

# Central European Free Trade Agreement (CEFTA) and Regional Cooperation with a View to the Improvement of Dispute Resolution Mechanism

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**Abstract**—Initiatives that support economic development and improve intra-regional trade in the Western Balkans have been perceived by the European Union as an opportunity to strengthen regional economic cooperation and integration. In this context, this paper looks at CEFTA from the viewpoint of a deviation from policy cooperation, consultation and integration. The framework of this analysis evolves around the question how to better link CEFTA with the EU integration so as to improve the rule of law and commitment to regional cooperation. The analytical approach looks at the problem of the infringement of CEFTA and explores an example of punitive tariffs on imports of goods. The paper examines legal and economic implications in this respect and proposes policy solutions with a focus on the improvement of dispute resolution mechanism.

**Index Terms**—CEFTA, dispute resolution mechanism, EU enlargement, free trade, regional integration.

## I. INTRODUCTION

Based on the ideas of building security, prosperity and solidarity, an intra-trade regional group within the Central European Free Trade Agreement (CEFTA) was established in 1992. With the first CEFTA members joining the European Union (EU) in 2004, a new CEFTA agreement was initiated and signed in 2006. The European Union (EU), in particular the Commission's DG Trade, was the main driving force in creating the second CEFTA in the early 2000s [1]. The current members of the agreement are Moldova, Bosnia and Herzegovina, Serbia, Montenegro, North Macedonia, Albania and Kosovo<sup>1</sup> [2]. Taking into account that the CEFTA 2006 was designed to be a preparatory exercise for Western Balkan countries aspiring to become members of the EU, an important question is whether the CEFTA is an appropriate preparation mechanism for the EU Single Market. The EU believes that CEFTA should make important contribution to economic development and regional co-operation [3]. Amendments made to the original CEFTA mark significant developments in the economic integration of the Western Balkans [4].

This paper explores economic, political and legal contexts of a situation when a CEFTA party's unilateral move is a significant deviation from CEFTA commitments. As an

example, the paper looks at the case of 100% tariffs imposed by Kosovo in 2018 on products imported from two other CEFTA parties, Bosnia and Herzegovina and Serbia. The CEFTA text does not specify any penalties and/or sanctions for violating the provisions of the agreement in such cases. In general, dispute settlement mechanisms in international trade agreements vary from being highly legalistic to being more diplomatic, the latter focusing on good-faith effort to resolve open issues through consultations [5]. Dispute resolution mechanisms are typically an important tool to ensure an authoritative interpretation of the rules and norms of the agreement [6]. In order to enhance regional trade integration and cooperation, parties to CEFTA agreement which aim to become members of the EU in the future, should respect the CEFTA commitments.

The aim of this paper is to show that the current dispute resolution mechanism in CEFTA should be strengthened in order to improve regional economic cooperation. That can be achieved by improving the text of CEFTA agreement so as to add provisions that relate to legal and other remedies in response to non-trade related violations of the agreement. Moreover, additional options to stir CEFTA parties away from not respecting the agreement should include sanctions, financial compensation and/or withholding funds from the EU to the party that violates the agreement for political reasons only. The paper explores certain policy options and possible solutions in the political, legal and financial domain in this respect. The paper suggests that the dispute resolution mechanism in CEFTA should add provisions that clearly state which authority is financially responsible for damages in cases when a CEFTA party is not a UN member.

The paper is structured as follows: the first part analyzes political and economic context of punitive tariffs imposed by Kosovo on imports of goods from Bosnia and Herzegovina and Serbia. The second part looks at the dispute resolution mechanism in CEFTA, while the third, fourth and the fifth sections look at possible solutions, other options and discuss relevant implications. The final part draws conclusions on the current CEFTA text that should be improved in order not to be assessed as a mix of wishes and politics with unworkable economic, legal and financial solutions.

## II. PUNITIVE TARIFFS

### A. Political Context

With respect to the political context of the CEFTA agreement, the United Nations Interim Administration (UNMIK) was the UN body that governed Kosovo from 1999

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<sup>1</sup> Throughout this paper Kosovo is referred to and understood in accordance with the United Nations Security Council Resolution 1244 (UN Resolution, 1999) and within the meaning of the United Nations Interim Administration Mission (UNMIK) in Kosovo.

until 2008, when Kosovo declared its independence that was backed and promoted by some Western countries. Certain authors found [7] that the aim of those Western countries was to assist Kosovo to become a modern state, however, according to this author, the outcome is a fragile entity that threatens the stability of the Balkans and Europe's internal security. It appears that it is the EU mission (EULEX) and the UN mission UNMIK that could take the responsibility for a weak understanding of the rule of law in Kosovo. Failure of EULEX was mainly due to political interference considering that "if the EULEX director meets the prime minister or ministers, and EU ambassadors on a daily or weekly basis, it becomes very difficult for EULEX lawyers to arrest said ministers"[8]. That Kosovo politicians, officials and others have problems with the rule of law, especially when it comes to Serbia and Serbs living in Kosovo, has recently been seen in relation to respecting Kosovo's own Constitutional Court with regard to the monastery property of Serbs in Kosovo after a call to return the property by the European Parliament's representative Viola von Cramon [9].

The region has a complicated history, but according to some authors [10] CEFTA is beneficial because it fosters cooperation. Other authors [11] find that trade relations within CEFTA may be complicated by a variety of external and domestic reasons. With respect to domestic reasons in Kosovo these authors emphasize "poor performing institutions and high level of corruption. Both have contributed substantially to a high-risk environment uncondusive to business activities. Flawed institutions generated a distorted set of incentives that favour specific segments of society, largely interest groups close to politicians or political parties" [11] (p. 9).

