

REGULATION OF TRADE ACROSS CONTESTED BORDERS

The cases of China/Taiwan, Serbia/Kosovo and Cyprus



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Executive summary

Since 2009, International Alert has engaged with a group of Abkhaz and Georgian legal and economic experts to research the issue of regulating cross-divide economic relations. The focus of this process has been to assess the potential of mutual economic interests as a basis for conflict transformation. To date, the work has resulted in four groundbreaking research reports:

- *Regulating Trans-Ingur/i Economic Relations: Views from Two Banks* (2011),¹ which explores political and economic gains and losses if trade relations across the Ingur/i river – the physical representation of the Georgian-Abkhaz conflict divide – were to be regulated;
- *Prospects for the Regulation of Trans-Ingur/i Economic Relations: Stakeholder Analysis* (2012),² which provides empirical evidence and analysis of the issue of regulation among business communities and puts forward recommendations on how such regulation could be implemented to benefit the wider conflict transformation agenda;
- *Trans-Ingur/i Economic Relations: A Case for Regulation* (2013, Volume I),³ which assesses the volume of trade across the Ingur/i and provides an overview of the legal context for Georgian-Abkhaz economic relations since the breakup of the Soviet Union, with particular emphasis on how economic relations featured in official negotiations;
- *Trans-Ingur/i Economic Relations: A Case for Regulation* (2015, Volume II),⁴ which assesses the size and structure of trade across the Ingur/i starting from November 2013, the period prior to the Sochi Olympics, and running to the end of December 2014.

The studies in this volume have been conducted in the framework of this process and constitute a new phase. They seek to build on the aforementioned in-depth research on the nature, social meaning and volume of trade across the Georgian-Abkhaz conflict divide.

This volume seeks to introduce a foundation for developing a regulatory framework that would place the existing illicit trade into a predictable, transparent context, which would in turn contribute to building relationships based on trust and mutual interest. Central questions of this volume include the following. What are the ways to encourage legal trade across the state formation conflict divide in the absence of a political solution? Under what circumstances might conflict parties be willing to trade with each other? How can the trade be de-criminalised while neither party's principal stand regarding the sovereignty of the disputed territory is compromised?

There are only a few cases where regulatory frameworks exist for trade and other economic interaction between conflict sides in which one side does not recognise the other as an equal state and hence treats cross-conflict trade as internal and not foreign. This volume describes three such cases of provisional trade regulatory frameworks: Taiwan–China, Kosovo and Serbia, and Cyprus (Republic of Cyprus and Northern Cyprus).⁵ In all three cases, the status of the disputed entity is not agreed by the sides⁶ and the conflict remains unresolved. Against this political

1 N. Mirimanova et al (2011). *Regulating Trans-Ingur/i Economic Relations: Views from Two Banks*, London: International Alert. Available at http://www.international-alert.org/sites/default/files/Caucasus_TransInguri_EconRelationsViews_EN_2012_0.pdf

2 N. Mirimanova et al (2012). *Prospects for the Regulation of Trans-Ingur/i Economic Relations: Stakeholder Analysis*, London: International Alert. Available at http://www.international-alert.org/sites/default/files/Caucasus_TransInguri_EconRelationsAnalysis_EN_2012.pdf

3 N. Mirimanova et al (2013). *Trans-Ingur/i Economic Relations: A Case for Regulation*, London: International Alert. Available at http://www.international-alert.org/sites/default/files/Caucasus_TransInguri_EconRelationsRegulation_EN_2013.pdf

4 The report will be published in April 2015 and will be available at www.international-alert.org

5 Disclaimer: references to terms Taiwan and China, and Kosovo and Serbia in this section including Introduction to this volume and Conclusions do not reflect political positions regarding these contexts. The views expressed in the chapters below are the authors'. Generally, Albanian spelling is Kosova or Kosovë; however, for the ease of brevity the default spelling for Kosovo in this volume is Kosovo.

6 The Taiwan (Republic of China) – China (People's Republic of China) dyad represents a situation where neither side recognises the other as 'China', but it is Taiwan that also lacks international recognition.

background, economic exchange of varying scale is legal on both sides. This means that there is an infrastructure supporting and protecting trade and investments as well as duties and taxes paid to the respective budgets.

The studies examine how these regulatory frameworks came into being and what set of circumstances made the sides align their positions on mutual trade.

The three cases differ on the conflict and economy indicators. However, the following characteristics can be derived from the process that led to agreement on the legal framework and the resulting institutional and procedural trade-enabling arrangements.

- **A common external normative and/or (geo)political framework** helps conflict sides to harmonise their trade policies towards each other. In the case of Cyprus, Kosovo and Serbia, it was the European Union (EU) accession prospects and the EU regulations or frameworks designed by the EU for these specific cases. Thus, the Green Line Regulation (GLR) is essentially an EU trade regulation that prescribes rules of entry for goods from the territory in which the *acquis communautaire*⁷ is suspended (non-EU area, Turkish-Cypriot community) to the EU member state (Republic of Cyprus). The EU encouraged the countries of former Yugoslavia, including Kosovo (under the United Nations Interim Administration in Kosovo (UNMIK) at the time), to sign free trade agreements with each other and then join together in the Central European Free Trade Agreement (CEFTA) in 2007. Since all the countries of the conflict-ridden Western Balkan region had launched their accession to the EU, the latter had undisputed authority in guiding them through this process. Liberalisation of trade on the basis of World Trade Organization (WTO) rules was one of the stepping stones on the way. Serbia had to sign a free trade agreement with UNMIK and not with Kosovo authorities, which was not an insurmountable obstacle for Serbia.

In the case of Taiwan and China, a common WTO framework marked a new phase in their relations due to the elevated international economic status of Taiwan. As WTO is essentially a club of governments, Taiwan's lack of internationally recognised statehood formally would not prevent it from successfully applying for WTO membership. A status of 'separate customs territory', economic significance and non-objection by China were the factors that supported Taiwan's quest for membership. Taiwan has still not adhered to the 'most favoured nation' principle in relation to China and applies protectionist measures, but the main value of WTO membership for both lies elsewhere.

First, it paved the way for Taiwan to conclude free trade agreements with other WTO members, including the regional economies such as New Zealand and Singapore.⁸ This created a strong foundation for Taiwan's legal economic cooperation with countries that at the same time had trade agreements with China. China's condition is that there are no 'two Chinas' or 'one China, one Taiwan' references anywhere in the agreements that Taiwan signs with third parties. Taiwan has accepted the compromise and is referred to as the 'Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu'. Thus, mutual goodwill supported by a common frame of reference (WTO) results in the harmonisation of trade across the region and opens the way for Taiwan to join regional trade blocks, which is in everyone's economic interest. In fact, the cross-strait Economic Cooperation Framework Agreement (ECFA) has a reference to WTO as a preceding common framework.

- **Economic expediency** is an important factor that makes the sides search for creative solutions to facilitate legal trade. Taiwan was an important investor in China and a producer of much-needed

⁷ *Acquis communautaire* is accumulated legislation, legal acts and court decisions, which constitute the body of European Union law.

⁸ N. White, J. Chu and K. Lowmaster (2013). *ANZTEC and Taiwan's Quest for Economic Integration* 1 August, Center for Strategic and International Studies. Available at <http://csis.org/publication/anztec-and-taiwans-quest-economic-integration>

technologies at the time. At present, trade with China constitutes 25% of Taiwan's trade (over US\$100 billion) and is its top trade partner. At the same time, Taiwan, as the fourth economy in South East Asia after Japan, China and South Korea, is being sought as a partner in the regional free trade agreements. However, Taiwan could not have afforded to miss the train of signing a trade liberalisation agreement with China (ECFA) in light of the creation of the ASEAN + 1 (China) regional trade block, in order for its products to be competitive.

Serbia is the second largest trade partner for Kosovo, with annual exports from Serbia to Kosovo reaching US\$300 million in 2013. At the same time, Kosovo is among the 10 most important trade partners for Serbia and accounts for 3.5% of its exports. Moreover, the open Kosovo–Serbia connection is an indispensable part of the south–north transit route.

Conversely, Green Line trade is negligible and in many respects artificially stimulated. The Greek-Cypriot community is not a market of significance for the Turkish-Cypriot economy, which is predominantly service orientated (higher education and tourism). On the other hand, as the Turkish-Cypriot community is not able to trade legally with most of the countries in the world and has to always rely on Turkey for bar codes, accreditation of its universities under the Bologna system, internationally recognised ports and investments, the development of its market and as a producer of goods and services is seriously hampered. Had the Republic of Cyprus lifted its veto on direct trade by the Turkish-Cypriot community with the EU, intra-island economic links would have been stronger due to new opportunities for joint export of goods and services and the development of new business opportunities.

- **Institutionalisation of trade regulation** that does not challenge either side's position on the contested status represents a breakthrough in transforming the conflict. All three cases demonstrate a range of creative approaches to the seemingly zero-sum game. Taiwan and China established special institutions with clearly defined mandates and authority. In Taiwan, the Mainland Affairs Council was established to oversee mainland-related affairs without engaging in any official communication with China. To fill this gap, the Council in turn established a non-governmental structure, the Straits Exchange Foundation, to deal with people from the other side of the Straits. In a similar manner, the Association for Relations across the Taiwan Straits was established in China to deal with Taiwan. The two non-governmental institutions were signatories to the ECFA. In Cyprus, two Chambers of Commerce, both of them non-governmental organisations (NGOs), were designated to issue certificates of origin and oversee how Green Line trade regulations were followed by the companies. Interestingly, it was the two Chambers that advocated the issuing of symmetric, similar regulations by the Turkish-Cypriot side to enable trade across the Green Line for Greek-Cypriot goods. The so-called 'Asterisk Agreement' helped to end the wrestle over the Kosovo customs stamp between Serbia and Kosovo by means of keeping the name, but also denoting Serbia's position on this matter.⁹
- **The private sector as a proponent** of legalising and facilitating trade with the other side makes the regulatory frameworks sustainable as they resonate with business needs. In the case of Taiwan, the role of Taiwanese entrepreneurs in opening up legal possibilities to invest in and export to China was of primary importance. Local small and medium-sized enterprises (SMEs) in the south of Serbia, particularly the Muslim-populated Sandzak area, welcomed practical steps taken by Belgrade and Priština to legalise and facilitate trade across the contested border.¹⁰

9 The 2012 'Asterisk Agreement' states that the name of Kosovo should be accompanied by an asterisk (Kosovo*) to refer to a footnote stating that "this designation is without prejudice to positions on status, and is in line with UNSC 1244 and the ICJ Opinion on the Kosovo Declaration of Independence". This is one of the agreements reached in Brussels in 2012, which deals with regional representation and cooperation of Kosovo in international bodies.

10 *Monitoring of Implementation of the Agreement Concluded between Kosovo and Serbia in the Field of Free Movement of People and Goods*, September 2013. Available at http://www.centarzarregionalizam.org.rs/prilozi/monitoring/Monitoring_ENG.pdf

None of the three conflicts is likely to see a final political-territorial formula that would be acceptable to all in the near future. However, it is clear that progress has been made in terms of strengthening local and regional security, restoring freedom of movement of people and overall amelioration of tense relationships. Each conflict follows its own trajectory, which cannot be replicated in other cases. However, efforts by all sides and by external actors to normalise the situation through trade facilitation – whereby obstacles to the movement of people, goods and capital have been gradually removed – have already yielded impressive outcomes: trade is being slowly de-politicised, market laws reinstated into the conflict system and, as a result, the search for solutions expanded. Meanwhile, individuals and companies can attend to their business interests, create jobs, generate income, and develop technologies and skills in a less strained political environment.

Introduction

This volume presents the cases of Taiwan–China, Kosovo–Serbia and Cyprus (Republic of Cyprus and Northern Cyprus). The chapters provide a brief outline of the respective conflicts and the political processes that led to the endorsement of trade regulation arrangements (regulatory framework). They also outline the key elements of the regulatory frameworks and their impact on trade and cross-conflict relationships as well as prospects for a peace agreement.

The volume presents a unique collection of analyses of the regulatory frameworks that created an enabling environment for legal trade and other economic exchange between the sides of the conflicts. These conflicts are referred to as sovereignty or state formation conflicts, whereby sovereignty of the part that exists as a *de facto* independent state of the rump state is contested. Within the liberal theory of peace, economic exchange (trade) is a factor that promotes peace between trading parties. Since legal trade across the conflict divide is banned by one or both sides,¹¹ rapprochement driven by economic interest becomes politically unacceptable, while illicit trade thrives.

The chapters in this volume outline the various strategies that led to the establishment of mutually acceptable rules and regulations that legalise trade in the absence of a political solution to the conflict. The analyses explore the impact of the legal frameworks on the economic interaction between the sides as well as on the prospects for peace.

Theoretical foundation

Within the liberal peace paradigm, conflict is defined as “trade gone awry”. Indeed, macroeconomic modelling demonstrates that the risk of belligerence between countries engaged in trade is lower than between countries that do not trade with each other.¹² However, the causality in the trade–peace relationship is not empirically easy to infer. Put simply, it is equally possible that countries A and B trade with each other because they are at peace *or* that there is peace between A and B because they engage in trade with each other.

The theory of change underlying the strategy to facilitate trade across conflict as a peacemaking strategy is that trade fosters interdependence between people and companies across the conflict divide: the parties come to value their (repaired) relationships and they are more likely than in the absence of trade to gravitate towards a ‘win-win’ solution.

Irrespective of whether this theory of change is universally applicable, it should be kept in mind that trade across the conflict line is a phenomenon that is not identical to trade across a neutral and non-contested border. Thus, interventions informed by this theory have to take into account the peculiarities of cross-conflict trade. To add another layer of nuance, the phenomenon of trade with the other side has its particular traits depending on the conflict type.

In the absence of explicitly prohibitive internal legislation or external sanctions, there is nothing in international trade law that prevents states in conflict with each other – when diplomatic relations are cut or one of them does not recognise the other – from engaging in economic exchange as long as they have the necessary attributes to engage in international trade and/or are members of the World Trade Organization (WTO). One of the general principles of WTO trade law is the most favoured

¹¹ N. Mirimanova et al (2013). Op. cit.

