap to its CEFTA peers and move closer to Internal Market standards.

Chapter 5- BiH analysis

5.1 Overview of Bosnia and Herzegovina's economic structure and reform context

Bosnia and Herzegovina is a small Western Balkan economy of around 3.3 million people (double that of Kosovo's for context) (BHAS, 2023), characterised by a complex federal constitutional setup that fragments the economic space of the country. The country consists of multiple governing units. The highest level is the state, below this two main entities, the Republika Srpska, where the majority of Bosnian Serbs live and has a population of 1.1 million and GDP of €8 billion and the Federation of Bosnia and Herzegovina, populated mostly by Bosniaks⁵ and Bosnian Croats, which has a population of 2.2 million and GDP of €15 billion (World Bank, 2025; BHAS, 2023). There is also a single mixed ethnicity municipality, Brčko, which is part of neither and whose area prevents either the Federation or RS from having a contiguous land mass. Beyond this, the constitutional setup of the two entities is different, with the Federation being split into ten fairly powerful cantons that have tax raising powers, whereas RS resembles a more unitary structure with a directly elected President (SNG-WOFI, 2023). To further complicate the institutional setup, as BiH has not been able to ratify a constitution that updates the Dayton Peace Agreement, an internationally chosen High Representative holds veto "Bonn" powers that can block any legislation passed by any of these subjects (OHR, 2024). This factionalism results in no common internal economic space and duplicative regulatory frameworks, the sheer number of institutions also leads to far higher public sector employment than necessary.

Over the past decade GDP growth has averaged at 2.5% annually, largely driven by consumption, lagging behind other nations at a similar development level. As with many other countries, a strong pandemic rebound of 7.4% growth decelerated to 4.0% in 2022, 1.9% in 2023 but then bounced back to 2.6% in 2024. The 2025 projection remains in the region of 2.4-2.8 (World Bank, 2025; IMF, 2024). Per capita income remains low (at roughly a third of the EU average in PPP) and convergence with the EU has been sluggish. The global price shock crisis of 2022 led to a 17.5% rise in consumer goods, eroding real incomes and while they dropped to a healthy circa 1.7% in 2024, the most recent

⁵ Also known as Bosnian Muslims

year-on-year rate was 4.8%, something the Central Bank attributed to higher imported food prices, rising wages and domestic demand pressures as well as lingering cost increases in energy and utilities, the former of which are nearly fully imported (Central Bank of Bosnia and Herzegovina, 2025). The Central Bank expects inflation to ease in 2026.

BiH has a fairly strong industrial base, though its economy is mainly concentrated in services which account for roughly 58% of GDP while industry, including metals manufacturing, machinery and wood products, accounts for a quarter. Agriculture plays a fairly small role at around 6-7% of GDP, not necessarily reflecting limited arable land, but more due to post-war declines in output (World Bank, 2025). The public sector footprint is very large. Government companies and State-owned enterprises employ around 25% of the population but are incredibly inefficient, absorbing significant resources and thus crowding out public sector development (IMF, 2024). Despite a burdensome public sector, BiH's finances are stable. It has maintained macroeconomic stability through a currency board (pegging the Bosnian Mark to the Euro) and prudent fiscal policies. Public debt sits at 32.75% of GDP thanks in part to conservative budgeting and regular under-execution of capital projects (IMF, 2024; European Commission, 2024). Generally, the currency board has been able to keep inflation low other than in times of crisis, though BiH did undergo deflation from 2013 to 2016.

The labour market is showing signs of improvement but remains weak. Unemployment in Q1 2025 was at 13.4% slightly above the record low 11.7% showing of Q4 2024, though despite this unemployment is still below any pre-covid level. Youth joblessness stood at 30%, high but fitting the EU trend of being slightly above double overall level (World Bank, 2025). Labour force participation is low (49% for ages 15+ and 39% for women) reflecting both discouragement and structural barriers to employment. Compounding all of this, significant outflows of workers to the EU continues to cause labour shortages in certain skills, as is the case across the Western Balkans, with over half a million leaving since 2013 (OECD, 2024). Indeed, as is the case with Kosovo, remittances are defining features of the economy. Diaspora transfers exceeded a tenth of GDP, providing cushions for households but causing reliance, something that can also contribute to an aging population (Kupizewski et al, 2013; World Bank, 2025).

Bosnia and Herzegovina's structure is marked by fragmentation and underutilised potential. The macroeconomic picture is one of stability, but it is a stability of low growth and low productivity. Structural challenges such as the lack of a national uniform economic and governance framework and a dominant public sector constrain its readiness for the EU Internal market. As of its 2024 report, the EU assesses that BiH still lies at *an early stage* in establishing a functioning market economy and that there is limited progress on foundational reforms, though the last year has seen some progress including the creation of a Coordination Committee at the Prime Ministerial level, the first public financial management dialogue with the EU in May 2024 and the adoption of a state-level civil service law (European Commission, 2024).

5.2. Business environment

5.2.1. Regulatory and institutional framework

Attempting to do business throughout Bosnia and Herzegovina is both challenging and fragmented. There is no single economic space to operate in, given the different layers of jurisdiction across the two entities and their subdivisions. Businesses face different rules as well as different licensing regimes in the Federation as they do in RS, complicating nationwide operations, and creating transaction costs that wouldn't exist in virtually any other state in the world, ultimately discouraging investment (OECD, 2024; World Bank, 2025). As a result, many firms decide to operate informally. This demonstrates both the inefficiency of the current system, as the complex administrative procedures and overlapping red tape mean informality is the best way to create a truly national company but also the lack of cooperation between the two entities who both lose out but are unable to overcome their ethno-political divisions (OECD, 2024).

Corruption and weak rule of law undermine the business sector further. Corruption perception in BiH is amongst the worst in the region. Internal polling data shows that around 85% of citizens believe that the fight against corruption in BiH is ineffective (USAID/Measure BiH, 2023). There is no overarching anti-corruption framework that spans both the state and entity level and enforcement bodies are not only under-resourced but have recently started to come under the influence of semi-

autocratic leaders. This is bad news for investor confidence and tilts the playing fields in favour of firms that are well-connected. Furthermore, contract enforcement and property rights are also impeded by a slow judiciary and occasional political interference. The most striking example of this occurred two years ago when RS announced that it would no longer recognise the decisions of the Constitutional Court, leading many international organisations to warn that such decisions would create uncertain conditions that investors would not see too kindly. The decision was immediately reversed by current High Commissioner Schmidt through the use of his “Bonn powers” (OHR, 2022). These issues are assessed under chapter 23 (Judiciary and Fundamental Rights) and Chapter 24 (Justice, Freedom and Security), where the EU highlights weak rule of law and anti-corruption enforcement as constraints on the business environment (European Commission, 2023)

5.2.2. SME

As already outlined, chapter 20 of the acquis covers policies to enhance industrial competitiveness and support SMEs. Rooted in the EU *Small Business Act*, it states that candidate countries must provide a predictable business framework that strengthen innovation and sectoral policies while also ensuring SME access to finance and services. Alignment remains at an early stage. The EU notes that the country lacks a unified enterprise and industry policy, as the two entities implement different strategies without coordination (European Commission, 2023 ; Western Balkans Info Hub, 2024).