That the imposition of 100% tariffs was against the CEFTA commitments was clearly articulated by the EU. The EU High Representative Mogherini released a statement on 22<sup>nd</sup> November 2018, saying that the decision to increase the tax on goods from Serbia and Bosnia and Herzegovina to 100% was a "clear violation of the CEFTA agreement and of the spirit of the Stabilisation and Association Agreement between the European Union and Kosovo" [12]. The European Commissioner Hahn added that this decision has economic impact as well, because "This act – which also hurts Kosovo consumers and businesses–must be reversed immediately. Kosovo holds the CEFTA chairmanship and thus has special responsibility" [13]. The 100% tariff were preceded by 10% tariff weeks before. In respect to a 10% hike for imports from Bosnia and Hercegovina and Serbia the European Parliament concluded that a "unilateral move not only constitutes a serious infringement of the CEFTA, it comes as a serious blow to cooperation, good neighbourly relations and reconciliation in the region" [14].

Kosovo's tariffs on imports from Serbia and Bosnia and Hercegovina were imposed by Kosovo in response to "extensive lobbying efforts by Serbia to prevent Kosovo's membership in UNESCO and Interpol. Moreover, the withdrawal of a number of recognitions from countries that have already recognised Kosovo's independence seems to have had a bearing on the decision by Kosovo's authorities." [11] (p. 4). The delegations of the European Parliament called for a suspension of 100% tariff [15]. Also, the United States asked Kosovo to immediately suspend a tariff on goods

imported from Serbia in order not to face consequences in its relationship with Washington [16].

Since the United States is one of the main international actors with influence over Kosovo and it has in Kosovo one of the largest military bases in the world [17] it was expected that the Kosovar Government would back down. But it didn't, even as it held a CEFTA's chairmanship at the time [11]. The response from Pristina was that the tariff would be dropped when Serbia stops lobbying against Kosovo's joining international organizations and when it recognizes its sovereignty [16]. The position of Kosovo about its tariffs on imports from Serbia and Bosnia and Herzegovina was clearly political and had nothing to do with trade-related issues or the implementation of the CEFTA agreement of either party concerned. As a result of 100% tariffs, the dialogue between Belgrade and Pristina was suspended.

### *B. Economic Context*

The level of legalism in dispute resolution mechanisms in free trade agreements is related not only to the proposed depth of regional trade cooperation and liberalization but also to the level of economic asymmetry among member states [18]. The imposition of 100% tariffs by Kosovo on goods imported from Bosnia and Herzegovina and Serbia has nothing to do with economic asymmetry among member states of CEFTA. These tariffs had nothing to do with economics at all, tariff revenues and/or protecting domestic production. The tariffs by Kosovo were based on exclusively political reasons.

According to some authors [19] the impact of CEFTA agreement on the economy of Kosovo has been positive and that as a result of CEFTA, Kosovo has experienced export oriented economic growth. Other authors [20] emphasize that the most important trading partner of the Western Balkans region is the EU, while intra-regional trade comes second in importance. They found that while total exports have been on the rise since the crisis in 2009, intra-regional exports underperformed and declined in importance. However, data from the Eurostat show that the value of exports from Kosovo to other CEFTA members have grown from 2008 to 2018, while exports from Kosovo to the EU remained relatively stable in the period from 2011 to 2019. Kosovo has had trade deficit in goods with CEFTA members. From 2008 to 2018 trade deficit with CEFTA reached on average more than 600 millions each year (Fig. 1).



Fig. 1. Trade balance and imports/exports of goods from Kosovo to other CEFTA parties (in million euro).

According to the European Commission's report in 2021, the share of Kosovo's goods exports in 2020 to the EU and CEFTA relative to the total Kosovo's exports reached 34.4% and 44.4%, respectively [21] On the other hand, imports to

Kosovo from the EU has grown considerably, influencing the deterioration in Kosovo's trade deficit in goods. Kosovo imports more from the EU than from CEFTA parties. According to the European Commission, EU's share in total imports to Kosovo in 2020 was more than 45% while CEFTA's share was 18.7%, a slight increase after Kosovo abolished the 100% import tariffs on goods originating from Serbia and Bosnia and Herzegovina [21].

Data from Eurostat<sup>2</sup> with respect to Serbia (Fig. 5 and Fig. 7) and Bosnia and Herzegovina (Fig. 2 and Fig. 3) show that 100% tariff duties on imported goods from both countries brought imports to almost zero at the end of 2018. On the other hand, Kosovo's exports to Bosnia and Herzegovina and Serbia remained stable (Fig. 3, Fig. 4, and Fig. 6) during that period. Data from Eurostat show that Kosovo has a large trade deficit with the EU as it exports significantly less than it imports from the EU.

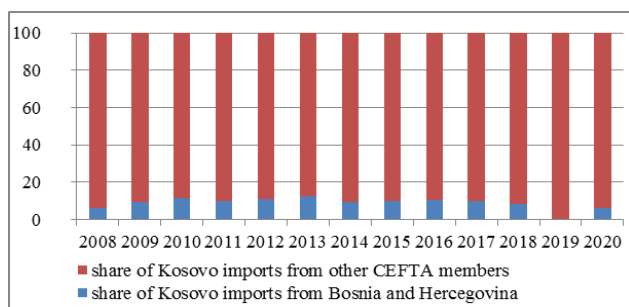


Fig. 2. Share of goods imports (%) by Kosovo from Bosnia and Herzegovina compared to the rest of CEFTA.

The share of Bosnia and Herzegovina's in total CEFTA imports to Kosovo has been fluctuating around 10% from 2008 to 2018 but it fell to 0.4% in 2019 as a result of a 100% tax on imports from that country (Fig. 2). Because of this drop, the trade balance of Kosovo with Bosnia and Herzegovina was slightly positive in 2019 (Fig. 3), the only surplus in trade balance in the period from 2008 to 2020.