¹² S. Polachek and C. Seigle (2007). Trade, Peace and Democracy: An Analysis of Dyadic Dispute, in T. Sandler and K. Hartley (eds.) *Handbook on Defense Economics: Defense in a Globalized World*, Volume 2, North-Holland. pp. 1017–1074.

nation (MFN) principle. This means that a member cannot discriminate against imports from another member. Article XXI of the General Agreement on Tariffs and Trade (GATT) contains national security considerations that can be considered as legitimate reasons for a country to waive trade commitments. However, application of this flexibility clause is not automatic and has to be tested against other WTO provisions. In sum, it is difficult for one WTO member state to deny another member state the possibility of engaging in trade with it.¹³ Thus, globalisation and regionalisation of trade along with the institutional and legal empowerment for trade proliferation can be considered as factors that encourage states to sustain economic links and let their private sectors interact, even against the background of negative or outwardly hostile political relations.

State formation conflicts that lead to the creation of entities of contested sovereignty that break away from the rump state constitute a particular type of conflict, where norms of international trade are not applicable. The breakaway entities lack international recognition as states and are usually referred to as ‘unrecognised states’ or ‘de facto states’. Their economic relations with the outside world are restricted because the necessary attributes of an international economic subject such as certificate of origin and bar code are unattainable, international trade arbitration procedures are inaccessible and prospects for membership in WTO or regional trade blocks are virtually non-existent. Independent statehood aspirations prevent them from accepting the internal trade rules set by the state from which they are trying to secede. This leads to economic isolation and in turn negatively affects development.

The main *subjective* obstacle to trade between states remains politics and collective sentiment. The moral burden of ‘trading with the enemy’ affects business decisions. It is reportedly difficult to empirically evaluate the number of business opportunities declined because of the moral pressure to not engage in any exchange with the ‘enemy’ and weigh these against the business deals struck.

The phenomenon of ‘emotional economy’ is typical for state formation conflicts just as it is for any other inter-group, identity-driven violent conflict between states, regions or classes. For example, Turkish-Cypriot entrepreneurs believe that their Green Line trade could have been stronger had Greek-Cypriots softened their rigid opposition to advertising Turkish-Cypriot goods in the media or putting them on the shelves in supermarkets. Of course, a rigorous test is needed to measure the degree to which such attitudes indeed reduce the actual trade level. However, the sentiment exists.

State formation conflicts are asymmetric by nature – the breakaway entity has *a priori* scarcer means to assert itself in the international arena as a legitimate party or to ensure its security by own force. Powerful states directly or indirectly involved in the conflict on behalf of the secessionist polity – or allegedly having encouraged secessionist movement – reverse the asymmetry with the rump state, which becomes vulnerable and threatened as a result of such protectorate. Trade with the opponent side in this case becomes subservient to security considerations apart from emotional obstacles. When commerce is taking place in a securitised context, in which escalation of the (tense) relationship into an armed standoff is a possibility, aiding the party that is gaining more through continuous engagement in trade with the less economically advantageous party becomes tantamount to contributing to the latter’s potential military defeat.

13 The General Agreement on Tariffs and Trade (GATT 1947), Article XXI: Security Exceptions – Nothing in this Agreement shall be construed (a) to require any contracting party to furnish any information, the disclosure of which it considers contrary to its essential security interests; or (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests (i) relating to fissionable materials or the materials from which they are derived, (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment, (iii) taken in time of war or other emergency in international relations; or (c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security. Available at https://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm

The principal challenge for the leadership contemplating a peace deal through the liberalisation of economic relations across the divide is how to move from the dominant ‘emotional economy’ and ‘security first’ approach – which is typical of the uncompromising political position in the conflict – towards a pragmatic yet socially meaningful approach that allows business interests to transcend political deadlock.

For the sake of accuracy, one needs to always distinguish between various social, political and human sub-currents within a seemingly monolithic conflict party.

The phenomenon of a principled boycott of any business deals with and products from the ‘other side’ coexists alongside pragmatic considerations concerning more competitive prices, better-quality goods and more accessible markets – yet often accompanied by predatory profit-seeking precisely due to the prohibitive trade regimes that the sides impose on each other.

The evolution of economic relations between Taiwan and China illustrates how the business community has managed to pressurise the government to accommodate its economic incentives through appropriate legislation. As soon as China became an attractive market for goods and investments, and explicitly changed its policy towards Taiwanese companies to welcome their presence on the mainland, the Taiwanese private sector started grappling with the operation via third parties, such as Hong Kong or Japan. It took the Taiwanese government just over 10 years to soften its resistance to allowing Taiwanese businesses to engage in trade and investment with mainland China. In 1990, legal economic interaction with China was allowed in Taiwan, albeit with restrictions and not direct interaction. Private economic interest, but also national economic growth considerations, prevailed and led to the legally guaranteed de-criminalisation of economic relations with the mainland. It was also an important message to the population regarding the ‘emotional economy’.

In the context of the irresolvable conflict between Serbia and Kosovo over the status of the latter, joint smuggling enterprises run by Kosovo Serbs in partnership with Kosovo Albanians have been flourishing throughout the different conflict phases. Protests against introducing the customs regime between Serbia and Kosovo in the Serb-run part of Mitrovica are believed to have been fuelled not only by political outrage against the unacceptable institutionalisation of Kosovo independence, but also particularly by fear of losing their immensely profitable business operating outside of any tax or control framework.¹⁴

Thus, one can conclude that, at least for the private sector, the priority of making profit can be at odds with the ‘emotional economy’ and even supersede collective attitudes. However, even if atomised trade links are created across the conflict divide, private entrepreneurs lack the legal and political foundation for making this trade transparent and protected. As trade with the ‘enemy’ is criminalised by law and condemned by society, business people who are ready to engage need to make a difficult decision about whether to engage in illicit business, assume the associated risks but benefit from tax evasion and minimal competition.

Smuggling flourishes when legal trade is impossible or official tariffs are too high, and also when those in charge of ensuring that trade barriers are not crossed are corrupt. Cross-divide criminal networks benefit from the lack of income-generating options available to the population on both sides of the divide and their readiness to take risks and engage in shadow economy activities. These networks can be very profitable for gatekeepers and internally sustainable as long as profits outweigh risks for the ordinary traders or until a power external to the network cracks down on such activities. For example, the giant illicit market in the village of Ergneti at the Georgian-South Ossetian divide had for years been providing thousands of people from both sides of the conflict with income and generating millions of

14 D. Carvajal (2011). ‘In Kosovo, Smuggling Fosters Unusual Ethnic Cooperation’, *New York Times*, 24 October. Available at http://www.nytimes.com/2011/10/24/world/europe/in-balkans-smuggling-forges-a-rare-unity.html?pagewanted=all&_r=0

dollars in profits for the gatekeepers. However, this disappeared in a matter of days after the decisive moves of the newly elected Georgian leadership, which was determined to eradicate corruption.¹⁵ Another informal market at the Georgian village of Sadakhlo, close to the borders with Armenia and Azerbaijan and serving as a meeting place for Armenians and Azerbaijanis to strike business deals and maintain human relationships was also subsequently closed. The illegal operation of this self-styled 'alternative to conflict' made the markets vulnerable to internal and external shocks.¹⁶

Legal obstacles are a key *objective* factor that impedes transparent and eventually positively regarded trade across the contested border. The contested nature of the boundary that separates the two sides of the conflict leads to a situation where one side (rump state) considers this boundary as an administrative border and hence any economic exchange across this boundary as internal trade. Conversely, the unrecognised state treats this same boundary as an international border and hence cross-boundary trade as external trade. Even if there was mutual willingness to engage in trade, issues such as placement of customs points and customs procedures, tax application, certificate of origin, licensing power and other factors are deeply intertwined with the essence of the conflict – that is, the status of a particular breakaway territory and political control over it – and are therefore impossible or seemingly impossible to agree on.

The following chapters will look at the cases of Taiwan–China, Kosovo–Serbia and Cyprus (Republic of Cyprus and Northern Cyprus), providing an insight into the various strategies that led to the establishment of mutually acceptable rules and regulations that legalise trade in the absence of a political solution to the conflict.

15 International Alert (2006). 'Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector. Executive Summary'. London. Available at http://caucasusbusiness.net/wp-content/uploads/2014/09/local_business_local_peace_01.pdf

16 For more information on the Ergneti and Sadakhlo markets, see N. Mirimanova (2006). 'Local Business, Local Peace: the peacebuilding potential of the domestic private sector. Caucasus case study'. London: International Alert. Available at www.international-alert.org/sites/default/files/publications/28_section_2_South_Caucasus.pdf

China and Taiwan Economic Cooperation

Yao-Ming Hsu

Introduction

Taiwan, officially named the ‘Republic of China’ (ROC), was established in 1911. However, since 1949, ‘China’ was divided into two parts: the former ROC was moved to Taiwan, led by the Kuomintang (KMT) Nationalist Party; and the newly established ‘People’s Republic of China’ (PRC) controlled most of mainland China, led by the Communist Party. In 1971, the United Nations (UN) officially recognised China’s seat in the UN, represented by the PRC. Since then, the ROC, otherwise commonly known as Formosa or Taiwan, still acts as a *sui generis*¹⁷ entity in the international arena and maintains a semi-official relationship with other states. For example, there is visa-free treatment for Taiwanese people by over 130 countries and Taiwan is officially a member of the World Trade Organization (WTO).

Even though, according to each side, China and Taiwan are still at the stage of ‘civil war’, some economic cooperation is still needed. Before the 1990s, there was no official interaction between both governments and just a few civic/commercial relationships existed. China introduced temporary regulations regarding opening trade with Taiwan as early as 1979 in its rather unhidden attempt to motivate Taiwanese business people to pressurise their government into reunification. For its part, Taipei kept economic exchanges limited, fearing that strengthened economic dependency on the mainland could leave Taiwan vulnerable. However, in October 1990, Taipei legally allowed Taiwanese investments on the mainland under the ‘Measures on Indirect Investment and Technical Cooperation with the Mainland’ provisions – but only through third parties (most notably, Hong Kong or Japan) and with the approval of the government.¹⁸ This initiative amended the prior policy of no direct communication, no trade and no transport connections with China. After the 1990s, Taiwanese businesses increasingly started to invest in China because of the convenience of the shared language and lower labour cost in China. From then on, both sides of the Taiwan Strait commenced dialogue. This dialogue went through its ups and downs, but despite the political concerns of Taiwan’s leadership over being economically entrapped by China, the relationship between the two entities has been steadily developing towards greater economic liberalisation. At the time of writing in 2014, about 22% of trade in Taiwanese goods was connected to China (see Table 1).

¹⁷ Latin term meaning ‘of its own kind/genus’ or ‘unique in its characteristics’.

¹⁸ C. Chen (2012). ‘Useful adversaries: How to understand the political economy of cross-security’, in J.-M.F. Blanchard and D.V. Hickey (eds.) *New thinking about the Taiwan issue: Theoretical insights into its origins, dynamics, and prospects*. Oxford: Routledge. pp. 48–70.

Table 1: Trade in goods between Taiwan and China (January–October 2014)

Trade in goods in Taiwan January to October 2014		Trade volume	
		In US\$	Percentage (%)
Top 10 countries	Rank	Volume	%
China	1	107,888,809,684	21.926
United States	2	51,678,425,269	10.502
Japan	3	51,507,543,144	10.468
Hong Kong	4	36,540,419,880	7.426
Singapore	5	24,183,419,283	4.915
Republic of Korea	6	22,737,374,638	4.621
Malaysia	7	14,863,818,264	3.021
Saudi Arabia	8	13,659,032,734	2.776
Germany, Federal Republic of	9	13,053,795,627	2.653
Vietnam	10	10,475,021,965	2.129
Global	All	492,060,260,686	100.00

Source: Bureau of International Trade (Taiwan)¹⁹

Legal framework

Taiwanese constitutional amendments

The possibility of official – albeit non-governmental – direct interaction between Taiwan and China was created under the constitutional revisions of 1992 in Taiwan. Under the ROC Constitution Amendments (1992),²⁰ it is prescribed in the foreword that “to meet the requisites of the nation prior to national unification, the following articles of the ROC Constitution are added or amended to the ROC...”. Furthermore, in Article 11, special arrangements are set out that “rights and obligations between the people of the Chinese mainland area and those of the free area, and the disposition of other related affairs, may be specified by law”.

Consequently, the ‘Act Governing Relations between the People of the Taiwan Area and the Mainland Area’,²¹ sometimes simplified as the Cross-Strait Relationship Act (CSRA), was also promulgated in 1992, as authorised by ROC Constitution Amendments, Article 11. Article 1 of the CSRA states that:

“This Act is specially enacted for the purposes of ensuring the security and public welfare in the Taiwan Area, regulating dealings between the peoples of the Taiwan Area and the Mainland Area, and handling legal matters arising there from before national unification. With regard to matters not provided for in this Act, the provisions of other relevant laws and regulations shall apply.”

In addition, Article 3.1 stipulates the competent authority in charge of cross-strait affairs:

“[The] Mainland Affairs Council, Executive Yuan (Cabinet) shall coordinate the handling of all Mainland-related affairs and is designated as the competent authority of this Act.”

¹⁹ Bureau of International Trade (Taiwan), available at <http://cus93.trade.gov.tw/FSCI/>

²⁰ ROC Constitution Amendments (1992). Available at <http://law.moj.gov.tw/Eng/LawClass/LawContent.aspx?PCODE=A0000002>

²¹ Act Governing Relations between the People of the Taiwan Area and the Mainland Area (2011). Available at <http://law.moj.gov.tw/Eng/LawClass/LawContent.aspx?PCODE=Q0010001>

Significantly, this CSRA covers all the administrative affairs, regional private law (conflict of laws) and mutual relationship in criminal matters.