There are support mechanisms for SMEs but they remain uneven. SME development funds exist both in the Federation and in RS, but there is a lack of harmonisation. In 2019, the latest available data online, SMEs accounted for 69.1% of employment and 62.7% of value added (European Commission, 2021), but productivity remains low with little integration into EU value chains. Business services such as incubators, advisory programmes and cluster initiatives are heavily dependent on donors and, remain underdeveloped (OECD, 2024).

Access to finance however, is slightly better than other CRM countries in large part thanks to the stability of Bosnia’s banking sector which provides 44.1% of its total business lending to SMEs (OECD, 2024 – FBiH brief). However, almost non-existent alternative finance means scaling up can

be very difficult. Venture capital is scarce, innovation policy is minimal, with less than 0.2% of spending going to R&D and there is little collaboration between industry and universities (World Bank Data, 2024; OECD, 2024). The OECD's *Competitiveness Outlook 2024* scored BiH below the Western Balkan average in enterprise policy, innovation and industrial competitiveness, reflecting capacity and policy gaps. As will be seen in the next chapter, dominance of state-owned enterprises is also something that must be addressed under chapter 20, as the lack of state-aid control hinders private sector development.

Overall, as of now, BiH's alignment with chapter 20 is minimal. The Commission's recommendation has repeatedly been to create a "*coherent national framework for SME and industrial policy and strengthen its institutions to support competitiveness in line with Eu standards*" (European Commission, 2024; Western Balkans Info Hub, 2024). In lack of such developments, the private sector will remain underequipped to deal with EU Internal Market pressures.

5.2.3. State-Owned Enterprises and Market structure

State-owned enterprises (SOEs) dominate Bosnia and Herzegovina's economy, enjoying monopoly positions in utilities, transport and other sectors, though they tend to be inefficient and loss-making, relying on subsidies (World Bank, 2021; IMF, 2024). The reform and privatisation pushes from the early 2000s have resulted in continued fiscal drains and limited space for private enterprise (OECD, 2024).

This situation, as stressed by the Commission in its report (2024), is inconsistent with chapter 8 of the *acquis* (competition policy). Chapter 8 requires a functioning state-aid control system and a level playing field for private sector development. BiH has been assessed to still be at an early stage of preparation. The State-Aid council is weak, transparency limited and reform is blocked by political influence (European Commission, 2024). The IMF and World Bank have both emphasized that SOE reforms will be critical to levelling the playing field and freeing up the resources necessary for private sector development.

5.2.4 Access to Finance and FDI

Alignment with the acquis under Chapter 4 (Free Movement of Capital) and Chapter 9 (Financial Services) remains at an early stage. While capital flows have largely been liberalised in line with EU obligations under the SAA, institutional weakness and differing investment promotion systems in the two entities prevent the country from attracting more FDI. In financial services, the banking sector is broadly aligned with EU prudential standards and is stable (helped by the fact that most banks in Bosnia are EU ones), but capital markets, non-bank finance and investment promotion mechanisms remain underdeveloped (European Commission, 2024).

The financial sector is heavily dominated by banks which account for around 90% of financial assets (European Commission, 2024). The foreign ownership of the majority of these banks, that guaranteed alignment with EU banking standards means that the system is stable and well-capitalised. Non-performing loans are now at 3.8% from 15% in 2013, thanks to stricter oversight, write-offs and improved risk management (Džidić et al, 2022) and bank credit has increased moderately. However, as already analysed, SMEs and investors face persistent constraints. Aside from the high collateral, loan maturities remain short, limiting long-term investment and as already mentioned alternative methods are almost inexistent - even leasing and factoring are severely underdeveloped in comparison to EU levels (OECD, 2024).

On the positive sides, there have been reforms recently that allow for electronic tax filing, reducing compliance costs, with usage rates reaching 90% in the RS, though only 64% in the Federation (OECD, 2024). The Foreign Trade and Economic Relations Ministry has introduced the New Computerised Transit System, a platform that simplifies cross-border trade declarations. These reforms, though they may not be directly targeted at addressing financing gaps, modernise the business environment and support investor confidence. They were described by the Commission (2024) as a “*major step towards aligning customs procedures with EU standards*” that moved Bosnia and Herzegovina closer to eventual participation in the Common Transit Convention, a prerequisite to eventually joining the Customs Union (European Commission, 2024).

FDI inflows remain amongst the lowest in the CRM. Net inflows stand at around 2-3% and per capita stock is also among the smallest in the region (World Bank, 2024). Moreover, inflows commonly merely reflect reinvested earnings by firms already present. Greenfield investment is rare, often concentrated in non-tradeable sectors (e.g. real estate). Export-orientated and technology-intensive sectors attract little investment compared to the levels of Serbia or North Macedonia where targeted promotion has been successful in integrating national firms into EU value chains (OECD, 2024). The OECD stressed that investment policy and promotion is underperforming. The absence of a state-level investment promotion agency leaves a fundamental gap (once again divided between the entities), and gives the country weak international visibility. The absence of this puts it at a huge disadvantage to its neighbours who through centralised agencies are able to actively target strategic national sectors. This lack of a coherent strategy is not only a red flag for foreign investors but also keeps BiH at odds with the *acquis* under chapter 4, which requires liberalised, transparent and well-regulated capital flows.

To conclude, BiH's financial system demonstrates stability and EU-compatible supervision, but a lack of FDI and alternative finance highlight fundamental shortcomings. Chapters 4 and 9 both remain at early stages of progress for BiH and reforms are urgently needed to expand but mainly diversify financing instruments, harmonise investment promotion and attract export-oriented greenfield FDI. Without this, capital will not be able to be channelled effectively into the private sector to create the financial integration needed for the EU Internal Market.

5.2.5 Governance, Informality and Anti-corruption

Alignment with the *acquis* under Chapter 23 (Judiciary and Fundamental Rights) and Chapter 24 (Justice, Freedom and Security) is assessed in Bosnia and Herzegovina to be at an early stage of preparation, with little progress in strengthening rule of law, judicial independence, or anti-corruption enforcement (European Commission, 2024).