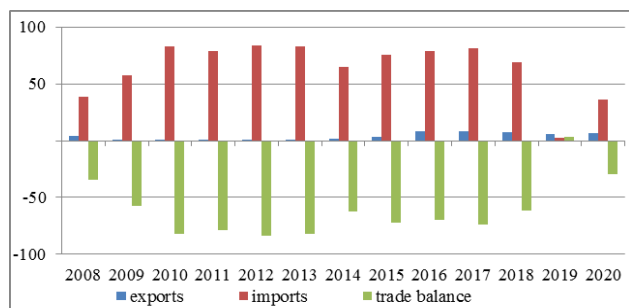


Fig. 3. Kosovo trade balance with Bosnia and Herzegovina (in million euro).

With respect to Serbia, the share of Serbia's imports by Kosovo increased from 34% in 2008 to reach 52.6% in 2017 relative to other CEFTA members. However, due to a tariff hike to 100% in the end of 2018, the share of imports from Serbia to Kosovo fell to 1.2% in 2019 and recovered to 28.4% in 2020 (Fig. 7). At the end of 2020 the share of imports from Serbia to Kosovo was therefore lower than in the early years of the implementation of CEFTA agreement. As a result of the 100% tariff on imports from Serbia, Kosovo's trade balance with Serbia was positive in 2019

while remaining strongly negative with the rest of CEFTA members (Fig. 4).

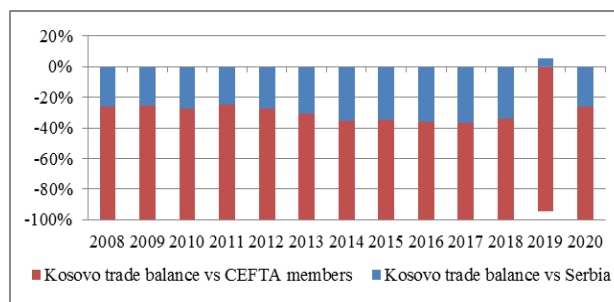


Fig. 4. Share (%) of Kosovo trade balance in goods with Serbia compared to the rest of CEFTA.

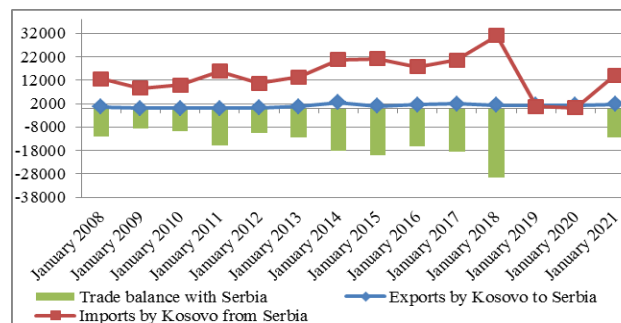


Fig. 5. Trade balance and exports and imports of goods by Kosovo to/from Serbia in January of each year in 2008-2021 (in 000 eur).

To see the exact immediate monthly impact of a tariff imposed on imports from Serbia at the end of November 2018, data for the beginning of 2019 and 2020 (January) was compared to the same month over the period from 2008 to 2021 (Fig. 5). Monthly data show a full impact of tariffs as imports in January 2019 and 2020 from Serbia to Kosovo fell considerably below long-term average. On the other hand, Kosovo's exports to Serbia didn't experience a significant drop. From 2008 when the share of Kosovo's exports to Serbia was 14.2% relative to the share of Kosovo's exports to all other CEFTA members, Kosovo's exports to Serbia were growing and reached 31% in 2016. In 2017 the share was 28%, but fell to 19.3% in 2018 and 16.5% in 2019 (Fig. 6).

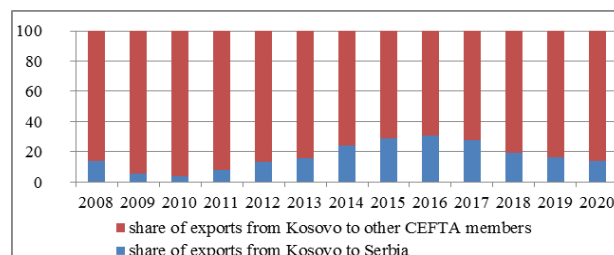


Fig. 6. Share (%) of exports from Kosovo to Serbia in comparison to other CEFTA members.

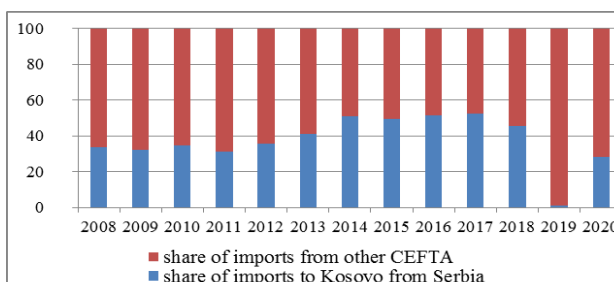


Fig. 7. Share (%) of imports by Kosovo from Serbia in comparison to other CEFTA members.

<sup>2</sup> The source of all figures is author's compilation of data from the Eurostat's database.

Looking at the data, it is clear that exporters from Bosnia and Hercegovina and Serbia suffered huge financial losses due to the 100% tariffs imposed by Kosovo (Fig. 8). Kosovo imposed 100% tariffs in November 2018 and, after the pressure from the EU and US it abolished them only in March 2020. It became effective in April 2020. Looking at the overall trade data, Kosovo has a large trade deficit with the EU and with CEFTA members. Kosovo has had a large trade deficit with Serbia as well for most of the period since the CEFTA agreement entered into force (Fig. 8).

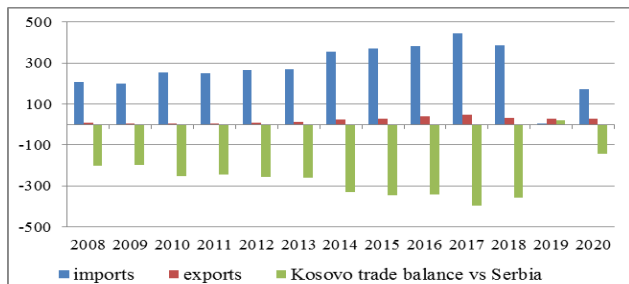


Fig. 8. Trade balance and imports/exports from Kosovo to Serbia (in million euro).