However, the Taiwan government is still reluctant to have official contact with China through governmental organs, and China has the same reservations. For this reason, a semi-non-governmental organisation (NGO) has been established in Taiwan – namely, the Straits Exchange Foundation (SEF).²² This SEF is set by official authorisation of the Mainland Affairs Council. Article 4 of the CSRA states that:

“[The] Mainland Affairs Council, Executive Yuan may entrust the institution referred to in the preceding paragraph or any private organization meeting the following criteria to handle affairs relating to any dealings between the peoples of the Taiwan Area and the Mainland Area:

- 1. Upon establishment, more than half of its total assets is donated by the government; and*
- 2. The purpose of its establishment is for handling affairs relating to any dealings between the peoples of the Taiwan Area and the Mainland Area, and the central competent authorities for it or for its business is the Mainland Affairs Council, Executive Yuan.”*

In addition, for regulating the Cross-Strait Agreements Procedure, Article 4.2 of the CSRA states that:

- “1. The Mainland Affairs Council, Executive Yuan shall coordinate the administration of the matters related to any agreement making between the Taiwan Area and the Mainland Area; where the content of the agreement is of professional and technical nature, and suitable to be made by each competent authorities concerned, the administration may be taken charge by the referred competent authorities in conjunction with the Mainland Affairs Council, Executive Yuan upon the approval of the Executive Yuan;*
- 2. The Mainland Affairs Council, Executive Yuan, or each competent authorities approved by the Executive Yuan in accordance with the preceding paragraph, may entrust any institution or private organization referred to in Article 4 to negotiate and execute agreements, in the name of the entrusted, with the concerned authorities of the Mainland Area or their delegated juristic person, organization, or any other institution;*
- 3. The agreement referred to in this statute means any written document involving the exercise of governmental powers or any matter of political issues, and executed between the Taiwan Area and the Mainland Area; any additional protocol, additional provision, protocol executed, agreed minutes, annex, and any other attachment shall constitute an integral part of the agreement.”*

Moreover, all these cross-strait agreements should be approved by or reported to Taiwanese Congress. Article 5 of the CSRA states that:

- “1. The institution, private organization, or any other non-profit juristic person entrusted to execute an agreement in accordance with Paragraph 3 of Article 4 or Paragraph 2 of Article 4.2, shall submit the draft agreement through the entrusting authorities to the Executive Yuan for approval before its execution of the agreement.*
- 2. Where the content of the agreement requires any amendment to laws or any new legislation, the administration authorities of the agreement shall submit the agreement through the Executive Yuan to the Legislative Yuan (Congress) for consideration within 30 days after the execution of the agreement; where its content does not require any amendment to laws or any new legislation, the administration authorities of the agreement shall submit the agreement to the Executive Yuan for approval and to the Legislative Yuan for record, with a confidential procedure if necessary.”*

22 Straits Exchange Foundation (SEF). Available at <http://www.sef.org.tw/ct.asp?xItem=110671&CtNode=4716&mp=300>

However, in practice at the time, agreements reported to the Congress at the approval rate by the Executive Yuan had been extraordinarily high, which sparked controversy among sections of society and eventually led to the so-called ‘Sunflower protests’.

Chinese constitution and anti-secession law

In paragraph 9 of the preamble to the Constitution of the People’s Republic of China (1982),²³ it is stated that:

“Taiwan is part of the sacred territory of the People’s Republic of China. It is the inviolable duty of all Chinese people, including our compatriots in Taiwan, to accomplish the great task of reunifying the motherland.”

Furthermore, in 2005, a special law named the Anti-Secession Law²⁴ was announced. Article 1 solemnly states that:

“This Law is formulated, in accordance with the Constitution, for the purpose of opposing and checking Taiwan’s secession from China by secessionists in the name of ‘Taiwan independence’, promoting peaceful national reunification, maintaining peace and stability in the Taiwan Straits, preserving China’s sovereignty and territorial integrity, and safeguarding the fundamental interests of the Chinese nation.”

Regarding Taiwan’s status, Article 2 of the Anti-Secession Law stipulates:

“There is only one China in the world. Both the mainland and Taiwan belong to one China. China’s sovereignty and territorial integrity brook no division. Safeguarding China’s sovereignty and territorial integrity is the common obligation of all Chinese people, the Taiwan compatriots included. Taiwan is part of China. The state shall never allow the ‘Taiwan independence’ secessionist forces to make Taiwan secede from China under any name or by any means.”

In addition, Article 3 of the same Act excludes any possible international interference regarding Taiwan:

“The Taiwan question is one that is left over from China’s civil war of the late 1940s; solving the Taiwan question and achieving national reunification is China’s internal affair, which is subject to no interference by any outside forces.”

Article 8 reinforces the point that:

“In the event that the ‘Taiwan independence’ secessionist forces should act under any name or by any means to cause the fact of Taiwan’s secession from China, or that major incidents entailing Taiwan’s secession from China should occur, or that possibilities for a peaceful reunification should be completely exhausted, the state shall employ non-peaceful means and other necessary measures to protect China’s sovereignty and territorial integrity.”

After affirmation of Taiwan’s status, some cooperation is still necessary according to Article 6 of the Anti-Secession Law:

“The state shall take the following measures to maintain peace and stability in the Taiwan Straits and promote cross-Straits relations:

²³ Constitution of the People’s Republic of China. Available at http://english.gov.cn/archive/laws_regulations/2014/08/23/content_281474982987458.htm

²⁴ Anti-Secession Law. Available at <http://www.china.org.cn/english/2005lh/122724.htm>

1. *To encourage and facilitate personnel exchanges across the Straits for greater mutual understanding and mutual trust;*
2. *To encourage and facilitate economic exchanges and cooperation, realise direct links of trade, mail and air and shipping services, and bring about closer economic ties between the two sides of the Straits to their mutual benefit;*
3. *To encourage and facilitate cross-Straits exchanges in education, science, technology, culture, health and sports, and work together to carry forward the proud Chinese cultural traditions;*
4. *To encourage and facilitate cross-Straits cooperation in combating crimes;*
5. *To encourage and facilitate other activities that are conducive to peace and stability in the Taiwan Straits and stronger cross-Straits relations;*
6. *The state protects the rights and interests of the Taiwan compatriots in accordance with law."*

In the long run, some prospective arena is also envisaged under Article 7:

"The two sides of the Taiwan Straits may consult and negotiate on the following matters:

1. *Officially ending the state of hostility between the two sides;*
2. *Mapping out the development of cross-Straits relations;*
3. *Steps and arrangements for peaceful national reunification;*
4. *The political status of the Taiwan authorities;*
5. *The Taiwan region's capacity of international operation that is compatible with its status; and*
6. *Other matters concerning the achievement of peaceful national reunification."*

Membership of the WTO

It is evident from the previous paragraphs that even though some political tensions remain between China and Taiwan, a degree of economic cooperation is essential. China used to have a greater economic interest in developing business links with Taiwan, particularly in the area of technology and innovation, as well as investment a couple of decades ago, before it became a great economic power. These days, Taiwan's significance as an economic partner for China has diminished, although it is still important and Taiwan has its niche. Trade with China constitutes about one-fifth of Taiwan's overall trade. However, a more important consideration has arisen regarding Taiwan's liberalisation of economic and civic relations with China. Membership of the regional trade blocks has become crucial for Taiwan in order to lower or eliminate trade barriers with other countries. For this to happen, China's 'non-objection' had to be secured.

From the perspective of international economic integration and international trade, it is also evident that the participation of China and Taiwan in a multilateral trading system is of great significance. China has been a member of the WTO since 11 December 2001 and Taiwan since 1 January 2002 (officially as a 'Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu', simplified as 'Chinese Taipei'). Taiwan could accede to the WTO as the latter is an organisation of governments, not necessarily states – for example, unlike the Organisation for Economic Co-operation and Development (OECD).

However, thus far, because of political considerations, neither the Most Favoured Nation Treatment (MFN) nor National Treatment (NT) has applied in actual economic and commercial activities between China and Taiwan. Even in 2006, a trade dispute arose named the 'Towel war' concerning the importation of towels from China to Taiwan; in the end, both sides settled the matter politically. For this reason, special *sui generis* agreements between Taiwan and China are required. Consequently, the Economic Cooperation Framework Agreement (ECFA)²⁵ was signed and entered into force in 2010. Nevertheless, although some early harvest provisions of the ECFA

25 Cross-Straits Economic Cooperation Framework Agreement. Available at <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/ECFA.pdf>. See: Annexes, available at <http://www.international-alert.org/resources/publications/regulations-trade-across-contested-borders-en>

have been implemented, as it is merely a framework, supplementary agreements for the ECFA are still needed to accomplish detailed regulations for both sides. Due to the protest against Trade in Services Agreements for further implementing the ECFA in March 2014 (Sunflower students' movement), no further agreements have been officially approved. Some negotiations are still ongoing.

Economic cooperation

The potential for cross-strait agreements actually commenced following the '1992 Consensus',²⁶ a political declaration between semi-official representatives from China and Taiwan. In this consensus, it was declared that there was only "one China", but with "different (respective) interpretations".

From 1998 until the time of writing, 21 agreements and 2 consensuses had come into force – including those concerning air and maritime transportation, postal services, food safety, mutual support and cooperation in criminal matters, financial and monetary cooperation, sanitary and phytosanitary measures, fishery, protection of intellectual property, medicine and health, nuclear safety, investment protection and promotion, and custom cooperation. In 2014, three more agreements were under negotiation – the Trade in Services Agreement, the Meteorological Cooperation Agreement and the Earthquakes Monitoring System Cooperation Agreement.²⁷

Economic Cooperation Framework Agreement (ECFA)

For cross-strait economic cooperation, the most important legal instrument is probably the 2010 ECFA. The Straits Exchange Foundation (Taiwan) and the Association for Relations Across the Taiwan Straits (China) mutually agreed to this agreement, adhering to the principles of equality, reciprocity and progressiveness and with a view to strengthening cross-strait trade and economic relations. Even though *prima facie* this is an agreement between two private organisations, the ECFA has its *sui generis* legal binding force, according to China's and Taiwan's respective internal authorisation.

Because China and Taiwan are both WTO members as separate entities, in the preamble to the ECFA, it is clearly stated that both parties:

"...have agreed, in line with the basic principles of the World Trade Organization (WTO) and in consideration of the economic conditions of the two Parties, to gradually reduce or eliminate barriers to trade and investment for each other, create a fair trade and investment environment, further advance cross-Straits trade and investment relations by signing the Cross-Straits Economic Cooperation Framework Agreement."

Moreover, Article 9 prescribes that:

"No provision in this Agreement shall be interpreted to prevent either Party from adopting or maintaining exception measures consistent with the rules of the World Trade Organization."

The detailed introduction to the ECFA explains the different Articles as follows.

26 "'1992 consensus" means "different interpretations"', *China Times* (editorial), 28 November 2012. Available at <http://www.kmt.org.tw/english/page.aspx?type=article&mnum=113&anum=12234>

27 Cross-strait exchanges, Available at <http://www.mac.gov.tw/np.asp?ctNode=5890&mp=3>

Article 1 – objectives

Article 1 of the ECFA outlines its objectives as follows:

- “1. To strengthen and advance the economic, trade and investment cooperation between the two Parties;
2. To promote further liberalization of trade in goods and services between the two Parties and gradually establish fair, transparent and facilitative investment and investment protection mechanisms;
3. To expand areas of economic cooperation and establish a cooperation mechanism.”

Article 2 – cooperation measures

Article 2 of the ECFA describes the measures aimed at enhancing cross-strait cooperation:

“The two Parties have agreed, in consideration of their economic conditions, to take measures including but not limited to the following, in order to strengthen cross-Straits economic exchange and cooperation:

1. Gradually reducing or eliminating tariff and non-tariff barriers to trade in a substantial majority of goods between the two Parties;
2. Gradually reducing or eliminating restrictions on a large number of sectors in trade in services between the two Parties;
3. Providing investment protection and promoting two-way investment;
4. Promoting trade and investment facilitation and industry exchanges and cooperation.”

Article 3 – trade in goods

Article 3.1 states that:

“The two Parties have agreed, on the basis of the Early Harvest for Trade in Goods as stipulated in Article 7 of this Agreement, to conduct consultations on an agreement on trade in goods no later than six months after the entry into force of this Agreement, and expeditiously conclude such consultations.”

However, at the time of writing, no further implementation agreement had yet been passed due to a number of political considerations. Thus, the “six months” demand in this paragraph seems to be illusory.

In relation to Early Harvest for Trade in Goods, Article 7.1 of the ECFA states that:

“To accelerate the realization of the objectives of this Agreement, the two Parties have agreed to implement the Early Harvest Program with respect to the goods listed in Annex I²⁸ titled ‘Product List and Tariff Reduction Arrangements Under the Early Harvest for Trade in Goods’.”

²⁸ Annex I. Product List and Tariff Reduction Arrangements Under the Early Harvest for Trade in Goods. Available at <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/Annex%20I%20Product%20List%20and%20Tariff%20Reduction%20Arrangements.pdf>. See: Annexes, available at <http://www.international-alert.org/resources/publications/regulations-trade-across-contested-borders-en>

Article 3.2 states that:

“The consultations on the agreement on trade in goods shall include, but not be limited to:

- 1. Modalities for tariff reduction or elimination;*
- 2. Rules of origin;²⁹*
- 3. Customs procedures;*
- 4. Non-tariff measures, including but not limited to technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures;*
- 5. Trade remedy measures, including measures set forth in the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, the Agreement on Subsidies and Countervailing Measures and the Agreement on Safeguards of the World Trade Organization, and the safeguard measures between the two Parties³⁰ applicable to the trade in goods between the two Parties.”*

Article 4 – trade in services

For regulations on trade in services, Article 4.1 of the ECFA states that:

“The two Parties have agreed, on the basis of the Early Harvest for Trade in Services as stipulated in Article 8, to conduct consultations on an agreement on trade in services no later than six months after the entry into force of this Agreement, and expeditiously conclude such consultations.”

The Early Harvest Program for Services is set out under Article 8.1 as follows:

“To accelerate the realization of the objectives of this Agreement, the two Parties have agreed to implement the Early Harvest Program on the sectors and liberalization measures listed in Annex IV. The Early Harvest Program shall be implemented expeditiously after the entry into force of this Agreement.”

Annex IV of the ECFA is entitled ‘Sectors and Liberalization Measures under the Early Harvest for Trade in Services’.³¹

Nevertheless, similar to the situation regarding trade in goods, no further agreements for trade in services had been set six months after the entry into force of the ECFA. Moreover, the economic scale in the Early Harvest Program for trade in services is much smaller than the one for trade in goods.