The informal economy is large, at 30% of GDP (OECD, 2024), weakening the tax base and creating unfair competition, prompting many SMEs to operate partly or wholly informally. Informality is slightly more pronounced in the Federation, especially in construction, retail and services, mainly due

to a more decentralised structure and less strict tax enforcement. Enforcement overall remains weak however, with labour inspections and tax audits being under resourced and coordination between state and entity authorities limited. The Commission has been urging BiH to strengthen anti-informality strategies for years, but implementation has lagged due to political fragmentation.

Corruption further undermines the market. BiH has consistently ranked amongst the worst performers in all of Europe in the Corruption Perceptions index, 114th out of 180 in the world in 2024, below any EU member and only ahead of Russia on the continent (Transparency International, 2024). Surveys undertaken have shown that both citizens and businesses perceive corruption as widespread in the judiciary, procurement and licensing systems. Judicial independence, especially in the RS is weak. Courts are under political pressure, case backlogs are significant and contract enforcement slow. While legal frameworks exist — such as anti-corruption laws and public procurement regulations, enforcement is inconsistent and often politically selective. The OECD (2024) finds that BiH lags behind the regional average in anti-corruption and governance indicators. International actors, including the EU and IMF, have highlighted governance reform as being essential for economic development and market integration.

In summary, BiH faces serious structural barriers to creating a predictable and transparent business environment. The large level of informality and the remarkably high corruption make BiH years away from being anywhere near to the acquis requirements. It will necessitate incredible levels of political will to strengthen enforcement and depoliticise the judiciary. Until this is done, BiHs private sector remains constrained and unattractive to domestic and foreign investors alike.

5.2.6. Institutional Assessments and Reforms

European Commission (2024) reports outline that while BiH maintains macroeconomic stability and has passed some EU-aligned legislation, the business environment remains held back by divisions in governance, lack of rule of law and poor institutional capacity. It points to certain positive steps though, including the extension of the Public Administration Reform Strategy in 2022, passed with aims to modernise civil service management and improve service delivery. Justice sector strategies

have also sought to strengthen judicial independence (European Commission, 2023, 2024). When it comes to direct progress on the acquis, reforms have been made in areas of public procurement, financial services and product safety. But once again here, just as implementation differs across entities and cantons, so too does progress on reforms, which remains uneven, and also at an early stage (European Commission, 2024).

Reports from International Organisations are largely in line with such assessments. In the OECD *Competitiveness Outlook* report BiH has only improved in a handful of indicators since 2021 and remains below Western Balkan average in the majority of areas with particularly low scores in innovation governance and business services (OECD, 2024). The IMF Article IV consultation too warns that structural weaknesses, especially corruption, SOE inefficiency and political fragmentation, will remain serious obstacles to productivity growth if not addressed. The World Bank (2024) highlights that BiH's growth model is over-reliant on consumption which in turn depend on remittances and does not have the ability to converge with EU living standards unless major reforms are undergone to strengthen institutions, improve infrastructure and boost private investment. BiH scores low in certain quantitative indexes too, such as the World Bank Worldwide Governance Indicators (2024), in particular corruption and rule of law, and as previously mentioned it is last bar Russia in the European Transparency International ranking (2023).

Overall it is clear that there is a deep need for institutional reform to improve business climate and prepare the country for the Internal Market. This will mean depoliticisation of the judiciary, upgraded anti-corruption, regulatory and administrative agencies, but most and hardest of all, a unitary state structure. This will require parties to converge and draft a new constitution, something that seems increasingly impossible in the fragmented Bosnian political scene of today.

Agricultural exports remain modest and include dairy, meat and processed foods. Import demand is much more diverse: machinery, chemicals, fuels and consumer goods dominate (European Commission, 2024). This structure leaves BiH vulnerable to swings in global commodity prices as shown by the widening of the trade deficit in goods in 2024 when metal and energy prices softened (World Bank, 2025)..

Services are becoming more and more important, though they remain too low to account for a current account surplus. Tourism receipts have substantially grown largely as a result of new visitors from Gulf countries that have expanded on the EU and Turkish tourist base. However, in comparison to Croatia and Montenegro, who have access to a large stretch of coast, the tourism sector is underdeveloped (OECD, 2024). There is significant potential as the country has plenty of history and cultural landscape- from being the start point of World War I, the host of a Winter Olympics in 1984 and having many historical sites from the civil war such as the Mostar bridge or Sarajevo itself whose scars from the longest siege suffered in history are still visible, but many museums are underdeveloped or poorly managed. Natural sites too provide opportunities such as rafting through the Dinaric Alps and skiing in the legacy of 1984. Perhaps BiH's tourist industry and national issues are best exemplified by the bobsleigh track from 1984, a beautiful course weaving through the mountains on the border of the RS and Federation with a fantastic view on Sarajevo, trapped in no mans land during the war and now covered in graffiti, far from being in use anytime soon. BiH's role as a transport corridor, sitting on the Corridor Vc, has been of huge benefit, through freight but also being on the route home for many diasporas, particularly Turks (European Commission, 2024).

In conclusion, BiH's trade performance is marked by deep trade integration but limited diversification, consistent deficits and underdeveloped services potential. Despite the access to the EU market tariff free under the SAA, exports have failed to grow while imports have risen. The structural bottlenecks we have outlined in the chapters above prevent BiH from achieving the higher export-to-GDP ratios seen in neighbouring countries.

5.3.2. Regional trade integration

As with Kosovo, though not nearly to the same extent, CEFTA is an important market for BiH. In 2024, the latest year with full data, exports to CEFTA countries accounted for around 18% of exports, mainly to Serbia, which accounts for 11.9%, absorbing a substantial share of BiHs industrial and agri-food exports, and Montenegro at 3.6%, all others are below or around 1%. Imports are slightly lower at 15%. BiH runs a deficit of around €5.5 billion with Serbia and €49 million with North Macedonia and surpluses with the others (European Commission, 2024e).

Modernisation on CEFTA has been slow. Key Additional Protocols remain signed but unratified. AP5 on trade facilitation would simplify customs procedures and reduce border delays; AP6 on trade in services would liberalise service provision across CEFTA; and AP7 on dispute settlement would strengthen mechanisms for resolving trade disagreements. At the start of the year, BiH was yet to ratify AP6 or AP7 and had only partly implemented AP5, the only CEFTA country yet to have ratified all three. Once again domestic division has been the cause, as under AP6 a new unified system would have to be in place but the RS has not been willing to commit to this (European Commission, 2024).

A full implementation of AP5 would also help tackle many of the issues the Commission has highlighted such as: slow clearance and too many physical inspections of customs, repetitive inspections and extra paperwork for agri-food (Sanitary and Phytosanitary measures included in AP5) and old Yugoslav standards not recognised by CEFTA partners or the EU (European Commission, 2024). BiH has signed onto the essential CRM agreements including on freedom of movement with ID cards, mutual recognition and regional broadband connectivity. However, the third mobility agreement remains unratified which the EU has urged to complete as soon as possible (Regional Cooperation Council, 2023; European Commission, 2024). The Commission has also commented that BiH should “*implement the [CRM] action plan, in particular by urgently implementing the [CEFTA] additional protocol 5 on trade facilitation and the additional protocol 6 on trade in services, take the necessary steps to implement additional protocol 7 on dispute settlement and implement actions under the new action plan for 2025-2028*” (European Commission, 2024, p. 120).