The average Kosovo's deficit in trade of goods with Serbia from 2008 to 2018 was 290 million euro (Fig. 8). It is only in 2019 that Kosovo had trade surplus with Serbia on the back of the 100% tariff on goods from Serbia (Fig. 8).

### C. Extreme Unilateral Moves

CEFTA parties manage the implementation of the agreement through the Joint Committee that is composed of representatives of CEFTA. All decisions by the Joint Committee are to be taken by consensus. The Joint Committee is a forum to exchange information, initiate consultations, sort out disagreements and explore the possibilities of further increasing trade among parties. In addition to the Joint Committee, there are also Sub-Committees, for instance on agriculture, sanitary and phyto-sanitary issues, on customs, rules of origin, on technical barriers to trade and nontariff barriers. There is also CEFTA Secretariat based in Brussels [3].

It is recognized that the CEFTA is a free trade agreement that provides a legal basis for policy implementation, not only in regard to trade liberalisation in goods. The Article 1 of the CEFTA agreement states that the free trade area shall be established in a transitional period ending at the latest on 31 December 2010 [2]. The CEFTA agreement, that comprises a main text and a number of Annexes supplemented by additional Protocols in different areas, is an agreement largely oriented towards the EU *acquis*. CEFTA liberalized trade of most industrial goods and many agriculture products and aims to also foster investment, including foreign direct investment, provide fair conditions of competition, appropriate protection of intellectual property rights and a framework for efficient resolution of disputes. According to the European Commission, the agreement aims to consolidate, simplify and modernise the region's "rule book" on trade, including on competition, government procurement and protection of intellectual property. The benefits of increased trade is a positive stimulus for economic growth, job creation and employment, making the region more attractive for foreign investment [3].

In addition to regional trade cooperation, a (potential) EU

candidate country's satisfactory achievement in implementing its obligations under a Stabilisation and Association Agreement, is a key element of the EU enlargement process. In the case of Kosovo example, the Stabilisation and Association Agreement, concluded in 2016 between the EU and Kosovo is based on a number of important principles [22]. With respect to the topic of this paper, the most relevant principles of the Stabilisation and Association Agreement with Kosovo are the rule of law, cooperation and good neighbourly relations, implementing CEFTA and pursuing bilateral and regional cooperation with countries involved in the stabilisation and association process. Moreover, Kosovo should align its laws to the EU laws, including in trade related areas and competition rules. In order to achieve the objectives of the agreement, Kosovo receives financial assistance from the EU, which is conditional on further progress in satisfying the Copenhagen criteria. These criteria are the "stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities; a functioning market economy and the ability to cope with competitive pressure and market forces within the EU and the ability to take on the obligations of membership, including the capacity to effectively implement the rules, standards and policies that make up the body of EU law (the 'acquis'), and adherence to the aims of political, economic and monetary union"[23].

The economies of the Western Balkans are small, still in the process of transition to a market economy and most have growing trade deficits [24]. International trade and regional trade integration therefore seem a logical choice on the way to economic and political stabilisation, and a logical choice to achieve their common goal of EU membership. All parties to CEFTA except Moldova are (potential) candidates for accession to the EU at the moment. If the EU wants to strengthen regional cooperation in order to prepare countries for the EU membership, there should be a consistent level playing field and a clear timetable for the accession to the EU. This is needed because –as the case of Kosovo 100% tariffs shows- not all CEFTA parties might be willing to respect their legal commitments, especially vis-à-vis former adversaries. Parties to CEFTA might not be ready for political cooperation without ultimatums and unilateral moves. To prevent decisions that are against good neighbours relations and against the commitments within CEFTA, a clearer timetable for EU integration would likely be an attractive option to align the behaviour of CEFTA parties accordingly.

Despite large financial assistance and good intentions, the EU does not seem very successful in achieving regional economic integration among (potential) candidate countries as Kosovo example has shown. The EU claims that its values are peace, democracy, rule of law and human rights but what are the consequences if a party to CEFTA violates the agreement (promoted by the EU) by making conscious damage to other CEFTA parties? As seen by reactions in a Kosovo's 100% tariff case, the violations of the CEFTA rules didn't lead to any political or economic consequence for Kosovo. The EU and US officials called Kosovo to abolish the tariff, but that didn't produce any adequate reaction by Kosovo until 16 months after the imposition of 100% tariff on imports from Serbia and Bosnia and Herzegovina. Legal



commitments on paper are apparently not a guarantee that the regional free trade area will work as envisaged by the EU.

The Kosovo 100% tariff case is the most explicit reason as to why CEFTA agreement should be amended so as to strengthen the dispute resolution mechanism and to incorporate political sanctions together with other measures in order to deter parties to violate the commitments to CEFTA. Sanctions should include tighter conditionality provisions and reviewing indicators of progress with respect to the rule of law with a view to CEFTA and the Stability and Association Agreements. Political sanctions might be most suitable in cases where it is not clear which authority is financially responsible for damages. This is especially relevant in the case of Kosovo that -due to its status- was not a signatory of the CEFTA [25].

### III. AMENDING AND STRENGTHENING THE DISPUTE RESOLUTION MECHANISM

A dispute resolution mechanism is important for all trade agreements because it allows for the adequate settlement of disputes. It has been included in all EU trade agreements and modeled according to the World Trade Organization rules. The current approach to resolve disputes in CEFTA evolves around consultation and cooperation. The Joint Committee is responsible for the implementation of the CEFTA agreement but has limited legal powers and acts by consensus. Researchers have already found that the main concept in dispute issues in CEFTA are consultation and cooperation [4].