“The consultations on the agreement on trade in services shall seek to (Article 4.2):

- 1. Gradually reduce or eliminate restrictions on a large number of sectors in trade in services between the two Parties;*
- 2. Further increase the breadth and depth of trade in services;*
- 3. Enhance cooperation in trade in services between the two Parties.”*

²⁹ Annex II. Provisional Rules of Origin Applicable to Products. Available at <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/Annex%20II%20Provisional%20Rules%20of%20Origin%20Applicable%20to%20Products.pdf>. See: Annexes, available at <http://www.international-alert.org/resources/publications/regulations-trade-across-contested-borders-en>

³⁰ Annex III. Safeguard Measures Between the Two Parties Applicable to Products Under the Early Harvest for Trade in Goods. Available at <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/Annex%20III%20Safeguard%20Measures%20Between%20the%20Two%20Parties.pdf>. See: Annexes, available at <http://www.international-alert.org/resources/publications/regulations-trade-across-contested-borders-en>

³¹ Annex IV. Sectors and Liberalization Measures Under the Early Harvest for Trade in Services. Available at <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/Annex%20IV%20Sectors%20and%20Liberalization%20Measures.pdf>. See: Annexes, available at <http://www.international-alert.org/resources/publications/regulations-trade-across-contested-borders-en>

Article 6 – possible further economic cooperation

As well as trade in goods and in services, there has been agreement to strengthen economic cooperation in areas including, but not limited to, the following:

- “1. Intellectual property rights protection and cooperation;*
- 2. Financial cooperation;*
- 3. Trade promotion and facilitation;*
- 4. Customs cooperation;*
- 5. E-commerce cooperation;*
- 6. Discussion on the overall arrangements and key areas for industrial cooperation, promotion of cooperation in major projects, and coordination of the resolution of issues that may arise in the course of industrial cooperation between the two Parties;*
- 7. Promotion of small and medium-sized enterprises’ cooperation between the two Parties, and enhancement of the competitiveness of these enterprises;*
- 8. Promotion of the mutual establishment of offices by economic and trade bodies of the two Parties.”*

Article 10 – dispute settlement

According to the first paragraph of this article:

“The two Parties shall engage in consultations on the establishment of appropriate dispute settlement procedures no later than six months after the entry into force of this Agreement, and expeditiously reach an agreement in order to settle any dispute arising from the interpretation, implementation and application of this Agreement.”

At the point of writing, however, there has been no negotiation about these special dispute settlement procedures. Therefore, in practice, only the second paragraph of this article currently applies:

“Any dispute over the interpretation, implementation and application of this Agreement prior to the date the dispute settlement agreement mentioned in paragraph 1 of this Article enters into force shall be resolved through consultations by the two Parties or in an appropriate manner by the Cross-Straits Economic Cooperation Committee, to be established in accordance with Article 11 of this Agreement.”

In fact, the Cross-Straits Economic Cooperation Committee was already established on 6 January 2011.

Article 11 – Cross-Straits Economic Cooperation Committee

The responsibilities of this committee include the following:

- “1. Concluding consultations necessary for the attainment of the objectives of this Agreement;*
- 2. Monitoring and evaluating the implementation of this Agreement;*
- 3. Interpreting the provisions of this Agreement;*
- 4. Notifying important economic and trade information;*
- 5. Settling any dispute over the interpretation, implementation and application of this Agreement in accordance with Article 10 of this Agreement.”*

Article 16 – termination of the ECFA

Regarding its termination, Article 16 of the ECFA states that:

- “1. The Party terminating this Agreement shall notify the other Party in writing. The two Parties shall start consultations within 30 days from the date the termination notice is issued. In case the consultations fail to reach a consensus, this Agreement shall be terminated on the 180th day from the date the termination notice is issued by the notifying Party.*
- 2. Within 30 days from the date of termination of this Agreement, the two Parties shall engage in consultations on issues arising from the termination.”*

Investment protection

Taiwanese investment in China reached around US\$110 billion in September 2013. Moreover, around two million Taiwanese now reside in China.

According to Article 5.1 of the ECFA:

“The two Parties have agreed to conduct consultations on the matters referred to in paragraph 2 of this Article within six months after the entry into force of this Agreement, and expeditiously reach an agreement.”

Concretely, based on Article 5.2, such an agreement shall include, but not be limited to, the following:

- “1. Establishing an investment protection mechanism;*
- 2. Increasing transparency on investment-related regulations;*
- 3. Gradually reducing restrictions on mutual investments between the two Parties;*
- 4. Promoting investment facilitation.”*

For implementing this task, a Cross-Strait Bilateral Investment Protection and Promotion Agreement³² (BIPPA) was also signed in August 2012 between China and Taiwan.

The preamble of the BIPPA declared the following:

“In order to protect the rights and interests of investors across the Taiwan Straits, promote mutual investments, create an impartial investment environment, and enhance cross-strait economic prosperity, in accordance with Article 5 of the ECFA, the Straits Exchange Foundation and the Association for Relations Across the Taiwan Straits reached an agreement as follows upon equal negotiations...”

For actual application, Article 2.1 sets the scope and prescribes that:

“This Agreement applies to the measures adopted or maintained by a Party toward investors of the other Party and their investments.”

With regard to implementation of the BIPPA (Article 2.4):

“A Party may adopt, maintain, or enforce any measure it considers necessary to protect its essential security interests.”

³² Cross-Strait Bilateral Investment Protection and Promotion Agreement (BIPPA). Available at <http://www.mac.gov.tw/public/Attachment/210417181458.pdf> (only in Chinese, so all the translations of the Agreement's texts below are the author's own, not an official translation).

Article 2.7 also excludes the application to public procurement and subsidies or grants provided by a Party. Finally, except as expressly provided in other articles, this Agreement does not apply to taxation measures of either Party (Article 2.8).

Adopting similar logic as that in Article XX of the General Agreement on Tariffs and Trade (GATT), Article 2.5 of the BIPPA defines the possible exceptions and prescribes that:

“ Party may adopt or maintain the following restrictive measures on investments based on the principle of non-arbitrary and non-unjustifiable discrimination, and provided that such measures do not constitute a disguised restriction on trade or investments:

- 1. Measures necessary to secure compliance with laws or regulations that are not inconsistent with this Agreement;*
- 2. Measures necessary to protect the life or health of humans, animals or plants;*
- 3. Measures necessary to protect exhaustible natural resources.”*

In consideration of investment protection, Article 3.1 of the BIPPA sets the standards of protection:

“Each Party shall ensure fair and equitable treatment to investors of the other Party and their investments, and shall provide full protection and security:

- 1. Fair and equitable treatment means that the measures adopted by a Party shall be in accordance with the principle of due process and shall not deny justice and fair trial to investors of the other Party, and that obviously discriminatory or arbitrary measures may not be implemented.*
- 2. Full protection and security means that a Party shall adopt reasonable and necessary measures to protect the safety of investors of the other Party and their investments.”*

In addition, for the benefit of Taiwanese investors, Article 3.2 clearly prescribes that:

“The Parties shall reinforce the protection of personal freedom and safety of investors and related personnel, fulfil the notification obligations related to personal freedom within the prescribed time limit under their respective laws and regulations, and strive to perfect the existing notification mechanism.”

However, there is only limited opportunity for dispute resolution. Article 3.6 stipulates:

“Investors of the other Party may not claim to initiate dispute resolution proceedings other than those provided in this Agreement.”

For transparency and investment facilitation, Article 4.1 of the BIPPA states that:

“A Party shall, in accordance with its laws and regulations, publish or otherwise make publicly available in a timely fashion the investment-related laws, regulations, measures, procedures, etc. that are generally applicable or are specifically applicable to the other Party.”

In addition, Article 6.2 requires that:

“The Parties agree to provide the other Party with investment facilitation.”

Regarding possible expropriation, Article 7.1 states the following:

“A Party may not expropriate the investments or returns of an investor of the other Party in the Party (including direct expropriation and indirect expropriation), unless all of the following conditions are met:

1. *It is for public purpose;*
2. *It is in accordance with the Party's laws and regulations, and with due process;*
3. *It is non-discriminatory and non-arbitrary;*
4. *Payment of compensation is provided in accordance with paragraph 4 of this Article."*

Article 8 also sets the standards for compensation of losses:

"If an investor of a Party suffers a loss with respect to its investments or returns in the other Party due to armed conflict, state of emergency or similar event that takes place in the other Party, the other Party shall provide restitution, compensation, or other resolution no less favourable than that accorded to its own investors or to the investors of any third party in like circumstances, whichever is most favourable to investors."

As mentioned above, possibilities for resolution of investment disputes are limited in this context. For disputes between China and Taiwan, Article 12 of the BIPPA prescribes that:

"Disputes between the Parties concerning the interpretation, implementation or application of this Agreement shall be dealt with in accordance with Article 10 of the Cross-Strait Economic Cooperation Framework Agreement [i.e. by the Cross-Straits Economic Cooperation Committee]."

For disputes between investors and a host party, some other possible ways for dispute resolution, similar to international investments dispute resolution methods, are still nevertheless available. For example, based on Article 13, the following ways are envisaged for the settlement of disputes between an investor and the host party:

1. *Amicable negotiation between the parties to the dispute;*
2. *Coordination through the coordination mechanism at the place of investment or the superior authorities thereof;*
3. *Resolution through the investment dispute settlement mechanism established under Article 15 of this Agreement;*
4. *An investor may submit an investment compensation dispute arising out of this Agreement between an investor and the host Party to a Cross-Strait Investment Dispute Settlement Institution for settlement through mediation. Every six months, the Cross-Strait Investment Dispute Settlement Institutions shall report to the investment working group referred to in Article 15 of this Agreement on the status of investment compensation disputes under disposition;*
5. *Recourse in accordance with the administrative remedy or judicial proceedings of the host Party."*

Article 14 of the BIPPA relates to investment-related commercial disputes. First, when an investor of a party enters into a commercial contract with a natural person, juridical person or other institutions of the other party in accordance with relevant laws and regulations and the principle of autonomy of the parties, the contracting parties may stipulate the methods and means of commercial dispute settlement. In addition, such a contract may include a provision for the arbitration of commercial disputes arising out of investments. If no arbitration provision is included, the disputing parties may consult with each other to submit a dispute to arbitration after the dispute occurs. For arbitration, the parties to a commercial dispute may designate an arbitration institution of either side of the strait and agree on the seat of arbitration. If no arbitration clause is included in a commercial contract, the disputing parties may consult with each other to submit a dispute to an arbitration institution of either side of the strait and settle the dispute at a mutually agreed seat. Finally, both China and Taiwan affirm that the parties to a commercial contract may petition for the recognition and enforcement of arbitration awards in accordance with the relevant laws and regulations.

Conclusion: the ECFA and beyond

As outlined, economic cooperation between China and Taiwan largely proceeds according to the ECFA and the BIPPA at present. Some goods and services are already covered by the Early Harvest Program, but not enough. Fortunately, Taiwanese investors and investments in China are properly protected under the BIPPA, even though Chinese investors and investments in Taiwan are still rare because of legal limitations imposed by the Taiwanese government based on political concerns. Thus, more negotiations are still needed.

The ECFA has a number of intrinsic shortcomings, and some external elements potentially hinder further negotiations.

Regarding the ECFA, as it is just a framework agreement, the terms of its text appear to be very political and ambiguous. From a legal perspective, the ECFA sometimes seems to have a soft law and non-binding nature, requiring more supplementary agreements to accomplish actual economic cooperation. The ECFA resembles the contents page of a book, in which the actual chapters are still blank.

In terms of other elements, in March 2014, during the Congress ratification process for the Cross-Strait Trade in Services Agreement, which will further strengthen cooperation in the services sector, many student protests against the approval of this agreement arose in Taiwan. The ‘Sunflower movement’,³³ organised mainly by college students and some NGOs, emerged in the context of the rising division in recent years between the rich (simplified as investors in China) and the poor (ordinary people in Taiwan), and increasing mistrust towards the ruling party (Kuomintang). This finally culminated in the temporary occupation of the Taiwanese Congress (the Legislative Yuan) for nearly a month and forced entry of the Cabinet Office (the Administrative Yuan). The Sunflower movement asserts that all the cross-strait agreements should be examined on an article-by-article basis by the Congress, even by public referendum. As it stands, almost all the cross-strait agreements have been ratified by the Cabinet alone and are merely reported to the Congress – except in the case of the ECFA’s ratification, when lump-sum voting was held.

Alongside this movement’s concerns, many people in Taiwan have reservations regarding future possible reunification with China, either voluntary or forced. Closer economic cooperation with China creates more economic dependence. However, since China’s economic power is rising across the world, one wonders how Taiwan can choose a safer way to coexist with China – especially since actual immigration from Taiwan to China has reached about two million, mostly business people and their employees. This represents nearly one-tenth of Taiwan’s total population of 23 million people, while China has a population of 1.3 billion people. Moreover, in 2013, a total of 2.87 million Chinese tourists visited Taiwan, almost 5,000 a day. On the one hand, this creates tourist revenue for Taiwan and contributes towards Chinese people’s understanding of a democratic Taiwan; on the other hand, it also increases economic dependence on China. Put simply, when trade and business interests interact with national identity, such a dilemma cannot be resolved easily.

New developments in November 2014 in Taiwan show a slight reluctance regarding further economic cooperation with China. Results of the domestic elections at the end of November showed that more Taiwanese people are turning towards the Democratic Progress Party, which has tended to distance itself from mainland China. Thus, even though the existing ECFA remains effective between China and Taiwan, the pace of further negotiations may decline temporarily.

33 The ‘Sunflower movement’ refers to 2014 protest by students and civil groups to prevent the passage of an agreement allowing for freer trade in services with China.

Trade between Serbia and Kosovo

Predrag Bjelić

Introduction

Kosovo is deeply rooted in Serbian history, myth and religion. Once a part of the medieval Serbian principalities, it was a significant location during the collapse of the Serbian empire following Turkish invasion. This battle was immortalised in Serbian folklore during the Ottoman rule of Serbia. After the Balkan wars when Serbia regained independence, Kosovo was integrated into modern Serbia and, following the First World War, into the Kingdom of Serbs, Croats and Slovenes, later the Kingdom of Yugoslavia. After the Second World War, Kosovo was a part of the Socialist Republic of Serbia and gained limited autonomy as a defined area. This autonomy was later institutionalised as the Autonomous Province of Kosovo and Metohija. The unrest in Kosovo started in the 1980s, after the death of President Tito, when Kosovar Albanians demanded greater self-government. In the 1990s, Kosovo and Metohija was stripped of its autonomy by the Serbian government, led by Slobodan Milošević.