5.3.3. Alignment with the EU acquis and Trade Facilitation

- *Free movement of goods (Chapter 1)*: Bosnia and Herzegovina remains at an early stage of preparation in terms of alignment of legislation and institutions with the EU acquis. The key requirement of this chapter is the harmonisation of technical regulations, standards and conformity assessment with EU norms that allow for Bosnian goods to circulate freely in the EU single market. Through the Institute for Standardisation, BiH has adopted a substantial number of European standards, including 1,207 in 2023 (European Commission, 2024). However, still many old ex-Yugoslav standards remain in place and unsurprisingly, conflicting rules are in place in the Federation, RS and Brcko. The laws on the market surveillance agency are outdated, still being largely based on mandatory standards and pre-market inspections, lacking significant capacity to ensure that product safety requirements are consistently applied. On accreditation, neither conformity assessment bodies, nor conformity assessment procedures are applied consistently throughout the country, meaning BiH firms often need to repeat testing and certification. The Commission (2023, 2024) has urged Bosnia to develop a unitary strategy and action plan for adopting product rules and building quality infrastructure to achieve a genuine free market able to adapt to EU free trade, but progress remains slow. In practice, exporters rely on the SAA for preferential access, but deeper alignment is required.
- *Customs Union (Chapter 29)*: BiH has been assessed to have reached **some level** of preparation when it comes to customs (European Commission, 2024). A new Law on Customs Policy, adopted in 2015 but only implemented in 2022 introduced concepts such as Authorised Economic Operators (trusted traders under the Union Custom Code that enjoy simplified customs procedures) and electronic signatures, bringing BiH more in line with the EU's Union Customs Code. As of late 2024, only two companies have been recognised as AEOs however, for context there are tens of thousands in the EU and dozens in other CEFTA countries, so while this is symbolic progress there is still far to go (European Commission, 2024). Furthermore, 60% of checks are still done physically. The report also highlights that

the Indirect Taxation Authority (ITA) still requires further capacity building in risk-analysis, IT systems and cooperation with EU customs platforms. Tariff schedules and product nomenclature have been aligned with the EU by using the Common Customs Tariff and Combined Nomenclature and BiH applies the Pan-Euro-Med rules of origin, enabling cumulation with both EU and regional partners. Preparations are also underway to join the Common Transit Convention through the implementation of the New Computerised Transit System (NCTS), however, this requires consistent enforcement at all border points to be implemented.

- *External relations (Chapter 30)*: In the field of Common Commercial policy, the Commission regards BiH's preparation to be of **some level** (European Commission, 2024). Currently BiH employs its own trade measures, some of which are in conflict with EU ones. A temporary wood exports ban, for example, was introduced in order to protect domestic supply (Sarajevo times, 2022). Something the EU criticised as a violation of BiH's obligations under the SAA. On a larger scale, BiH is still not a full member of the World Trade Organisation, holding only observer status, thus making it one of the last UN Member States to yet not be admitted. Negotiations have been ongoing since the end of the Bosnian War with bilateral market access talks remaining unresolved, notably with Russia (Reuters, 2018). As already mentioned, regional participation in CEFTA and CRM is hindered by the delays in ratifying AP6 and AP7. If BiH has any hope of aligning with Chapter 30 of the acquis in the near future, it must implement CEFTA commitments consistently and refrain from any unilateral trade restrictions.

Alignment with acquis chapters directly linked to trade is partial and uneven. While tariffs have become harmonised with those of the EU, enforcement capacity is still unfortunately limited (European Commission, 2024). Issues of outdated technical regulations and standards or undeveloped infrastructure only complicate matter further. External trade is inconsistently applied, with BiH still not being a member of the WTO and the occasional protectionist measure still coming up every so often. The European Commission (2024) concludes that BiH must accelerate legislative

harmonisation, build regulatory and customs capacity, and demonstrate consistent commitment to CEFTA and CRM obligations if it is to move from “some level of preparation” toward full readiness for Internal Market integration.

5.4. Summary of Economic Readiness

Since gaining candidate status, Bosnia and Herzegovina has only made mild progress in terms of economic reform and acquis alignment, overall readiness for the Internal market remains limited. The two reports published since accession describe the nation of 3.2 million as being at an **early stage of preparation** when it comes to the development of a functioning market economy. Though some stabilising reforms have been adopted, weak competitiveness, institutional fragmentation and uneven implementation undermine progress

Key strengths

Bosnia and Herzegovina is able to benefit from a fairly diversified base, compared to other CEFTA economies, especially Kosovo, exporting metals, machinery, wood products and electricity alongside services in tourism and transport. The main macroeconomic picture is one of relative strength, with inflation moderating at a good level after the 2022 global shocks and the banking sector remaining liquid, foreign-owned and with non-performing loans reduced to around 4% by 2023. Public debt at around 30% is very manageable and indeed far lower than the EU average. The SAA has provided BiH with a liberal trade regime with preferential access to the largest economic union on the globe. Their countries absorb nearly three quarters of its exports. Regional integration efforts such as CEFTA and more recently the CRM, set up by the Berlin Process continue to offer tariff-free access to neighbouring markets, though there is much untapped potential here as many integration measures are yet to be ratified with BiH lagging the most behind. Still, the positives achieved so far point to further potential success if full integration were to be achieved. Finally, institutional reforms such as the Customs Policy Law and the gradual introduction of electronic systems (NCTS, e-signatures) are

some of the few passed in the two years since candidate status was granted. Modest, yet concrete steps towards alignment.

Main constraints

The main constraints are undoubtedly the huge structural weaknesses. The economy is hampered by deep institutional fragmentation between the state and entity levels, discouraging economic growth, undermining policymaking and slowing ratification of CEFTA and CRM commitments. High informality, at circa 30%, weighs down on the business environment, as does corruption and weak judicial independence. State-owned enterprises dominate utilities and transport, draining fiscal resources and distorting competition in violation of *acquis* principles. Though not as low as Kosovo's, BiH's export competitiveness is nothing to be envied of. The trade deficit has been steadily winding, reaching 25% of GDP in 2024. Productivity remains far below EU levels, and labour market challenges — high unemployment, skills mismatches, and emigration of the young and skilled — further erode competitiveness. Infrastructure bottlenecks continue: the flagship Corridor Vc motorway, planned to be part of the pan-European corridor, is still incomplete, railways are underdeveloped, and energy diversification has stalled. On *acquis* alignment, BiH is at only an early stage in free movement of goods, customs, and external trade; technical standards remain inconsistent, the WTO accession process is still unfinished, and occasional protectionist measures (such as the 2023 wood export ban) undermine credibility.