Typically a dispute settlement mechanism is crucial to the economic integration agreement in order to solve some conflicts that might be difficult to resolve unless turned to a third-party dispute resolution [26]. The current CEFTA agreement does not have a mechanism to sanction parties that significantly violate the rules and procedures of the agreement. As noted by some researchers, all disputes in CEFTA can be resolved only if the countries show a good will [4].

In general, it is expected that if there is a dispute over a possible violation, the provisions of the dispute resolution mechanism should first provide the possibility of consultation and arbitration. The parties should be *a priori* deterred from infringing the rules of the agreement [27]. This is more likely if the political and economic cost of breaching the agreement is perceived to be greater than the benefits. Kosovo obviously didn't think there would be high economic and/or political costs for breaching the rules of CEFTA agreement. That proved to be true as there were no sanctions from the US. There were also no sanctions from the EU.

An effective and efficient dispute resolution mechanism can enhance the legitimacy of the international organization to which it is aligned and to improve the credibility of international commitments in relevant multilateral contexts [28]. CEFTA signed in 2006 established a dispute resolution mechanism and provided the rules of procedure for the new Arbitral Tribunal [2]. If there is a dispute between CEFTA members, the parties are first expected to cooperate and try to resolve the dispute through direct consultations or consultations in the Joint Committee. In this respect under the heading "Fullfilment of Obligations and Consultations"

Article 42 in the first paragraph of the CEFTA agreement states that

*"Should any divergence with respect to the interpretation and application of this Agreement arise, the Parties concerned shall make every attempt through co-operation and consultations, if necessary in the Joint Committee, to arrive at a mutually satisfactory resolution"* (Agreement, p.30)

Article 42(2) further states that:

*"Any Party may request in writing to the Joint Committee that consultations with any other Party regarding any actual or proposed measure or any other matter that it considers might affect the operation of this Agreement take place within the Joint Committee. The Party requesting consultations shall at the same time notify the other Parties in writing thereof and supply all relevant information. The Joint Committee may recommend appropriate measures"* (Agreement, p.30)

The dispute resolution process as stated in Article 42(3) envisages that the mentioned consultations may take place in the presence of a mediator, if that is what the concerned parties agree upon. Therefore, the text of CEFTA agreement defines the process of finding a solution to a dispute by requiring parties' direct consultations to take place in the presence of a mediator who would submit a final report to the Joint Committee. According to Article 42(4), if a party considers that other party failed to fulfil an obligation under this agreement, and bilateral consultations, mediation or the Joint Committee have failed to arrive at an acceptable solution within ninety calendar days from the receipt of the notification referred to in Article 42(2), the party concerned may take provisional rebalancing measures under the conditions and in accordance with the procedures laid down in Article 24. The measures taken shall be notified immediately to the parties and to the Joint Committee, which shall hold regular consultations with a view to their abolition. Article 43 of the CEFTA stipulates that if the parties fail to reach agreement regarding the dispute through bilateral consultations and mediation, or through the Joint Committee, then they have the right to submit the dispute to an Arbitral Tribunal for a final resolution. Article 43 of the CEFTA envisages the possibility of an Arbitral Tribunal according to Annex 9 to the Agreement.

However, the consultation and cooperation in the Joint Committee was never initiated and it was not applicable in Kosovo's 100% tariffs case because CEFTA agreement does not provide any possibility to act in response to a party's domestic politics that lead to the violation of the CEFTA agreement.

The current dispute settlement mechanism as stipulated in Article 42 and 43 of the CEFTA could be more user's friendly in terms of the timetables when the violation of the agreement is of political nature. First, in Article 42(1) there should be an adequate timetable set for the initial phase of consultation and co-operation between the parties concerned. Further, Article 42(2) also does not provide the timetable on the consultation phase within the Joint Committee so as to include a clear timetable in a situation when a violation of the CEFTA agreement is based on politics. With respect to the direct consultation in the presence of a mediator as per Annex 8, paragraph 2 (referred to in Article 42 paragraph 3) it states:

*“If the Parties concerned do not agree on a mediator within ten days of receipt of the initial written request for mediation, the Chairman of the Joint Committee will provide the Parties concerned with names of five persons from the List of Mediators established in accordance with Article 41, paragraph 6. Each Party will number the names in the order of preference. In light of the Parties’ expressed preferences, the Chairman of the Joint Committee will appoint the mediator”*,

while on the other hand, Article 42, paragraph 3 of CEFTA states:

*“If the Parties concerned do not agree on a mediator, the Chairman of the Joint Committee or, if he is a national or resident of one of the Parties concerned, then the first of his predecessors who is not, shall appoint the mediator within 20 calendar days of receipt of the initial written request for mediation in accordance with the rules set out in Annex 8. The mediator shall present a final report to the Joint Committee at the latest 60 calendar days after his/her appointment. If no solution can be found on the basis of the mediator’s report, the Joint Committee will deal with the issue with a view to finding a commonly acceptable solution. Should this fail, the Joint Committee shall recommend appropriate measures.”*

If there is a political violation of the CEFTA agreement and therefore the violation is not based on any trade-related issues, ninety calendar days to undertake provisional rebalancing measures from the day of the receipt of the notification is too long. A dispute that does not require complex trade investigations should not take too long because the nature of the violation of the agreement is political. Therefore, the procedure can’t be comparable to the relevant World Trade Organization’s provisions in this respect. The resolution to a non-trade related violation that is politically motivated should be resolved as quickly as possible in order not to cause an irreparable damage to the businesses on both sides of the parties to the CEFTA. For small and medium companies time is crucial in their economic survival. This is particularly important since the region of the Western Balkans is less developed and is dominated by small and medium companies.