The crisis in Kosovo culminated in the NATO-led intervention in the Federal Republic of Yugoslavia in 1999. This situation was resolved by the adoption of United Nations Security Council Resolution 1244 (UNSCR 1244), when Kosovo was put under international (UN) control. The single market of the Federal Republic of Yugoslavia dissolved into three customs territories – Serbia proper (which included Central Serbia and the Autonomous Province of Vojvodina), Montenegro, and Kosovo and Metohija.³⁴ The Autonomous Province of Kosovo and Metohija, a constitutional part of the Republic of Serbia, according to UNSCR 1244 was put under international control and a special UN Mission was created – the UN Mission in Kosovo (UNMIK). Kosovo, as this territory is referred to in the Resolution, became a separate customs territory but supreme powers in the creation and execution of trade policy for Kosovo were vested in UNMIK.

Serbia effectively recognised Kosovo as a separate customs territory by signing the revised Central European Free Trade Agreement in 2006 (so-called CEFTA 2006³⁵), since UNMIK was a contracting party of this agreement in the name of the customs territory of Kosovo and according to the powers given to this Mission by UNSCR 1244. The important point for Serbia is that the trade policy creation and execution for the territory of Kosovo, as an indicator of trade sovereignty, is vested in UNMIK. However, recognition of one territory as a separate customs territory and a subject in international trade does not imply the legal recognition of that territory as an independent and sovereign state.³⁶

In 2008, the Kosovo provisional institutions in Priština unilaterally declared secession from Serbia. However, the government of Serbia did not accept this declaration. Kosovo authorities in Priština instantly tried to marginalise the role of UNMIK from that point onwards and to take over the creation and execution of trade policy for Kosovo, setting up the Ministry of Trade and Industry.³⁷ This situation was deemed unacceptable by the Serbian government. While many influential countries have recognised Kosovo as an independent country, the UN Security Council

34 P. Bjelić (2011). *Međunarodna trgovina*, Centar za izdavačku delatnost Ekonomskog fakulteta u Beogradu. Beograd, p. 495.

35 This is a revised CEFTA agreement and is much different to the original CEFTA agreement signed in 1993.

36 For more on this, see P. Bjelić et al (2012). *Freedom of Movement of People and Goods between Serbia and Kosovo: Scientific Research Study*. Novi Sad: Center for Regionalism.

37 P. Bjelić (2015). 'Building competitiveness and increasing trade potential in the Western Balkans: Economic policy making in preparing for European integration', in M. Thomas and V. Bojicic-Dzelilovic (eds.) *Public Policy Making in the Western Balkans: Case Studies of Selected Economic and Social Policy Reforms*. Netherlands: Springer Science and Business Media. p. 69.

did not change UNSCR 1244, which guarantees Serbia sovereignty over Kosovo, and UNMIK remained in Kosovo. The unilateral actions of Priština interrupted trade flows between Kosovo and Serbia proper, since Kosovo Customs started to issue customs documents with the 'Republic of Kosovo' insignia and without the UNMIK custom stamp. Serbia customs authorities refused to accept goods into Serbia proper if they were accompanied by such documents.

Nevertheless, some of the goods reached Serbia since they were re-exported through Montenegro, which reissued the customs and related documents that contained indication that the goods originated in Kosovo. This was considered acceptable by Serbian customs authorities. Since Serbia did not have a formal free trade agreement with Kosovo (only with UNMIK), it was not obliged to document preferential status of goods that had originated in Kosovo.

The European Union (EU) wanted to play a greater role in the resolution of the Kosovo conflict and set up the EU Mission for Kosovo (EULEX). Many of the powers that were originally vested in UNMIK were taken over by EULEX. However, before this transition of power was made, Serbia had to agree. In the UN, a special plan was adopted on 26 November 2008 before the introduction of EULEX. According to the so-called Six Points Plan, adopted by the UN Security Council as proposed by the UN Secretary General,³⁸ UNMIK was to be transformed, meaning reduced, and EULEX was to be deployed in Kosovo as a mission concentrated on the rule of law, in police and juridical matters.

The Plan stated that Kosovo would remain a single customs territory. For Serbia, one of the important points in the section concerning customs was that the border crossings 1 and 31 in the North of Kosovo, known as Jarinje and Brnjak, would remain under international control (see Picture 1). The duties collected at these two border crossings on the administrative line with Serbia proper would be used for the development of local communities. This is very important, since North Kosovo is populated by a Serbian ethnic majority. That is why Kosovo Customs had established a customs point in South Mitrovica, part of the town of Kosovska Mitrovica under the control of Priština authorities.

Picture 1: Jarinje and Brnjak crossing points



38 According to *Daily Politika*, 'Plan Ujedinjenih Nacija od šest tačaka', 18 September 2011.

The situation on the ground thus indicated that Kosovo was not a single customs territory, since crossings in the North of Kosovo were not under the authority of Kosovo Customs. In light of this situation, negotiations between Belgrade and Priština authorities on technical matters started in 2011 in Brussels, facilitated by EU institutions. EU authorities have managed to act as a mediator since both entities have aspirations to become an integral part of the EU. One of the main questions concerning trade matters was the question of Kosovo customs documents and customs stamp. In the middle of negotiations in the summer of 2011, since agreement was not fully reached, the Kosovo authorities introduced a blockade on Serbian exports to Kosovo and tried to take over control of border crossings in North Kosovo (Jarinje and Brnjak), with the deployment of special police forces and the institution of Kosovo customs officers. The Serbs living in North Kosovo rebelled by putting up road blockades and Kosovo Force (KFOR) finally took over control of the mentioned border crossings.

A compromise on Kosovo customs documents and customs stamp was reached in October 2011 and the blockade was lifted on the Kosovo side. Goods are shipped to Kosovo from Serbia usually through the border crossing at Merdare, and the situation at border crossings in the North of Kosovo has been resolved through agreement between Belgrade and Priština on integral border management of crossings. All accords agreed in Brussels between Belgrade and Priština (so-called Brussels Agreements) are still not fully implemented by both sides. Apart from these agreements, some other questions remain unresolved, such as in relation to electricity, so talks are expected to continue between Belgrade and Priština in the near future. For Serbia, the status of Kosovo is still unresolved. Serbia had used the instrument of the International Court of Justice (ICJ) to make a unilateral declaration of secession by Priština authorities as unlawful, but this court has not given a clear sign on the unlawfulness. One of the agreements reached in Brussels in 2012 deals with regional representation and cooperation of Kosovo in international bodies. It states that the name of Kosovo should be accompanied by an asterisk (Kosovo*) to refer to a footnote stating that “this designation is without prejudice to positions on status, and is in line with UNSC 1244 and the ICJ Opinion on the Kosovo Declaration of Independence”.³⁹ Further in the text, the name ‘Kosovo*’ is used.

Trade flows between Serbia and Kosovo

After the dissolution of the market of the Federal Republic of Yugoslavia in 1999, trade links between Serbia and Kosovo were disrupted. This was attributed to the conflict that took place in Kosovo during 1999, but also to the undefined status of Kosovo as a customs territory. The first recorded flows between the customs territories of Serbia and Kosovo* show trade of small intensity just above €30 million in 2001 (see Figure 1). Although trade doubled until 2004 to €60 million, this is a small level of trade compared with trade flows in former Yugoslavia. Serbia’s exports are the predominant trade flow, since imports from Kosovo* to Serbia were insignificant at just around €6 million in 2004. However, it should be borne in mind that in this period many of the flows were not officially recorded because customs authorities were not controlling these trade flows.⁴⁰

39 Agreement on regional representation and cooperation. Available at <http://www.srbija.gov.rs/kosovo-metohija/index.php?id=168200>. See: Annexes, available at <http://www.international-alert.org/resources/publications/regulations-trade-across-contested-borders-en>

40 Most of the data in this part is obtained from the Serbian Chamber of Commerce and Industry from a project carried out by the Center for Regionalism in Novi Sad, Serbia during 2011–2013, and funded by the EU.

Figure 1: Trade between Serbia and Kosovo* from 2001 to 2012 (€ million)



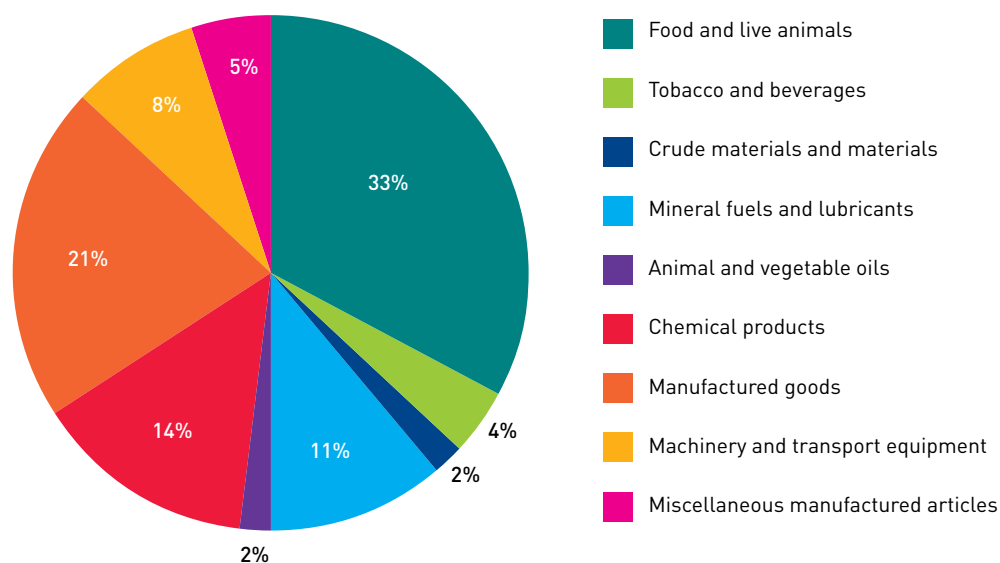
Source: Customs of Serbia for the period 2001–2004 and Serbian Chamber of Commerce and Industry for the period 2005–2012

From 2004, the trade exchange between Kosovo* and Serbia started to pick up. This was mainly stimulated by Serbia's rising exports to the customs territory of Kosovo. Kosovo's exports to Serbia were highest in the observed period in 2006, reaching more than €12 million. However, the biggest rise in trade flows between Serbia and Kosovo* came after 2006. This trade was influenced most by the signing of the CEFTA 2006, in which Serbia and Kosovo* (represented by UNMIK) are contracting parties. The full application started at the end of 2007, so we record rising flows from 2008 onwards. The declaration of independence of Kosovo* curtailed trade between the two entities only slightly, but the bigger fall was recorded in trade flows in 2011 due to the insistence of Priština authorities that Kosovo Customs would take over from UNMIK customs and start using trade documents with 'Republic of Kosovo' insignia. This was deemed unacceptable by the Serbian government and all goods with this document were sent back to Kosovo*. Authorities in Priština saw this as a blockade of trade on Serbia's part and introduced countermeasures in the form of a ban on import of products from Serbia to Kosovo*.

In order to resolve this problem in trade relations, the EU initiated dialogue on technical questions in Brussels. This resulted in a set of accords between Serbia and Kosovo* that facilitated their trade. Most important was the agreement reached on the customs stamp of Kosovo Customs. From that time, trade between Serbia and Kosovo has been steadily rising. Serbia's exports to Kosovo* reached €300 million, while Kosovo*'s exports to Serbia reached almost €10 million. Thus, one of the main features of Serbia–Kosovo trade relations is a big imbalance in mutual exports, with a large surplus on the Serbian side. This is due to the level of development in the two economies.

If we observe the general product structure of exports from Serbia to Kosovo* (see Figure 2), we can see that group 0 – Food and live animals – represents the most important product group, with a share of 33% in 2012. Other important groups in exports from Serbia to Kosovo* are group 6 (Manufactured goods) and group 5 (Chemical products), with 21% and 14% shares, respectively, in 2012. These three groups make up almost 70% of total exports from Serbia to Kosovo*. Another significant group of products is group 3 – Mineral fuels and lubricants – with a share of 11%.

Figure 2: Product structure of Serbia's exports to Kosovo* in 2012



Note: Percentages are based on the Standard International Trade Classification (SITC), revision 3 groups.

Source: Serbian Chamber of Commerce and Industry data

The more detailed product structure of exports from Serbia to Kosovo* reveals the individual products playing the most significant role in this trade flow in 2012, based on Serbian Chamber of Commerce and Industry data. Individual products are classified according to the World Customs Organization Harmonised System (HS) at a 6-figure level (see Table 2). We can observe that food products dominate exports from Serbia to Kosovo*, with wheat being the most important with a share of 5.55% in 2012. Apart from wheat, flour and foodstuffs are also important. Other significant products include energy products, such as oil and electric energy. Construction related products, such as ceramic roof tiles, are also in demand, as well as chemical products such as medicaments and fertilisers.