Overall assessment

Bosnia and Herzegovina's readiness can be described as partial and further stagnant. Macroeconomic stability and integrated trade provide a foundation, but institutional and structural weaknesses persist and dominate. To overcome this, BiH must first of all tackle its deep political fragmentation, without this no significant progress can be achieved. Regardless progress should continue to be attempted to accelerate *acquis* alignment, and tackle informality, corruption, and SOE reform. If meaningful progress in these areas is achieved, BiH could better leverage its industrial base, geographic proximity, and tourism potential to converge with EU standards. Absent such reforms, however, BiH risks falling further behind in the regional race towards Internal Market readiness.

Chapter 6- Comparative Analysis

6.1. Cross-case comparison

When comparing Kosovo and Bosnia and Herzegovina, it is clear that both display a limited degree of readiness in terms of Internal Market preparedness, however, the underlying dynamics differ substantially and it is with this nuance that we will be able to draw out the most interesting conclusions and proposals for the future. Overall, Kosovo's trajectory mirrors much more that of a country with a low starting base, but with momentum in reform. BiH on the other hand suffers deeply from institutional deadlock despite having an overall better performing economy and broader industrial structure.

6.2. Business environment

Kosovo has made more progress here. The establishment of a state-level commercial court (Assembly of the Republic of Kosovo, 2022) (something that only exists in the entities in BiH) and the expansion of digital services through the e-Kosova platform, which in the latest OECD report listed 195 services and more have been added since (Western Balkans Info Hub, 2025, Telegraph, 2025), will lower transaction costs and increase transparency. Informality plagues both countries and their economies but Kosovo has demonstrated far clearer momentum. BiH on the other hand is plagued by the squabbles and subsequent inefficiency of the Federation-RS division. Efforts such as the Public Administration Reform and justice sector reforms do exist de jure, but implementation is limited and inconsistent. In terms of SMEs, they dominate both economies and both face issues in helping them scale up as the access to finance simply is not there. Having said this, Kosovo's credit guarantee fund and donor-supported SME financing instruments provide more active support than Bosnia and Herzegovina's fragmented entity-level schemes (World Bank, 2024, Hauser et al, 2016). This reflects relatively stronger progress in Kosovo under Chapter 20 (Enterprise and Industrial Policy).

On SOEs and subsidies, BiH lags behind significantly. SOEs dominate utility and transport in often loss-making ways reliant on subsidies. This affects free competition, a clear misalignment with Chapter 8 (competition policy). Kosovo also lacks a State Aid authority, but the problem is less severe given that SOEs do not dominate nearly as much as in BiH. Both countries have stable, foreign-owned banking systems with low non-performing loans. Kosovo's SME-focused Credit Guarantee Fund has improved access to finance while in Bosnia and Herzegovina entity level fragmented programmes and shallow capital markets leave firms more constrained. In *acquis* terms, this puts Kosovo further up the path of integration when it comes to Chapter 9 (Financial Services). On investment, Kosovo's regime for capital flows is more liberalised and consistent with Chapter 4 (Movement of Capital). BiH's fragmented framework, on the other hand, together with the high degree of political uncertainty deters FDI and weakens alignment. Kosovo's political tensions can cause problems too, but for investors, the situation is far more secure than the one in BiH. Finally on Chapters 23 and 24 regarding justice, the conditions are much the same. Both countries have weak rule of law to deal with corruption and the informal economy accounts for around 30% of GDP.

6.3. Trade Integration

Trade structures are fairly different with BiH sending around three quarters of its imports to the EU whereas as Kosovo only sends around a third, with regional trade playing a larger role, reflecting its geographic position and small export base, sitting at 10%, one of the smallest in the region. BiH's export base is more diversified — metals, machinery, wood, electricity —, but this has not prevented a widening trade deficit as incomes have increased, now sitting at 25% (CountryEconomy.com, 2025). When it comes to regional integration, Kosovo has fully ratified CEFTA additional protocols 5,6 and 7 and participates actively in the Common Regional Market where, unlike in CEFTA they are treated as equal members. BiH on the other hand has not ratified AP6 or AP7, pending due to political consensus (European Commission, 2024). This weakens their compliance with the obligations under Chapter 30 of the *acquis* (External Relations), where WTO membership and inconsistent trade policy also remain an issue, though it is worth remembering that Kosovo is also not a member. When it comes to customs (Chapter 29), more progress can be found in Kosovo where it has been successful

in applying modern IT systems, BiH on the other hand has adopted the legal framework but struggles with implementation. Both countries have also begun preparations for the New Computerised Transit System (NCTS), with Kosovo being much more advanced and closer to the Common Transit Convention membership; BiH has only recently operationalised NCTS with limited intake. Similarly when it comes to freedom of movement of goods (Chapter 1), we see that Kosovo has adopted some EU-aligned product safety and procurement legislation while BiH continues to operate with fragmented and out-of-date standards. Infrastructure is a weakness for both countries, though partial Bosnian progress on the Corridor Vc and electricity exports do provide it with some assets that Kosovo lacks.

6.4. Overall Comparison

Kosovo's reform momentum is clearly superior, even though, as stated, it starts with a structurally weaker economic base. BiH has stronger industrial capacity making import dependency less of a problem but progress is marred by deep institutional blockages. Both are currently at an early stage of preparation. Kosovo because of underdeveloped productive structures and limited capacity under **Chapters 1 and 29**, Bosnia and Herzegovina because of institutional fragmentation and stalled reforms that slow progress under **Chapters 20 and 30**.

6.5. Patterns of Convergence or Stagnation

6.5.1. Convergence trends

As mentioned various times, Kosovo has demonstrated steady, if uneven reform momentum. Under Chapter 20 (Enterprise and Industrial Policy), the expanded Kosovo Credit Guarantee Fund and adoption of the Law on Sustainable Investments are a reflection of steps being taken toward improving SME access to financing and alignment of investment policy, in a way that BiH has not done, with the requirements set forward in the *acquis*. The operationalisation of the NCTS and preparation for the Common Transit Convention bode well for Kosovo's convergence with Chapter 29. Alignment with Chapter 1 has also occurred, with laws having been passed on product safety and public procurement mirroring EU directives, though capacity is still weak. With regards to Chapter

30, the swift ratification of the CRM additional protocols indicate strong willingness to advance integration. Both these last two points represent areas in which BiH has instead stalled.