Second, the current dispute resolution mechanism in CEFTA should be amended so as to include the scope of action in response to the violation of the agreement based exclusively on political reasons, in which case the initial phase of consultation, co-operation and mediation as defined in CEFTA agreement become unworkable. That phase is neither feasible nor adequate in cases such as punitive tariffs. The dispute resolution mechanism should be amended by adding a provision that enables immediate counter-balancing measures, including financial and other measures. The EU should draw a solution in the CEFTA text not only to possibly impose sanctions but to also compensate for the damage caused by a CEFTA member. There must be clear procedural guidelines about the course of action in such cases and who is financially responsible for damages when a CEFTA party is represented by an international organization such as the United Nations. There is no such provision in the current CEFTA agreement.

Third, Annex 9 (Constitution and Functioning of the Arbitral Tribunal referred to in Article 43) in paragraph 5

allows the possibility that the appointment of arbitrators may be delayed without formally breaching the agreement, thereby prolonging the proceedings. This might be appropriate in trade-related violations but might be less suitable in violations of political nature because there is no need to undertake complex trade-related investigations to determine and explore all aspects of trade-related violation because there is no such violation.

Fourth, Annex 9 (Constitution and Functioning of the Arbitral Tribunal referred to in Article 43) in paragraph 7 allows the possibility that the arbitral award may be delayed by six months without formally breaching the agreement, thereby prolonging the proceedings. As with paragraph 5 of Annex 9, this is a lengthy process, not best suited for a situation of the violation of CEFTA when the violation is not about a trade-related issue.

Fifth, in Article 43 of the Agreement and paragraph 7 of Annex 9 (Constitution and Functioning of the Arbitral Tribunal referred to in Article 43) there are no provisions that explain what a complaining party can do if the other party does not respect the decision of the Arbitral Tribunal. Since there is no procedure describing the steps that can be subsequently taken, any ruling given by the arbitrators might not have any effect.

Sixth, the dispute resolution procedure should reduce the risk that politics will delay proceedings if a party requests the establishment of an Arbitral Tribunal. In this respect, the dispute settlement process in CEFTA should be clearer and faster in those cases of breaching the CEFTA agreement when the reasons for that are exclusively political (as in the case of Kosovo’s tariffs).

Finally, the dispute resolution procedure must make it clear which entity/authority is responsible for damages caused towards other CEFTA parties. This is especially relevant in the case of Kosovo, considering that the signatory to CEFTA on behalf of Kosovo is UNMIK. Since Kosovo is not a member of the UN, the question is who pays for the damage caused by Kosovo. The dispute resolution mechanism has no provisions on such situations but it should be clear about that if CEFTA is to be seen as a credible agreement supported by the EU.

#### IV. OTHER OPTIONS

##### *A. Financial and Technical Assistance to CEFTA Parties*

The CEFTA agreement complements the EU’s Stabilisation and Association Agreements for the countries of the Western Balkans. The EU provides large financial assistance to CEFTA parties through the general support and through financial and technical assistance in the framework of the Instrument for Pre-Accession Assistance (IPA). With respect to the example of Kosovo, the EU has committed 1.21 billion euro in EU assistance funds in the period 2007-2020 [29]. In addition, 280 millions euro were provided in European Investment Bank loans since 1999.

Since 2009 198.7 million euro were provided in Western Balkans Investment Framework grants, to leverage investments of estimated 1.8 billion euro [29]. Total EU Multi-country financial assistance programme under IPA II for the period 2014-2020 was 2.98 billion euro. The

programme provides assistance through horizontal support such as technical assistance (information and training for authorities in IPA II beneficiaries); through regional structures and networks (regional cooperation, networking and sharing of best practice to help IPA II beneficiaries prepare for EU membership, align their national legislation with EU law (*acquis*) and gradually adapt to EU standards and practices through initiatives such as CEFTA); through regional investment support and through territorial cooperation (Promoting good neighbourly relations and local development in border regions).

However, as for components of IPA funding, rather vague expected results are stated in the programming documents. The Instrument for Pre-Accession Assistance (IPA II), 2014-2020 in regard to “Multi-Country, EU4 Business: Fostering regional economic integration through support to the implementation of the trade pillar of the Regional Economic Area” [30] states: “The action aims to strengthen regional economic integration among the Central European Free Trade Agreement (CEFTA) Parties by enabling smooth implementation of CEFTA 2006 and measures planned under the trade pillar of the Multi-annual Action Plan for a Regional Economic Area (MAP REA). This will be achieved by assisting the CEFTA Parties, the Secretariat and its Bodies in trade-related matters in the following three core areas: (1) reducing the negative impact of non-tariff measures and developing a harmonised legislative framework for dispute settlement; (2) strengthening cooperation on quality infrastructure – including market surveillance; and (3) extending cooperation in trade services (e.g. in e-commerce).” [30, p.1]. The budget allocated to this “support of regional trade agreements” is 6 million euro and the objective is to support increased trade flows in goods and services via the convergence of standards, conducive to regional economic integration.

The overall political motivation behind this document is clear; however, it is less clear how this will be achieved. Looking at the above mentioned document, the first core area implies that the activity under (1) will reduce the negative impact of non-tariff measures and develop a harmonised legislative framework for dispute settlement. It is not clear how exactly that will be achieved. First, legal commitment to CEFTA rules is not the same as de-facto commitment to CEFTA rules, as the case of Kosovo’s 100% tariff case has shown. Second, it is not clear what a harmonised legislative framework for dispute settlement means. Is the current CEFTA dispute resolution mechanism not harmonised? Further, looking at the core area under (2) in this document about “strengthening cooperation on quality infrastructure-including market surveillance”, it is also not clear what this entails, what is actually done and what the end result is. It sounds good on paper, but it implies many issues, especially taking into account that the region lags behind developed countries in many aspects, including quality infrastructure. The core area under (3) “extending cooperation in trade services (e.g. in e-commerce)” is also unclear as to its meaning and as to its results. Typically e-commerce is depending on companies and their business strategies that may or may not include e-commerce.