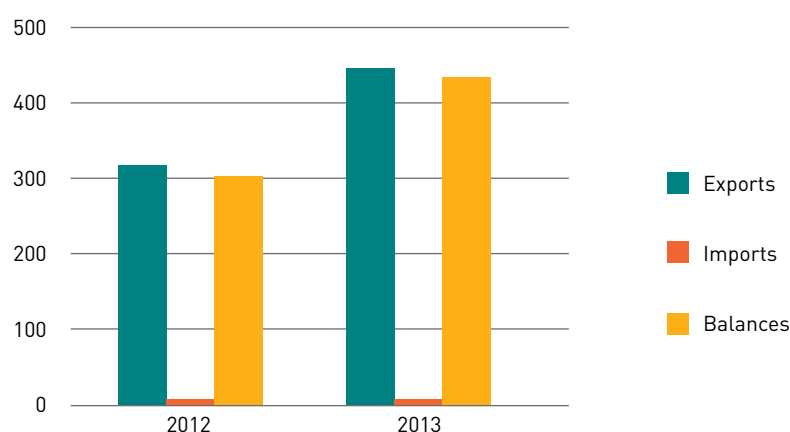
Table 2: Main individual export products from Serbia to Kosovo* in 2012, value and percentage

	HS code	Name	Value (€)	Share of total exports (%)
1	1001.19	Wheat and meslin, other	16,403,403	5.55
2	2709.00	Crude oil, other	12,407,378	4.20
3	1101.00	Flour	10,129,674	3.45
4	6905.10	Ceramic roof tiles	8,784,774	2.97
5	2106.90	Food products	7,785,683	2.64
6	2716.00	Electric energy	7,493,761	2.54
7	3003.20	Medicaments containing other antibiotics	7,222,675	2.45
8	3105.90	Fertilisers	7,072,913	2.39
9	2202.90	Non-alcoholic beverages	5,753,177	1.95
10	2103.90	Mixed spices	5,406,449	1.83
		All the above	88,459,887	29.97
Total			295,358,692	100.00

Source: Serbian Chamber of Commerce and Industry data

The latest data, from 2013, shows that the rising trend of exports from Serbia to Kosovo* is continuing. Figure 3 shows the data on exports, imports and balance of trade flows from Serbia to Kosovo* in US\$ million terms for the first 10 months of a respective year. The results show a significant rise of 41% in Serbian exports in 2013 compared with the same period in 2012. In addition, the big trade surplus on the side of Serbia is still present, representing 97.4% of Serbian exports in the first 10 months of 2013.

Figure 3: Serbia's exports to and imports from Kosovo* in first 10 months of 2012 and 2013 (US\$ million)



Source: Serbian Chamber of Commerce and Industry data

This continuing imbalance in trade relations between Serbia and Kosovo* is the result of differences in development between the two economies, but also shows that trade flows have been preserved from the period when the two entities were in the single market. Kosovo* is in a group of 10 most important export markets for Serbia, with around 3.5% of total Serbian exports destined for the Kosovo* market in 2013. Many of the goods that Kosovo* imports are still cheaper when imported from Serbia. Serbia is also very important for Kosovo* transit trade since it is the closest link with Western Europe. In light of this, service trade is important between Serbia and Kosovo* and should be analysed in more detail. This trade still faces many limitations connected to trade procedures and insurance policies of both entities.

In studies⁴¹ produced by a group of researchers from the Center for Regionalism in Novi Sad under the framework of EU-funded projects,⁴² data on trade flows between Serbia and Kosovo* from both Serbian and Kosovo sources were compared. Serbian data was obtained from the Chamber of Commerce and Industry of Serbia – the data had been collected first by a Special Tax Administration at the Ministry of Finance of the Republic of Serbia (until 2004) and later by Serbia Customs. Sources of Kosovo data were trade data published by the Statistical Office of Kosovo obtained from UNMIK customs and later from Kosovo Customs.

If we observe the data on exports from Serbia to Kosovo* and compare it with the data obtained from Kosovo* on its imports from Serbia, we may notice that in the early years of the observed period, official data from the Republic of Serbia tends to be smaller than the official data issued by Kosovo*. We can conclude that part of the trade remains unrecorded in Serbia. However, this difference in recorded trade flows exceeded 30% in some of the observed years prior to 2008. In 2005, the data on exports from Serbia to Kosovo* shows 30% lower levels than data obtained from Kosovo* sources, and this difference in 2007 was as high as 38%. Since 2008, the situation has changed, with data

⁴¹ The first study was published in 2012 [Bjelić et al (2012). Op. cit.] and dealt with the freedom of movement of goods and people between Serbia and Kosovo. The second study was produced in 2013 and deals with the monitoring of trade flows and procedures in trade between Serbia and Kosovo [P. Bjelić et al (2013). *Monitoring of Implementation of the Agreement Concluded between Kosovo and Serbia in the Field of Free Movement of People and Goods*, Expert Report. Novi Sad: Center for Regionalism].

⁴² Funded by the EU as Project No. EuropeAid/130847/L/ACT/RS.

obtained from Serbia about exports to Kosovo* tending to show a higher level of trade than the data obtained from Kosovo* sources; the difference between the two is slightly smaller, a little above 10% of the total value. The discrepancy increased each subsequent year, and in 2010 it was around 12% of observed trade flows. This change occurred in 2008 due to the enforcement of the CEFTA 2006, and is also related to the new reality on the field caused by Kosovo's unilateral declaration of independence.⁴³ Until 2008, Serbia did not have precise records since customs were not present at the administrative line with Kosovo, and because some of the goods from Serbia to North Kosovo not included in the statistics were re-exported to South Kosovo. After 2008, Serbian customs began to carry out precise records, including of goods exported to North Kosovo* that are now included in exports to Kosovo. On the other hand, Kosovo Customs do not have the Serbia–North Kosovo export and re-export data since they do not control North Kosovo* crossings.

This discrepancy in official trade data for Serbia and Kosovo* also indicates that some of the trade is unrecorded on one of the sides and that there is possible grey zone trade. The grey trade includes trade flows that are not illegal, but rather concealed in order to minimise tax and customs duties. In the course of our research for the Center for Regionalism in Novi Sad in 2012, we explored official trade flows but also grey trade that occurred between Serbia and Kosovo*. Field research was conducted in the North part of Kosovo* populated by Serbs, since it was observed that this zone was a de facto free trade zone, where goods from Serbia exempt from value-added tax (VAT) were sent back to Serbia or further to South Kosovo*, which was controlled by institutions in Priština. Our field researcher, Biserka Šećeragić, observed and recorded the turnover of all major goods in a selected period of one week. In addition, this data was cross-referenced with an opinion survey of transporters from Novi Pazar who transport the goods to Kosovo*.

Table 3: Estimate of grey zone trade between Serbia and Kosovo* in 2010

	Type of goods	Estimated value of turnover (€ thousands)	Share of over-all grey grade (%)
1	Motorised vehicles and hydraulic oils	144,100	29.0
2	Trading commodities (foodstuffs, alcohol and non-alcoholic beverages, household chemicals)	100,000	20.1
3	Milling wheat	80,000	16.1
4	Seeds (wheat and corn)	40,000	8.1
5	Construction products	40,000	8.1
6	Cement, facade and concealed materials, iron	32,000	6.4
7	Sugar	12,600	2.5
8	Mercantile corn	12,500	2.5
9	Fertilisers, additives	12,000	2.4
10	Flour	10,000	2.0
11	Animal feeds	5,000	1.0
12	Ceramic products and bathroom equipment	3,750	0.7
13	Live animals	1,700	0.3
14	Furniture	1,500	0.3
15	Bread, milk and dairy products	1,250	0.2
16	Textile (jeans)	450	0.1
17	Textile materials	400	0.1
18	Other industrial products	250	0.1
	Total	497,500	100.0

Source: Field research data from Center for Regionalism project

⁴³ For more on this, see Bjelić et al (2013). Op. cit.

The results of our field research show that total trade between Serbia and Kosovo* was around €500 million. If we compare this to the officially registered trade flows that were around €300 million in 2010, we can estimate that grey trade was around €200 million, or around 40% of total trade. In this grey trade, motorised vehicles dominate, with a 29% share in 2010 (see Table 3). Other significant products include commercial commodities and milling wheat, with 20.1% and 16.1% shares, respectively, in 2010. Goods that call for special attention in this unregulated trade are motorised vehicles (cars) and crude oil and its derivatives. Foreign vehicles are transported from Serbia to North Kosovo. Dealers and representatives of foreign car companies in Serbia have been selling those vehicles to individual buyers in North Kosovo, in keeping with a procedure that secures VAT exemption in Serbia. On the basis of our field research findings, we estimated that between 2007 and June 2011, around 14,400 vehicles were sold. The total value of vehicles sold during this period was around €666 million. Buyers in North Kosovo* were thus granted the opportunity to buy, for example, a new VW POLO for €16,500, while in Serbia it cost around €19,500, a price difference of 25.4%. In this same period, only around 1,500 vehicles imported from Serbia were sold to South Kosovo, through regular VAT refund procedures for authorised dealers. Large amounts of crude oil and its derivatives were sold as well to North Kosovo* in the same period, not only from Pančevo and Novi Sad refineries in Serbia, but also from countries like Bosnia and Herzegovina, Romania, Bulgaria and Ukraine. From 2008 to June 2011, according to our field research estimates, an annual average of around 191,625,000 litres were sold by Serbian refineries to North Kosovo*, which is 670,687,500 litres in total for the entire observed period. The value of these goods amounted to an annual average of around €143 million, or around €503 million in total for the entire observed period.

Serbian trade regime towards Kosovo*

With the dissolution of the single market of the Federal Republic of Yugoslavia in 1999, the question of trade regulation between customs territories of Serbia proper and Kosovo* emerged. In the beginning, Serbia was trying to maintain the treatment of trade with Kosovo* as a form of internal trade, despite the existence of separate customs territories.⁴⁴ The specific problem was trade with the Northern part of Kosovo populated by a Serb majority, which was not under the control of Priština institutions. This territory served as a de facto free trade zone. However, the situation changed in 2006 after the signing of CEFTA, when Serbia finally recognised Kosovo* as a separate customs territory and started to use customs authorities to control trade with Kosovo*. During this period, trade policy and customs matters were managed by UNMIK. A new regulation of trade with Kosovo* in Serbia was needed when Kosovo* declared its independence, which Serbia has not accepted. The problems arose with customs documents of Kosovo* because instead of UNMIK customs, the documents had 'Republic of Kosovo' insignia, which were not acceptable to Serbia. Dialogue on technical questions between Serbia and Kosovo started immediately in Brussels, sponsored by the EU. Many agreements were reached to urge Serbia to readjust its trade regime towards Kosovo*.

Trade with Kosovo* as internal trade (1999–2005)

After the 1999 exclusion of the customs territory of Kosovo⁴⁵ from the rest of Serbia, the problem of regulation of trade between these two economic entities arose. Trade in the first few years after the separation was insignificant due to security operations in Kosovo, but later became more important. The government of the Republic of Serbia in the first period, from 2000 until 2005, viewed trade flows between the customs territories of Kosovo and Serbia proper as internal trade flows. Due to this view, the regulation of trade between Kosovo and Serbia was a question of tax payments. Finally, in 2001, the Serbian government adopted the *Regulation on the Conditions and Method of Assessing Public Revenues and the Contents and Method of Keeping Records of Trade of*

⁴⁴ For more details, see J. Minic, P. Bjelić, M. Bobić et al (2005). *A Joint European Vision: Free Movement for Goods and People in Kosovo and Serbia*, Policy paper. Priština: European Movement in Serbia Belgrade and Kosovar Institute for Policy Research and Development Priština.

⁴⁵ In the following part of this chapter, the asterisk is not used since the author refers to the history prior to the announcement of Kosovo's declaration of independence in 2008.

Goods with the Autonomous Province of Kosovo and Metohija.⁴⁶ At the time, customs duties were not charged on trade between Serbia and Kosovo because it was treated as intra-Yugoslav trade. However, the Regulation stipulated⁴⁷ that a tax of 5% had to be levied on all goods exported to Kosovo from Serbia. This was a tax equalisation fee, which ensured that the same level of tax was paid for goods in trade due to the different tax rates applied in Kosovo and in Serbia. In Kosovo, the tax rate was 15% and was levied as VAT, while in Serbia the sales tax rate was 20%. The proof that goods have left the customs territory of Serbia and have entered Kosovo is a document called a Tax Declaration.⁴⁸ These documents were first issued by the Serbian state administration, and were later issued in agreement with UNMIK. A company from Serbia selling its products in Kosovo had to keep special records of these transactions. All payments for these goods went through foreign banks in foreign currency in accordance with the *Federal Law on Temporary Performance of Certain Payment Transactions in the Territory of the Federal Republic of Yugoslavia*.⁴⁹

Goods imported from Kosovo to the customs territory of Serbia were charged sales tax of 20%, unless they were intended for resale or further processing, which is proven with a tax declaration. Companies that buy products in Kosovo also had to keep special records on all transactions.

Goods transiting Serbia with the final destination of Kosovo were charged a 5% tax equalisation rate in Serbia. For the goods in transit through Serbia to Kosovo, such as petroleum and its derivatives or tobacco, an excise duty was also charged in the amount of RSD 230,887.14⁵⁰ per truck, payable in foreign convertible currency. For petroleum and its derivatives that transit Serbia with the final destination of Kosovo, the approval of the Serbian Ministry of Energy was necessary. The goods transiting the customs territory of Serbia with Kosovo as a final destination had to be declared at border crossings in Serbia. The customs duties were not levied for these products in transit, but the shipper was required to place a deposit at the border crossing or to secure a bank guarantee for the goods in transit in the amount of customs duties payable if the goods were destined for Serbia. Goods in transit through Serbia to Kosovo had to be declared at the crossing points between two customs areas when leaving the customs territory of Serbia. For goods imported to Kosovo by international organisations, this deposit was not necessary.

In 2004, the government of Serbia adopted another *Regulation on Special Conditions for Trade in Goods with Autonomous Province of Kosovo and Metohija*,⁵¹ which additionally regulated the trade regime of Serbia towards Kosovo. Domestic goods are defined as goods produced in Serbia or in Kosovo with a minimum local content (value added in production) of 51%. This Regulation also set the rules for the transit of foreign goods through Kosovo with the final destination of Serbia. These foreign goods transiting through Kosovo could not be cleared at crossing points between Serbia and Kosovo, only at the international border crossings of Preševo and Prohor Pčinjski. For these goods, all customs duties, tax and excise duties had to be paid. A special procedure was designed for excise goods and sugar, and all tobacco products and spirits had to have UNMIK excise labels when transiting Serbia.

Customs duties were not charged on intra-Serbia and Montenegro trade transactions, even in 2005. However, the adoption of the Law on Value Added Tax⁵² in Serbia, which replaced sales tax

46 This Regulation was published in the Official Gazette of the Republic of Serbia No. 48/2001 and later amended in the Official Gazette of the Republic of Serbia No. 5/2002, 24/2002, 26/2002, 45/2002, 69/2002, 15/2003, 56/2003, 93/2003, 2/2004, 31/2004, 51/2004, 78/2004, 116/2004, 139/2004, 5/2005, 15/2005 and 27/2005.

47 The practical application of the Regulation was ensured under the *Instructions on the Method of Issuance and Certification of Tax Reports and on the Method of Monitoring and Control of Trade of Goods with the Autonomous Province of Kosovo and Metohija*, published in the Official Gazette of the Republic of Serbia No. 54/2001.