The limited convergence is noticeable on the Bosnian side. Progress has been made on Chapter 29 with the adoption of the new Customs Policy Law and tariff harmonisation with the EU, still lacking in Kosovo, but the Commission has reported that implementation is weak and customs procedures remain slow, as seen by the large number of physical checks still in place. Furthermore, to date only two Authorised Economic Operators have been recognised under the NCTS. With regards to Chapter 1, BiH has transposed parts of the acquis in standardisation and accreditation, albeit years after Kosovo, but conflicting entity-level rules are a barrier to uniform application, stalling convergence. Moving on to Chapter 30, BiH's failure to ratify CEFTA AP6 and AP7 and ad-hoc trade restrictions such as the ban that was placed on wood exports exemplify not just stagnation but reduction in progress on external trade alignment. Finally, Chapter 20 reforms have progressed little if at all, enterprise policy remains fragmented between the Federation and the RS, SOEs dominate important sectors and a unified national industrial policy is lacking.

6.5.2. Shared stagnation

Despite these difference in trajectories, both countries do have common structural problems that block meaningful convergence. Kosovo and BiH both have large problems with corruption, weak governance and weak judicial enforcement, all deterrents to investment that undermine the business community. Informality also sits at around 30% in both economies (OECD, 2024), distorting competition and lowering tax funds. Kosovo struggles with high youth unemployment and skills mismatches, BiH from a heavy public sector. Both, but even more so BiH also struggle with severe brain drain and declining workforce participation. Infrastructure problems are also present in both, from Kosovo's unreliable electricity supply to the unfinished Corridor Vc highway in Bosnia, constraining trade integration.

The main divergence lies in reform momentum in Kosovo versus large scale institutional blockages in BiH. Kosovo's small size and unitary institutions allows for quick adoption, even if implementation

capacity is limited. Bosnian fragmented constitutional structure prevents the state from acting coherently, producing stagnation across acquis chapters. In EU terms, Kosovo can be said to be on the path to “*moderate preparation*”, while Bosnia increasingly risks remaining stuck at an “*early stage*”

6.6 Structural Constraints vs Policy choices

We cannot attempt to do a meaningful analysis of Kosovo and BiHs preparedness for Internal Market simply by looking at the various stages of acquis alignment. There are structural constraints that are not in immediate control of both countries that impact possibility of reform and disproportionately influence progress. By separating these out and seeing which issues are simply hindered by structural constraints and which on the other hand are caused by policy choices we can explain why reform trajectories change.

6.6.1. Structural Constraints

The main structural challenges undermining Kosovo’s integration potential are its economic size and international status. Its population is less than 2 million, offering limited possibilities for economies of scale. A lack of recognition by many states (119 UN member states) also complicates several trade agreements, including WTO membership and participation in CEFTA mechanisms. There has been some progress on talks with Serbia, but recently with the Kurti government that has stalled, especially after Kosovo passed laws banning Serb currency and numberplates (The Guardian, 2024). The economy is also highly dependent on remittances. This reinforces a consumption-driven growth model rather than export-led development. Partially as a result of this, its export base also remains very small, with goods exports only at about 10% of GDP, leaving the country structurally reliant on imports and thus very prone to shocks. As with most of the region, Kosovo struggles with informality and demographic pressures further constrain growth. Finally, the reliance on aging, coal-based electricity constrains competitiveness and complicates energy transition, a key part of the acquis, though not considered in this paper.

Bosnia and Herzegovina is riddled with structural constraints that are not only more limiting but also harder to remove than Kosovo’s. The first issue is the lack of the upgraded constitutional framework

since Dayton, planned to be only a short-term constitutional agreement to simply preserve immediate post-war stability. The framework splits BiH into two entities with three Presidents, each of which has blocking power, as does each populations group in the upper house, the House of Peoples. Ethnic divisions have led to Serbs refusing to collaborate on issues seen as beneficial to the entire nation. Attempts at progress has not been made in years. The only significant attempt at establishing a new constitution was blocked in 2006 as some Bosniaks believed it did not go far enough, but had the backing of the Serbs and initially the Croats (Denti, 2018). Since then however, the same Serb reformists who championed constitutional change have become the most ardent nationalists and any hope for reform seems lost. Informality and demographic problems are present here, similar to Kosovo's, though BiH's population decrease is much worse, down 1.3 million from its pre-war max (macrotrends, n.d.). The presence of politically protected SOEs in sectors such as utilities and transport, which additionally are inefficient and thus a public burden, distort competition and tie up fiscal resources.

6.6.2. Policy choices

Structural constraints shape the playing field but government policy choices determine whether convergence with the EU aquis proceeds or stalls and is thus the best predictor for how ready countries will be for Internal Market Integration in the future, giving the best indication for a possible timeline. Here Kosovo stands far clear as there is strong evidence of reform momentum whether it be strengthening the business environment and reducing transaction costs through the establishment of a specialised Commercial Court and the expansion of the e-Kosova platform or the commitments to liberalising services and adopting dispute settlement mechanisms through the quick ratification of CEFTA Aps 5,6 and 7. Additionally there is no evidence of backtracking on any progress showing a clear unified goal. Some policy areas do remain neglected however. There is a lack of industrial strategy to attempt to boost export competitiveness, leaving SMEs focused on trying to make ends meet rather than giving them the potential to try and scale up. Similarly, limited public investment in R&D and innovation reflects a policy choice to prioritise stability and short-term reforms over long-term productivity.

The Bosnian narrative is a different one. The country has failed to ratify CEFTA protocols 6 and 7, being the only CRM members not to have done so. A deliberate political choice from the Serb party that also forms part of the national government to weaken regional integration and undermine Chapter 30 alignment. Successive governments have also avoided SOE reform, preserving them at any cost for political patronage despite the political and economic costs that comes with this. The ad hoc trade measures have also been a choice of the government directly in contradiction with EU norms, criticised as incompatible with the SAA. Even where reforms have been adopted, for example the Public Administration Reform strategy and Justice Strategies, implementation has been largely ineffective, showing a lack of political will.

6.7 Effectiveness of EU Tools

Having looked at the direct comparisons in progress between the two countries, it is now time we returned to assessing the effectiveness of the instruments at disposal. Both countries participate in the same enlargement framework, yet the divergent outcomes and trajectories illustrate the potential and limits of these tools. Through Kosovo and BiHs economic performance we can analyse the criticisms of the integration process posed earlier and try and understand whether they have delivered more than merely formal compliance.