Looking at the above mentioned document (Multi-Country, EU4Business), there is also a spaghetti of documents, plans,

strategies etc. referred to, such as the Multi-annual Action Plan for a Regional Economic Area (MAP REA), the revised IPA II Multi-country Indicative Strategy Paper 2014-2020, Protocols to the CEFTA agreement and EU *acquis*. The institution responsible for IPA II Multi-country Programme (2020) – part 2 is Directorate General for Neighbourhood and Enlargement Negotiations – Unit A3, Thematic support, Economic Governance and IFIs, Public Administration Reform. Other bodies involved are CEFTA Secretariat, CEFTA Joint Committee, CEFTA bodies, contracted entities for the implementation of the various components under this action, and the European Commission. In addition, the implementation of the action should also build upon the contract, under the same IPA programme, with the Gesellschaft für Internationale Zusammenarbeit (GIZ) to support regional economic integration (Trade Pillar of the REA MAP). Furthermore, the action plan should also depend upon the current work being elaborated with the Western Balkan 6 Chamber Investment Forum.

There are also a number of public and private institutions involved, while the action plan lacks in some logical and consistency aspects. One of them is about improving dispute resolution mechanism as proposed in this “action”. Measurable indicators of the above mentioned “action” are set up in the section 2-Intervention Logic, Intervention Logical Matrix. This “action will be implemented in indirect management with an entrusted entity(ies) for an indicative EU contribution of EUR 6 million with the indicative duration of the contract(s) to be 48 months.” (p.15). The progress in the action implementation will be assessed by the European Commission.

Judging from the text of this “action” it appears that this “improving dispute resolution mechanism” relates to the non-tariff barriers to trade only. This “action” of 48 months that will be implemented in indirect management with an entrusted entity(ies) overlooks the problem of imposing punitive tariffs (for political reasons) which can be a very significant problem, as the Kosovo 100% tariffs case clearly illustrates.

In summary, improving dispute resolution mechanism relating to non-tariff barriers only, will only contribute to the nominal amount of goals, plans, documents and entities involved, but will not really address the need to improve the dispute resolution mechanism as a whole. The dispute resolution mechanism needs more than just improving it with a view to non-tariff barriers only. That is so not only because non-tariff barriers are typically less quantifiable, and reductions in them are more complex to deal with than reductions in tariffs [31]. The dispute resolution mechanism should be amended so as to add clear provisions on the course of legal and other action in response to the violation of CEFTA that occur because of political reasons only.

As per indicators that are to be measured, the above mentioned document states that “all objectives and results in the action are linked with policy objectives set in the MAP REA, endorsed by the Prime Ministers of the Western Balkans and the EU. Political commitment in MAP REA additionally provides guarantee that actions are relevant and supported by the Parties. Furthermore, all activities are linked to one or more of CEFTA bodies and therefore feature in the relevant chairmanship programmes of these bodies. This

creates additional commitment to the Parties to be involved in implementation of the activities and deliver results.” (p.17).

These statements about the possibilities of CEFTA are nice in narrative as they imply cooperation but as illustrated by the case of Kosovo’s 100% tariffs, the reality is different, making it clear that cooperative behaviour by all CEFTA parties in line with the CEFTA agreement might not really be on the table. That is a clear indicator that the dispute resolution mechanism should be amended so as to include provisions on the scope of legal actions when the violations are not caused by any trade-related reasons. In addition to the legal improvement of the dispute resolution mechanism, there should be clear and measurable end results in documents such as above Multi-Country EU4Business which lacks in that respect as the expected outcomes are not clearly linked to the improved regional (trade) cooperation and integration.

### *B. Withdrawal and/or Conditionality of Support*

The Stabilisation and Association Agreements between the EU and CEFTA parties impose an obligation on CEFTA parties to fully implement the CEFTA agreement. To get closer to the EU membership, both the Stabilisation and Association Agreements and the CEFTA agreement have to be respected and implemented by CEFTA parties.

In this regard, a move such as the 100% tariff by Kosovo is not consistent with the fact that a party to CEFTA which committed to the Stabilisation and Association Agreement does not respect legal obligations within the framework of CEFTA to which they did commit in the Stability and Association Agreement. In order to remedy this inconsistency, financial and/or technical assistance penalty and (temporarily) reducing support should be imposed upon the parties that significantly violate the rules of the CEFTA. Not engaging in consultation and cooperation prior to imposing a tariff or a fiscal measure of equivalent effect on goods imported from the targeted CEFTA party should result in tightening conditionality of support to the CEFTA party that violates the rules of CEFTA.

With the respect to the example case of Kosovo, the EU funding allocation in financial assistance for Kosovo under IPA II for the period 2014-2020 was 602 million euro. This assistance was expected, among other things, to contribute to strengthening the rule of law and the funding allocation in this respect was 94 million euro for the period 2014-2020.

Any significant deviation from the CEFTA commitments should be penalized with the withdrawal of financial or technical assistance to the party that violates the CEFTA for political reasons. There should be measurable indicators associated with any component of IPA funding to all CEFTA parties, especially with respect to the rule of law and understanding international legal commitments, including CEFTA.

### *C. Increased Supervision of Financial Assistance*

For historical reasons CEFTA members from the Western Balkans could lack a commitment to cooperate. Therefore, one of the policy solutions to a violation of CEFTA rules could be to increase supervision of financial assistance to various programs and projects supported by the EU. The mechanism applied in respect to the strengthened supervision could be similar to the rules and principles of the EU

regulations on the control and financial management of EU structural and cohesion funds. The strengthened supervision could focus on how to deal with irregularities and how to conduct audits of accounts, systems and operations. In addition, the provisions of increased supervision should scrutiny financial allocations, use of funding instruments, programme performance, monitoring, evaluation and conditionality options.