48 *Poreska izjava* in Serbian language.

49 The Law was published in the Official Journal of the Federal Republic of Yugoslavia No. 9/2001.

50 Note: US\$1 = RSD 108 as at February 2015.

51 This Regulation was published in the Official Gazette of the Republic of Serbia No. 139/2004 and later amended in the Official Gazette of the Republic of Serbia No. 8/2005, 15/2005 and 91/2006.

52 *Zakon o porezu na dodatu vrednost*, published in the Official Gazette of the Republic of Serbia No. 84/2004 and 86/2004.

with VAT, also influenced trade with Kosovo. The new regulation was adopted in accordance with new conditions – the *Regulation on Execution of Law on Value Added Tax in the Territory of Autonomous Province of Kosovo and Metohija during the Validity of UN Resolution No. 1244*.⁵³ This regulation created the new legal basis for the current trade regime in Serbia towards Kosovo. Foreign goods that transit through Kosovo to Serbia proper are charged with VAT by the customs administration, and the document used is a customs declaration (Single Customs Document – or *Jedinstvena Carinska Isprava* (JCI) in Serbian). Domestic goods from Kosovo, defined as goods produced in Kosovo with local content (value added in production) above 51%, are charged with VAT when they enter the territory of Serbia by the Special Tax Administration Division. This Division for Kosovo and Metohija is made up of tax administrators, but later included even customs officers in order to encircle the customs territory of Serbia proper. The Kosovo origin of goods is proven by the registry of producers from Kosovo⁵⁴ or register of agricultural farms⁵⁵ administrated by the Serbian administration or with the declaration verified by UNMIK. For this purpose, the Special Tax Administration Division issues the document OLPDV,⁵⁶ where the VAT is calculated and levied. For foreign goods that did not pass through the procedure of customs clearance, and that are shipped from Serbia to Kosovo, the proper customs procedure is applied. For domestic goods originating from Serbia and foreign goods already cleared through Serbian customs, VAT is deducted when they are exported to Kosovo. As proof that goods have left the customs territory of Serbia, a document called an Evidence List (EL)⁵⁷ is applied. This document is issued by the Special Tax Administration Division,⁵⁸ but it must be accompanied by proof that foreign currency has been sold to the National Bank of Serbia. Companies from Serbia that trade with Kosovo had to report to the Special Tax Administration Division on all trade transactions with Kosovo using a special document – KMPDV – that is defined under this Regulation. However, the tax equalisation rate was abolished for trade with Kosovo at the beginning of 2005, and the *Regulation on the Conditions and Method of Assessing Public Revenues and the Contents and Method of Keeping Records of Trade of Goods with the Autonomous Province of Kosovo and Metohija*⁵⁹ was significantly amended so that only articles stipulating that tax was to be levied on goods traded with Kosovo in the amount of the applicable excise duties remained.

The next step in rounding up the customs territory of Serbia proper was the adoption in 2005 of the *Regulation on Special Procedures in Trade with Autonomous Province of Kosovo and Metohija*,⁶⁰ which regulated how goods can be temporarily exported from or imported to Kosovo or how the goods can be sent or received for further processing. The most important step in this direction was the adoption of the *Decision on Establishment of Customs Control Points where Customs Surveillance and Customs Clearance is Executed*.⁶¹ This decision defined six customs control points, two under the authority of the customs office of Kraljevo (Brnjački most and Rudnica), and four under the authority of the customs office of Priština (Depce, Končulj, Merdare and Mutivode).

53 This Regulation was published in the Official Gazette of the Republic of Serbia No. 15/2005; it replaced the Regulation with the same name and effect, which was first published in the Official Gazette of the Republic of Serbia No. 124/2004 and later amended in the Official Gazette of the Republic of Serbia No. 139/2004 and 05/2005.

54 In Serbian – *Registar proizodača dobara ne teritoriji APKM*. This Register is defined by the *Regulation on Contents, Type of Data and Maintenance of Register of Goods Manufacturers in the Territory of Autonomous Province of Kosovo and Metohija*, published in the Official Gazette of the Republic of Serbia No. 19/2005. The new Regulation is to be adopted but in the meantime this regulation still applies.

55 In Serbian – *Registar poljoprivrednih gazdinstava na teritoriji APKM*.

56 *Obračunski list za PDV* (OLPDV).

57 *Evidencioni List* (EL).

58 The details regarding the format and contents of both the OLPDV and EL documents are stipulated in the *Regulation on Form, Contents and Filling of OLPDV and EL and the Method and Procedure of VAT Collection and Other Expenses Connected to Bank Guarantee*, published in the Official Gazette of the Republic of Serbia No. 19/2005 and No. 38/2005.

59 This Regulation was published in the Official Gazette of the Republic of Serbia No. 48/2001 and later amended in the Official Gazette of the Republic of Serbia No. 5/2002, 24/2002, 26/2002, 45/2002, 69/2002, 15/2003, 56/2003, 93/2003, 2/2004, 31/2004, 51/2004, 78/2004, 116/2004, 139/2004, 5/2005, 15/2005 and 27/2005.

60 This Regulation was published in the Official Gazette of the Republic of Serbia No. 40/2005.

61 The new version of this Regulation was published in the Official Gazette of the Republic of Serbia No. 83/2010, while the previous version was published in the Official Gazette of the Republic of Serbia No. 9/2004, 73/2006 and 47/2009.

Institutionalisation of trade exchange (2006–2008)

The next big change in Serbia's trade regime towards Kosovo came with the signing of the revised CEFTA in 2006 (CEFTA 2006). The contracting parties of this agreement included Serbia⁶² and UNMIK in the name of the customs territory of Kosovo (referred to in the agreement as UNMIK/Kosovo). The contracting parties of the CEFTA 2006 agreed to set up a free trade area for goods until 2010, with the vision of liberalising trade in services, trade in agricultural products and trade in other sectors of the economy in the near future. The regional trade integration was achieved in accordance with the rules and principles of the WTO, even though many of the economies in the region of the Western Balkans were not WTO members. Before the CEFTA 2006, the network of bilateral free trade agreements was set in the region of the Western Balkans⁶³ as a result of the Memorandum on Trade Liberalisation, signed in 2000. Serbia and Montenegro were the only contracting parties that did not conclude free trade agreements with UNMIK/Kosovo in this process of regional trade liberalisation. However, UNMIK and Serbian authorities have both taken a stand not to levy any customs duties on goods trade between Serbia and Kosovo.

The signing of the CEFTA 2006 and the introduction of VAT in Serbia have necessitated the adoption of new by-laws in Serbia to regulate trade with Kosovo on new grounds. According to the *Regulation of Temporary Conditions for the Sale of Certain Goods*,⁶⁴ for precisely defined goods the approval⁶⁵ of the Serbian ministry in charge of commerce⁶⁶ is to be acquired before these goods are exported to Kosovo.

A very important provision is the *Regulation on Special Conditions for Trade in Goods with Autonomous Province of Kosovo and Metohija*,⁶⁷ applied from 1 January 2011. This regulation deals with trade between Serbia and Kosovo in foreign goods coming through one of the customs territories or foreign goods in transit. It stipulates that, in trade between Serbia and Kosovo, the rules defined under Serbia customs and tax legislation are applied. Foreign goods coming from the transiting customs territory of Kosovo are not allowed through administrative line crossings between Serbia and Kosovo. These goods must be reported to Serbian customs authorities at the customs points of Preševo and Prohor Pčinjski. Goods shipped by post are cleared at the customs office at Niš, and goods shipped by plane are cleared at the customs office at Belgrade airport. These goods are cleared according to customs laws, and customs, VAT, excise and other duties are levied. Foreign goods that have not been customs cleared in Serbia, and foreign goods in transit in the customs territory of Serbia proper, are forwarded to Kosovo with proper customs procedures of transit. For excise goods, such as petroleum and sugar, customs procedures are executed at the border crossing in Preševo. One of the conditions for forwarding these goods to Kosovo is that the company trading these goods provides a bank guarantee or lays a deposit in the amount of customs and other duties payable if goods are to be cleared in Serbia proper. Only goods needed for international organisations, such as UNMIK or NATO, are relieved of this obligation. The same treatment applies to goods that have been cleared for export and that are destined for the customs territory of Kosovo.

At that time, Serbia did not treat Kosovo as a single customs territory. Under Serbia's Customs Law,⁶⁸ the customs territory of Serbia is defined as being identical to the territory of the Republic of Serbia, meaning that this also includes Kosovo.⁶⁹ Generally, this law is applicable to all trade

⁶² For Serbia, the CEFTA 2006 entered into force on 24 October 2007.

⁶³ The Western Balkans region, as defined by the EU, includes Albania, Bosnia and Herzegovina, Croatia, Macedonia (FYR), Montenegro, Serbia and Kosovo (as defined by UNSCR 1244). In the regional trade liberalisation in this region, the Republic of Moldova is also active, even if geographically it is not part of this region.

⁶⁴ This Regulation was published in the Official Gazette of the Republic of Serbia No. 73/2007. Relevant Opinion of the Customs Service is promulgated – *Objašnjenje Uprave carina*, 01/2.1 br. D-14667/1 on 6 August 2007.

⁶⁵ *Saglasnost*.

⁶⁶ At present, the Ministry of Trade, Tourism and Telecommunications.

⁶⁷ This Regulation was published in the Official Gazette of the Republic of Serbia No. 86/2010.

⁶⁸ *Carinski zakon, Službeni glasnik RS*, br. 18/2010.

⁶⁹ Article 3 of the Serbia Customs Law.

flow of goods between the customs territory of Serbia and all other customs territories, meaning that it regulates Serbia's foreign trade in goods with the rest of the world.⁷⁰ However, in Article 309 of the Customs Law, it is stipulated that provisions of this Law are also applicable to "trade flows in goods with the Autonomous Province of Kosovo and Metohija during the validity of UNSCR 1244". Under this Law, the Serbian government is to establish customs-controlled crossings where customs surveillance and customs procedures are to be carried out. It is also envisaged that the government should adopt by-laws to regulate these matters.

On the field, Kosovo was not a single customs territory, even if the UN's six-point plan confirmed that Kosovo should be a unified customs territory, meaning that one customs authority should control the territory and all customs checkpoints. For border crossings in North Kosovo, part of Kosovo populated by a majority of Serbs, numbers 1 and 31 (Jarinje and Brnjak) are left under international control. Customs duties collected at these crossings along the administrative line would be used for the development of local communities. Unable to establish their posts in Jarinje and Brnjak, Kosovo Customs decided to settle in South Mitrovica, part of Kosovska Mitrovica under the control of Priština authorities. This was an indication that Kosovo was not functioning as a unified customs territory, because the customs territory of Kosovo covered only the territory south of the river Ibar (South Kosovo), while North Kosovo outside of the customs territory of Kosovo was implementing neither tax nor customs regulations of the Republic of Serbia. This is what made North Kosovo a *de facto* free trade zone. It resulted in big problems of illegal and grey trade, not only between Serbia and Kosovo – many of the goods that exited Serbia and were VAT exempt returned illegally to the Serbian market.⁷¹ Authorities in Priština attempted to forcefully impose their sovereignty in North Kosovo on 26 July 2011, but they failed, and KFOR took over border crossings in North Kosovo. This was one of the reasons for negotiations on technical issues between Belgrade and Priština.

Much confusion in the application of trade procedures in Serbia concerning trade with Kosovo was present, even when the CEFTA 2006 started to be applied. In practice, some of the goods have specific tax regimes and their export and import are accompanied by appropriate tax documents, such as the OLPDV or EL documents, including the Invoice and Certificate of origin (EUR 1) and other appropriate documents. Trade in certain products – especially if they are traded with the southern part of Kosovo (under the control of Priština authorities) – requires the use of a customs declaration (JCI) and the proper customs procedure to be followed. Trade in goods produced in Kosovo or Serbia proper, with sufficient local content, is still treated by Serbia as domestic trade and a proper tax procedure is applied. Kosovo products imported to Serbia are still not charged with customs duties. Only Protocol 4 of the CEFTA 2006⁷² is applied concerning the determination of the domestic origin of products. In this case, the exporter is not obliged to present the documents proving the local origin issued by Serbian tax authorities.

From blockade to dialogue (2008–2013)

In 2008, following the unilateral declaration of independence by the provisional authorities of Kosovo in Priština, problems emerged regarding trade between Serbia and Kosovo. One of the main problems was the issue of accepting Kosovo customs documents and stamps following the proclamation of independence of institutions in Priština. Serbia refused to accept documents that were not 'status neutral', and therefore import and export of goods accompanied by documents featuring the 'Republic of Kosovo' insignia were not allowed to enter. However, since trade always finds its way, goods from Kosovo entered Serbia through Montenegro. Kosovo goods were re-exported through Montenegro where they obtained Montenegrin documents stating that the goods originated in Kosovo, clearly indicating that they were re-exports. In the summer of 2011, the Priština authorities initiated a blockade of Serbian exports to Kosovo, since they interpreted

⁷⁰ Article 1 of the Serbia Customs Law.

⁷¹ For more details, see Bjelić et al (2012). *Op. cit.*

⁷² CEFTA 2006, Annex 4: Protocol Concerning the Definition of the Concept of 'Originating Products' and Methods of Administrative Cooperation.

the decision of Serbia from 2008 on non-acceptance of their documents and customs stamp as a blockade of their exports.

Due to many unregulated matters that obstructed the application of the CEFTA 2006 in trade relations between Serbia and Kosovo, the EU initiated talks between the two sides on technical matters. Serbia and Kosovo aspire to become EU members, so the power of this prospective integration to influence the trade policy of both entities is immense. Most significant were the negotiations on customs concerning the use of customs documents and seal. These talks were the precondition for Serbia's accession to the EU.

Negotiations focusing on technical issues between Belgrade and Priština began in 2011 in Brussels. In October 2011, a *Compromise in regards to Kosovo Customs documents and stamps* was reached. Accordingly, Serbia conceded to the use of stamps with 'Kosovo Customs' insignia on condition that 'Republic of Kosovo' insignia would not appear on customs declarations. This was confirmed by the adoption of an agreement on paper, without the official signature and confirmation from the bodies of Serbia and Kosovo.⁷³ The agreement stipulated that Serbia and Kosovo "will do everything in their power to secure free movement of goods in keeping with the CEFTA agreement". At that moment, Kosovo lifted the blockade on the import of goods from Serbia proper.