The most common critique is the one put forward by scholars such as Bieber and Kmezic (2018) of stabilitocracy, that the tools generate compliance but limited substantive change towards democracy. In Kosovo, instruments such as the IPA and the SAA have allowed for reforms in areas such as the establishment of a commercial court and digitalisation with the e-Kosova reform, suggesting that with political will EU support can amplify reform momentum. These schemes have led to a more democratic efficient state In BiH, in contrast, political elites have often treated EU agreements tactically, complying selectively but blocking underlying structural reforms. This asymmetry is what is described in Vachudova's (2019) problem of "state-capture" where *"the Western Balkan states in the membership queue are hobbled by the capture of the state by elites who [favour] rent-seeking and ethno-nationalist appeals over economic reform, media freedom, and the rule of law"* (p. 64). It is harder to think of positive examples in BiH. While reforms such as the introduction of the NCTS and

a strong banking sector are welcomed by the EU, they do not significantly improve the economic or democratic situation for firms or individuals. BiHs progress does indeed seem to point to a stabilitocracy. This however does not necessarily corroborate the arguments of scholars such as Bieber and Kmezic. It seems more the case that without political will, EU Internal Market integration can cause stabilitocracy, but Kosovo's economic progress, in spite of persistent challenges shows that with will can come significant reform.

Economically, SAAs and CEFTA have secured tariff free-access and greatly increased trade flows in all the Western Balkans. However, Uvalić's (2019) critique that "*trade liberalisation ... has in most cases led to a much faster growth of imports than exports. The EU has in fact had a surplus in its trade with the Western Balkan region throughout the [integration] period*" (p. 211) is very hard to deny in the cases where these dynamics are indeed at play, demonstrated by Kosovo's large trade-deficit and BiHs reliance on low-value exports, which thanks to recent price shocks have widened its deficit with the EU. This leaves both countries but especially Kosovo at risk to foreign price shocks.

The final critique was that EU conditionality has remained too technical and that this has led to "*thin-surface norm adoption which does not alter the political realities of the region*" (p. 13)". In Kosovo, measurable reforms have undergone however, most notably the expansion of the KCGF, which despite remaining problems of high collaterals, has expanded access to finance and helped business creation as constraints have been eased for individual firms, anti-corruption measures have also been successful in raising more tax revenue. So while the structural weaknesses of low productivity, high informality and a narrow export remain, progress is more than simply thin-surface. In BiH, as entrenched elites continue to resist change, technical assistance has been absorbed without tackling corruption or political intervention in economic reform. This divergence helps explain why, despite years of IPA allocations, BiH is still at an early stage of readiness for the EU Internal Market.

Taken together, the Kosovo-BiH comparison confirms somewhat what the literary criticism suggests. Trade liberalisation has not assisted either country diversify its export base and has arguably made matters worse. Criticisms of elitist rent-seeking, assistance being overtly technical and stabilitocracy however, all seem more tied to political will. The hope is that with the changes to the Growth Plan, it

will be impossible to receive more funds without substantial reform. One does wonder though, whether this will make the economic consequences in BiH even more dire, as Republika Srpska politicians attempt to profit over economic instability.

Chapter 7- Policy lessons and Conclusions

7.1. Restating the research question and contribution

This paper set out to answer the question: **To what extent are Kosovo and Bosnia and Herzegovina economically prepared for integration into the EU Internal Market, based on their business environments and trade integration, and what key reforms or gaps remain in these areas?**

Through analysis of acquis alignment and overall performance in these two domains, this study has shown how far Kosovo and Bosnia and Herzegovina have progressed towards a state of readiness and where significant challenges are still present, whether political or economic. The contribution lies in offering a structured comparison of the two countries through the lens of relevant acquis chapters to the two indicators, combining institutional assessments with academic perspectives and in drawing out concrete policy proposals for both the candidate countries and the EU itself on the accession process.

7.2. Main findings

7.2.1. Business environment

To recap, when it comes to Kosovo, recent reforms such as the establishment of a commercial court and the expansion of the E-Kosova digital platform have been able to improve transparency and helped to reduce some economic burdens. (European Commission, 2023a; OECD, 2024). The banking system is generally sound and the Credit Guarantee fund has expanded SME finance. This is important progress towards meeting acquis requirements of chapters 9 and 20. However, high informality, still around a third of GDP and ranked as worst in the Western Balkans by the Southeast European Leadership for Development and Integrity with an Hidden Employment index score of 76%, 20% over the next highest, BiH at 54%, together with issues of corruption and weak judiciary, prevent fair competition. The total dominance of SMEs in the marketplace and their difficulty in scaling up mean that Kosovo is ultimately, despite strong goodwill on reform nowhere near the competitiveness needed to withstand internal market pressures. For context, SMEs account for >99% of firms in the country yet only make up under a fifth of total exports (OECD), which are dominated

by a handful of large firms in the metal and mining industry. For context, the EU percentage of SME exports is just over 40% (Eurostat). Unfortunately political instability also limits FDI, preventing more access to funding infrastructure and scaling up. Progress is visible and there are strong signs for the future as the country is united behind European integration.. But the business environment is not yet ready for Internal Market participation.

Bosnia and Herzegovina has much better economic foundations in comparison. A stronger industrial base allows for better export competitiveness. Firm structure is more diversified with some large firms that are able to compete internationally and bank lending is distributed more evenly. However, governance and thus progress remains deeply in limbo as a result of fragmentation of government. Collaboration between the Federation and Republika Srpska is at an all time low, enterprise policies are uncoordinated and the State Aid council is ineffective. SOEs also dominate key sectors, distorting competition and draining public finances (European Commission, 2024a). These weaknesses are in direct contradiction to the *acquis* requirements under chapter 8 on competition. While the private sector is broader than Kosovo's, the lack of a level playing field and credible enforcement means the business environment is unfit for internal market conditions. In addition political reconciliation seems very distant, indicating the gridlock will remain for some time.

7.2.2. Trade integration

Kosovo's goods export level of 10% of GDP, is a major obstacle to trade integration. Export composition is narrow—dominated by metals, scrap, and a handful of niche products—and markets are concentrated in CEFTA and diaspora-linked EU countries. Despite duty-free access under the SAA, Kosovo's firms have been unable to exploit the EU market due to weak diversification, logistical bottlenecks, and limited quality infrastructure. Under *acquis* Chapters 1 and 29, Internal Market readiness requires the ability to trade competitively across borders. Kosovo's current deficit and export structure demonstrate that it is not yet prepared to integrate successfully.

Bosnia and Herzegovina exports around one-third of GDP, a higher share than Kosovo, and has a more diversified basket of products including metals, wood, energy, and machinery (Eurostat, 2024). The EU absorbs nearly three-quarters of its exports, underlining its integration into European markets.

However, the country still runs a substantial and widening trade deficit, reflecting competitiveness gaps and dependence on resource-based exports. CEFTA commitments remain only partially implemented: Bosnia has not ratified all Additional Protocols, slowing progress on services and dispute settlement (European Commission, 2024a). Infrastructure gaps—such as the incomplete Corridor Vc—raise costs for exporters. While Bosnia and Herzegovina is better integrated than Kosovo, its trade profile still falls short of Internal Market readiness.