An example is the launching a new format of regional cooperation Western Balkans Six (WB6) at the level of Prime Ministers during the Western Balkans Summit in London in 2014. Following that, the Western Balkans Summit in July 2017 in Trieste produced a multi-annual action plan for a regional economic area in the Western Balkans six. The six partners committed to trade, investment, mobility and digital integration, and in addition, they committed to deepening their collaboration within CEFTA so that goods, services, investments and skilled people could move freely. However, this did not deter Kosovo to impose 100% tariffs on goods imported from Bosnia and Herzegovina and Serbia in 2018, thereby confirming that political statements are not always transposed to the relevant de-facto commitment.

## V. DISCUSSION

The main goal of the EU in respect to enlargement to the Western Balkans is political [32]. However, the impact of CEFTA on the EU enlargement process has been rather limited until now. Moreover, unilateral moves such as 100% tariffs imposed by Kosovo leads to the question if CEFTA is relevant at all and if it is an appropriate way to bring the region closer to the EU. CEFTA aims at enhancing economic growth with regional trade liberalisation and market integration by improving regional trade. The idea has been to better prepare (potential) candidates before joining the EU. In this respect CEFTA should make important contribution to economic development and regional co-operation. According to the European Commission, if effectively implemented, “the Agreement provides an excellent framework for the Parties to prepare for EU accession, thus continuing the tradition of the original CEFTA, whose founding members are now in the EU” [3]. Unfortunately however, historical reasons and political reality in the Western Balkans have not translated legal commitments of liberalisation in regional trade to proper political cooperation in the region.

Typically, the dispute resolution mechanism in a regional free trade agreement is not only reflective of the economic and political goals and the level of domestic support for the agreement, it also reflects the relationship between the parties [26]. In this respect it could be concluded that a unilateral move by Kosovo in 2018 reflects its attitude not only to Bosnia and Herzegovina and Serbia but also towards the CEFTA agreement, towards the role of international institutions that promoted CEFTA and towards the dispute resolution mechanism itself.

In this respect it appears that when preparing CEFTA agreement the EU did not sufficiently take into account the realities of the Western Balkans. The major issue is politics. In the case of Kosovo with respect to its status, UNMIK signed CEFTA on behalf of Kosovo, but Kosovo has tried to send ministry representatives to attend some meetings



without UNMIK [33]. The reality is not just about politics and the unresolved status of Kosovo, it is also about countries at different speeds in transition to a market economy. The discrepancy between the current text of CEFTA agreement and the reality of the Western Balkans has been clearly seen in the Kosovo's tariff example. On one hand, CEFTA includes many "modern" provisions, foster investment, provide fair conditions of competition and appropriate protection of intellectual property rights, however on the other hand, CEFTA does not provide an adequate framework for effective resolution of disputes that would take into account the politics of the Western Balkans.

The latest EU reports in 2021 on CEFTA parties, the reality is that all CEFTA members have some problems in understanding and implementing EU acquis. The EU reports on CEFTA members with respect to their Stabilisation and Association Agreement [34] reveal that there is generally slow progress in the legal alignment with EU acquis and institutional set-up. Even if the latter exists, the enforcement capacity and implementation are weak. There are many weaknesses in the overall compliance in removing tariff and non-tariff barriers to trade in most CEFTA parties. Second, accession to the EU requires a functioning market economy and the capacity to cope with competitive pressure and market forces within the EU. Most CEFTA parties are moderately prepared in developing a functioning market economy. The regulatory and institutional environment for the functioning of the internal market in most CEFTA members is a crucial weakness.

All Stabilisation and Association Agreements with CEFTA parties emphasize that, in line with the conclusions of the European Council in Copenhagen in June 1993, to be able to join the EU, candidate countries should become a functioning market economy and have the capacity to cope with competitive pressure and market forces within the EU. In this respect economic governance has become even more central in the enlargement process [35]. However, almost all CEFTA parties are moderately prepared for developing a functioning market economy with effective implementation of legislation. In order to reap the benefits from CEFTA agreement, many CEFTA parties should enhance business support and improve access to finance and know-how to medium enterprises to improve their competitiveness and export capacity [36].

In line with all of the above, it is clear that the current dispute resolution mechanism in CEFTA needs improvement. The current CEFTA agreement with its intergovernmental nature and its Joint Committee whose primary task is to allow exchange of information and consultation, making decisions by consensus, needs improvement with respect to the dispute resolution mechanism so as to make it more legalistic and less diplomacy-oriented. In order to improve the credibility of CEFTA and its dispute resolution mechanism, the agreement should be amended so as to account for the possibility of violations of CEFTA for political reasons only. The text of CEFTA should incorporate such possibility and introduce and clarify the procedure in that respect. Moreover, the dispute resolution mechanism must make it clear which authority is financially responsible for damages when a signatory to CEFTA is a United Nations body. Finally, the improvement of a dispute resolution mechanism in CEFTA is

needed because CEFTA 2006 is an interim EU's pre-accession "training program" that has been in "action" for 15 years now but has achieved little compared to the first CEFTA agreement from 1992.

## VI. CONCLUSION

From an economic perspective, intra-regional trade in the CEFTA area has grown in the last decade. However, the level of economic cooperation and integration is not particularly high. This fact is an opportunity for the CEFTA parties to improve the implementation of the current agreement and to make necessary amendments to make it even better. From a political perspective and in order not to distort trade, CEFTA parties should try to harmonize their policies beyond the minimum required by the agreement.

CEFTA aims beyond a typical free trade agreement. However, to make it workable, the text of CEFTA should be amended otherwise the agreement might be only a mix of wishes and politics with weak, unsuitable enforcement mechanisms and unworkable legal and financial implications. The end result might be that the opportunities possible by CEFTA did not materialize due to the unresolved key challenges.

The largest opportunity for CEFTA parties is related to further regional trade integration and aligning their policies to the standards and principles of the EU. On the other hand, the biggest challenge for CEFTA to make progress in this respect is to overcome political attitudes that are rooted in national politics and history of the region.

## CONFLICT OF INTEREST

The author declares no conflict of interest.

## AUTHOR CONTRIBUTION

The author Vesna Lukovic conducted the research, analyzed the data and wrote the paper.

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