7.2.3. Comparative Summary

Taken together, the findings show that both Kosovo and Bosnia and Herzegovina are far from economically prepared for Internal Market accession. Kosovo demonstrates reform momentum but suffers from an underdeveloped production base, pervasive informality, and a trade deficit incompatible with market integration. BiH possesses a more diversified export structure but is paralysed by governance fragmentation and institutional weakness, leaving acquis alignment at a very early stage. Both countries remain at “some level of preparation” in Commission assessments, falling well short of the competitiveness and institutional reliability the Internal Market requires.

7.3. Policy lessons

7.3.1. Policy Lessons for Kosovo

Kosovo’s priority should be to consolidate the momentum it has from the rapid reform of the last years by moving from legislative adoption to effective implementation. We have seen that there has been notable progress in the area of SMEs that dominate Kosovo’s labour market, supported by the Kosovo Credit Guarantee Fund and EU-backed facilities which have unlocked new lending. This unlocked €87.1m of loans, creating over 3,500 jobs (World Bank, 2024). Yet, as Poland and North Macedonia, which both tied SMEs into growth via subsidised loans, have demonstrated, sustained competitiveness requires not only credit but also policies that can support industrial diversification, clustering and export capacity. Kosovo should therefore channel more of its support into SMEs capable of integrating into regional and European value chains, particularly in the sectors of agribusiness, light manufacturing and IT services. All in-line with the requirements of chapter 20.

Secondly, Kosovo has the fiscal space to pursue loose fiscal policy and use borrowing for productive investment. Though its political situation calls for more prudent fiscal policy, with public debt only at 20% of GDP, the country could safely access EU or international financial institution funds to finance transport, energy and digital infrastructure. Helpfully, it seems as though this is already underway. The new Reform and growth Facility provide 4 billion in loans to Kosovo and it also recently borrowed 35 million of concessional IDA credit to upgrade transport and trade infrastructure. These projects involved financing SME credit guarantees and national development banks, potentially crowding in nearly \$200 in private investment according to the World Bank. Historically, EU backed borrowing has helped underpin major growth such as in Poland and Slovakia and the evidence shows that directing concessional loans into roads, energy, tech and industrial parks (consistent with acquis on free movement of capital and single market) can substantially raise long-term growth. As part of my research I interviewed the International Political advisor to the Prime Minister of Kosovo, Tienmu Ma, who stressed that while the Minister of Finance remains a fiscal conservative, plans are underway to increase borrowing.

Thirdly, Kosovo needs to create conditions to attract export-orientated FDI. At present FDI is concentrated in untradeable assets such as real-estate or construction. Comparative lessons from North Macedonia; which also had undiversified exports in the 2000s, but created special industrial zones with tax incentives streamlined regulation, and investor support, directly attracting greenfield investment in tradable sectors, tells us that securing FDI requires transparent incentives, reliable infrastructure and regulatory stability.. By providing legal certainty and policy continuity, Kosovo can already begin to shift its FDI profile.

Finally, it is absolutely fundamental that Kosovo addresses high levels of informality and corruption. While tougher enforcement has brought progress, a stronger rule of law is essential to meet the requirements of chapter 23 and 24. This will include using the new commercial court to improve contract enforcement, ensuring anti-corruption measures are applied and strengthening independent agencies.

7.3.2. Policy lessons for Bosnia and Herzegovina

Bosnia and Herzegovina's principal obstruction to Internal Market integration is not the absence of industrial capacity or barriers to finance, it is institutional fragmentation preventing coherent reforms. Entity-level divisions have blocked everything from SME reform and industrial policies to ratification of CEFTA policies and State-Aid control. Overcoming these blockages is decisive for a number of acquis chapters, but unfortunately there is not much hope in sight. Milorad Dodik is becoming bolder by the minute and has the strong backing of Russian President Putin. Diplomats and UN representatives I spoke to in Sarajevo all told me that there is no current end in sight to the gridlock.

Reform of SOEs should be another priority, SOEs dominate utilities, transport and other sectors but are inefficient and extremely dependant on taxpayer subsidies. Whithout a stronger State-Aid framework (currently blocked by RS) and a level playing field for firms, as necessitated under chapter 8, fair competition cannot be ensured. The IMF and World Bank have consistently stressed that not only would SOE reform help private-sector development, but it would also free fiscal resources and reduce contingent liabilities.

Bosnia and Herzegovina must also diversify its trade supply, as its deficits with the EU are getting worse by the year and exports remain heavily concentrated in low-value commodities such as metals, wood and electricity. BiH must invest in quality infrastructure if it is to move up the value chain. Its fiscal situation is much similar to Kosovo's with regards to debt so it is perfectly possible that concessional financing can play a role, but this is provided that political coordination allows for it, something that as we saw in the analysis has not always been the case.

BiH must too address its persistent rule of law and corruption deficits. The European Commission continues to criticise the limited track record in prosecuting high-level corruption, while surveys show that weak governance deters investors. Empirical studies confirm that improvements in the rule of law are the single most important factor influencing FDI inflows to Bosnia (Babajić & Baraković, 2024)

7.3.3. Policy lessons for the European Union

The comparative findings also highlight lessons for the European Union. First, conditionality must be recalibrated. The EU has traditionally rewarded legislative adoption, but Bosnia and Herzegovina demonstrates the risk of producing formal compliance without substantive change. Instruments such as the Growth Plan and IPA III should therefore tie disbursements more closely to measurable implementation outcomes — for example, reductions in informality, faster judicial case resolution, or increased certification of firms to EU standards.

Second, the EU should prioritise building productive capacity, not merely removing trade barriers. Duty-free access under the Stabilisation and Association Agreements has not prevented Kosovo's large trade deficit. As the experience of Slovakia and Poland shows, integration succeeds when EU support is combined with targeted investment in infrastructure, industrial policy, and quality infrastructure. EU assistance should thus expand its focus on trade facilitation, SME finance, and investment promotion, consistent with Chapters 1, 20, 29, and 30.

7.4. Final Assessment

In conclusion, both Kosovo and Bosnia and Herzegovina remain at early stage of preparation for EU market accession, Kosovo's strong desire for reform has not yet been enough to overcome its structural weaknesses. Bosnia and Herzegovina on the other hand has remained paralysed by its governance issues even in spite of some strong economic indicators.

Ultimately, the two countries illustrate complementary challenges: Kosovo must translate reform energy into economic transformation, while BiH must unlock institutional coherence to leverage its productive base. Both cases converge on the same central lesson: Internal Market readiness depends on credible reforms that reduce informality, strengthen the rule of law, and build export competitiveness. It would be beneficial in both cases if the EU were to use tools outside of the orthodox accession procedure to tackle the unique cases both countries find themselves in. With sustained domestic commitment and targeted EU support, progress is achievable. Without it, the accession process risks reinforcing stagnation rather than driving transformation.

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