One of the problems with trade between Serbia and Kosovo, as well as for the functioning of the CEFTA 2006, was the fact that Kosovo rejected the participation of UNMIK in regional meetings. Serbia and Bosnia and Herzegovina refused to recognise the independence of Kosovo, contrary to other countries in the Western Balkans region, and this became an obstacle to the functioning of the CEFTA 2006 bodies. It was especially evident in 2011, when Kosovo took up the presidency of the CEFTA 2006. For that reason, it was necessary to reach an agreement that would enable Kosovo to participate in regional meetings and in regional organisations and bodies from which Serbia decided to step down whenever Kosovo was not represented by UNMIK. The *Agreement on regional representation and cooperation*, concluded in 2011, envisaged representation of Kosovo at the regional meetings on its own behalf and for its own interests under the title 'Kosovo*'. An asterisk following the name Kosovo indicates a footnote reading: "This designation is without prejudice to positions on status, and is in line with UNSC 1244 and the ICJ Opinion on the Kosovo Declaration of Independence." The EU was in charge of implementation of this agreement.

The most important agreement reached in the framework of the technical dialogue between Belgrade and Priština was the *Agreement on integrated management of the administrative line* (Integrated Border Management – IBM).⁷⁴ This agreement stipulates joint management over the customs line, which is becoming a standard model within the EU that includes conducting customs and immigration control in one place at the administrative line between the two customs territories. The EU's EULEX mission is to take on a greater role at the administrative crossings in North Kosovo – that is, at Rudnica and Brnjak. Other important crossings where integrated border management has taken place are Bela Zemlja/Konculj, Merdare, Mutivode and Depce/Mucibaba. The establishment of a tripartite group for the implementation of this agreement was envisaged.

Implementation of the agreement did not start immediately, despite official recognition from the government of Serbia on 6 December 2012.⁷⁵ The hardest part was implementing the agreement at the crossings in North Kosovo due to resistance from the local Serb population. They expressed

⁷³ Agreement on customs stamp. Available at http://www.media.srbija.gov.rs/medsrp/dokumenti/carinski_pecat-srp_eng.doc. See: Annexes, available at <http://www.international-alert.org/resources/publications/regulations-trade-across-contested-borders-en>

⁷⁴ Agreed conclusions regarding IBM. Available at http://www.media.srbija.gov.rs/medsrp/dokumenti/koncept_ibm-srp_eng.doc. See: Annexes, available at <http://www.international-alert.org/resources/publications/regulations-trade-across-contested-borders-en>

⁷⁵ Conclusion of the Government of Serbia concerning the implementation of the agreement on integrated management over the administrative crossings 05 No. 06-8907/2012, 6 December 2012.

concern at being cut off from Serbia, fearing that the expected complicated procedure would deprive them of obtaining goods of everyday use from Central Serbia. The issue of Kosovo Customs collecting customs dues and taxes at these administrative crossings was raised. In order to address these issues between Serbia and the government in Priština, verbal agreement was made, stipulating that all goods necessary for the inhabitants of North Kosovo would not be subject to customs charges when shipped by trucks with a load-bearing capacity of up to 3.5 tons. Moreover, excise taxes would not be collected for six types of excise goods – only customs registration would be performed instead. On the other side, Serbia cancelled transit truck convoys through Serbia that used to be scheduled for 8am and 3pm every day. Customs surveillance for certain types of goods from Kosovo transiting Serbia would be performed in Vranje and Niš.

The customs agreement has still not been fully implemented, as indicated by results from field research on monitoring of the Brussels agreements.⁷⁶ There are many open issues related to trading goods between Serbia and Kosovo that need to be addressed. One issue is that of vehicle insurance, which affects transport vehicles carrying goods between the two customs territories, as well as vehicles for the transit of goods through these customs territories. For now, an insurance regime that requires payment of the so-called border insurance is being enforced because Kosovo cannot become a member of the green card insurance club.

During the negotiations between Belgrade and Priština, it took longest to reach the *Agreement on normalisation of relations*⁷⁷ between the two sides, which was also a precondition for each side's advancement towards the EU. The agreement has 15 points, which the two sides agreed on, regarding the status of North Kosovo. The establishment of the Community of Serbian municipalities in North Kosovo is the most important part of the agreement. It comprises municipalities in North Kosovo that are populated by a Serb majority: North Kosovska Mitrovica, Leposavic, Zvečan and Zubin Potok. The agreement on normalisation of relations between Belgrade and Priština defines competencies of the established Community that need to be in compliance with both the legal system of Kosovo and the European Convention regulating local self-governance. However, additional competencies of the Community are also guaranteed. One of the important issues regulated by this agreement is that of the status of police forces and the judicial system. Despite being incorporated into Kosovo's judicial system and police, Serbs shall hold top management positions within departments in North Kosovo. This agreement has still not been fully applied.

In order to prevent tax evasion in trade with North Kosovo, Serbia has reintroduced VAT on trade flows for certain goods by adopting the *Regulation on Modifications and Amendments of Regulation on Execution on Law on Value Added Tax in the Territory of Autonomous Province of Kosovo and Metohija during the Validity of UN Resolution No. 1244*.⁷⁸ This regulation came into force on 16 September 2011.⁷⁹ The basic changes comprised the reintroduction of VAT on trade originating in North Kosovo towards the customs territory of Serbia proper, especially in motor vehicles, petroleum and its derivatives, and telecommunication services. VAT is still not levied on these flows, but exporters have to provide additional documentation proving that tax is paid in Kosovo. This is also relevant for the export of products with domestic origin.

After the conclusion of the Brussels dialogue between Belgrade and Priština at the end of 2013, Serbia adopted new regulations that introduced changes to the trade regime towards Kosovo. Three new by-laws were adopted and applied from 14 December 2013, replacing all the existing provisions in Serbia regulating trade with Kosovo. The new by-laws are: the *Regulation on the*

⁷⁶ Bjelić et al [2013]. Op. cit.

⁷⁷ Agreement on main principles of normalisation of relations between Belgrade and Priština. Available at <http://www.pressonline.rs/info/politika/269887/originalan-tekst-briselskog-sporazuma.html>

⁷⁸ Uredba o izmenama i dopunama Uredbe o izvršavanju Zakona o porezu na dodatu vrednost na teritoriji Autonomne pokrajine Kosovo i Metohija za vreme važenja Rezolucije Saveta bezbednosti OUN broj 1244.

⁷⁹ This regulation was published in the Official Gazette of the Republic of Serbia No. 68/2011.

*Execution on Law on Value Added Tax in the Territory of Autonomous Province of Kosovo and Metohija during the Validity of UN Resolution No. 1244; the Regulation on the Execution on Law on Excise Duties Added Tax in the Territory of Autonomous Province of Kosovo and Metohija during the Validity of UN Resolution No. 1244; and the Regulation amending Regulation on Special Conditions on Trade in Goods with Autonomous Province of Kosovo and Metohija.*⁸⁰ The main document proving the export of goods from Serbia to Kosovo is the customs declaration. It is no longer obligatory for Serbian companies that export goods to Kosovo to sell foreign currency paid in their account to the National Bank of Serbia, but they are obliged to report on all transfers to their accounts. The new element is the possibility for companies to be exempt from VAT in the case of advance payment if they have a contract to prove this fact. Essentially, therefore, export to Kosovo is now treated the same as standard exports to all other economies in the rest of the world.

⁸⁰ All three regulations were published in the Official Gazette of the Republic of Serbia No. 111/2013.

Kosovo–Serbia: Regulatory aspects of trade and economic relations

Shpend Kursani and Berat Thaqi

Introduction

This section examines economic exchange and models of trade regulations between Kosovo and Serbia for the period starting in June 1999, when the United Nations Interim Administration in Kosovo (UNMIK) was established, until December 2013. This period is examined because it includes various modes of cooperation between Kosovo and Serbia and disputes that followed as a result of Kosovo's declaration of independence in 2008. It also encompasses agreements and models that both parties agreed on, which regulate trade relations between the two. Despite the fact that Serbia lost its authority over Kosovo when the UN administration was established in June 1999, trade between the two has continued, with some interruptions after Kosovo declared its independence. In fact, Serbia is one of Kosovo's main trading partners. In 2013, Kosovo's imports from Serbia accounted for 11% of the country's total imports, reaching €285 million.⁸¹ On the other hand, Kosovo's exports to Serbia were only €14.5 million during the same period. This constitutes a large trade deficit for Kosovo, where on average only 5% of the imports from Serbia to Kosovo are covered by its exports.

Since the establishment of the UN administration in Kosovo in June 1999, trade regulation and models of cooperation between Kosovo and Serbia have evolved and changed a number of times. The following are the key milestones that took place in trade regulation and cooperation between Kosovo and Serbia.

- **Kosovo during effective UN administration (1999–2008):** During the first year after the establishment of the UN administration in Kosovo, trade between Kosovo and Serbia was considered as internal trade. This changed when the UN administration began enforcing the Constitutional Framework, which established the UNMIK Customs, among other institutions of self-government in Kosovo in 2001. During the period of effective UN administration over Kosovo, the latter did not have any formal bilateral trade agreement with Serbia. However, both countries allowed trade of goods and services until Kosovo changed its customs stamp as a result of its independence in 2008.
- **Kosovo after the Declaration of Independence (2008–2011):** During this period, Kosovo began acting as an independent state, sidelining the role of the UN administration. This led to trade and political disputes between Kosovo and Serbia. As soon as Kosovo decided to replace the UNMIK Customs stamp with the new 'Kosovo Customs' stamp, Serbia moved to block Kosovo's exports to Serbia, also banning it from using its territory as a transit route for trade with other third parties. Subsequently, Kosovo later decided to block imports from Serbia, leading to a further deterioration in relations between the two.
- **Kosovo after the commencement of the EU-facilitated negotiations with Serbia (2011–ongoing):** This period is marked by numerous rounds of negotiations between the two parties, where several agreements were reached, including the resolution of trade dispute between the two. Trade between the two parties was finally regulated only at the end of 2013. The negotiations were held at the level of technical experts as well as prime ministerial level, which enabled several agreements on the free movements of goods and customs to be reached.

81 Kosovo Agency of Statistics [2013]. 'Foreign Trade Statistics – 2013'. Available at http://ask.rks-gov.net/tregtia-e-jashtme/publikimet/doc_view/1127-statistikat-e-tregtisaeuml-saeuml-jashtme-2013?tmpl=component&format=raw

Kosovo under UN administration

On 10 June 1999, the United Nations Security Council (UNSC) adopted Resolution 1244, which called for the establishment of an international civilian presence in Kosovo – UNMIK.⁸² According to the same Resolution, Kosovo would “enjoy substantial autonomy within the Federal Republic of Yugoslavia”⁸³ (FRY). Moreover, the FRY would “begin and complete verifiable phased withdrawal from Kosovo of all military, police and paramilitary forces according to a rapid timetable”.⁸⁴

With the establishment of UNMIK in June 1999, a decision was taken to abolish the FRY customs regime within Kosovo borders on the grounds that this customs regime was weak and outdated.⁸⁵ Instead, a provisional system of customs administration was set in place, and a uniform customs tax of 10% was imposed on all products being imported to Kosovo, with a few exceptions for some foodstuffs and medicinal products. However, this regime was not applied uniformly for all of Kosovo’s neighbouring states. For instance, during this period, customs officers were placed only at the border crossing points with Albania and Macedonia (around 40 of them), while no customs services were operational at the border crossing points with the FRY, that is, Montenegro and Serbia.⁸⁶ Therefore, UNMIK considered trade with the FRY as internal trade. On the other hand, Montenegro and Serbia had independently and unilaterally set up customs collection points at some border crossing points with Kosovo, applying customs duties ranging from 10% to 90% of the value of the product being imported from Kosovo. Therefore, Montenegro and Serbia considered the trade with Kosovo as external trade.

In light of the establishment of UNMIK and the withdrawal of the FRY security forces, the UN Special Representative of the Secretary General (SRSG) in Kosovo, on 15 May 2001, signed the UNMIK Regulation 2001/9. This regulation put in place the Constitutional Framework on Interim Self-Government in Kosovo, which foresaw the establishment of all the necessary self-governing institutions in Kosovo.⁸⁷ In addition, the Constitutional Framework provided for the establishment of the Customs Service in Kosovo, which was referred to as the ‘UNMIK Customs Service’. Under the Kosovo Constitutional Framework, the Provisional Institutions of Self-Government (PISG) were responsible for only administrative and operational parts of the Customs Services.⁸⁸ The SRSG, on the other hand, enjoyed ‘supreme’ powers over the PISG, including powers over the Customs Services such as: exercising control and authority over the UNMIK Customs Service; and powers to appoint the chief executive of the Customs Service and Tax Inspectorate.⁸⁹

Trade with the FRY (Montenegro and Serbia) was treated as fully internal trade by UNMIK authorities only until 1 July 2001, when value added tax (VAT) came into force in Kosovo under Regulation 2001/11 on VAT passed by Kosovo Parliament on 31 May 2001.⁹⁰ Regulation 2001/11 provided that a VAT rate of 15% was to be collected for all imports, including those from the FRY (Montenegro and Serbia).⁹¹ This meant that customs services were, for the first time, established at border crossing points with the FRY (Montenegro and Serbia), where only VAT

82 United Nations [1999]. ‘Resolution 1244 [1999]’. Available at <http://www.securitycouncilreport.org/atf/cf/%7B65BFCF9B-6D27-4E9C-8CD3-CF6E4FF96FF9%7D/kos%20SRES%201244.pdf>

83 United Nations [1999]. Op. cit. Annex 2, Paragraph 5.

84 United Nations [1999]. Op. cit.

85 World Bank [1999]. *Kosovo: Building Peace Through Sustained Growth: The Economic and Social Agenda*. Available at http://ec.europa.eu/enlargement/archives/seerecon/kosovo/documents/kosovo_building_peace_1999.pdf

86 Ibid.

87 Assembly of Kosovo [2001]. ‘Constitutional Framework for Provisional Self-Government in Kosovo’. Available at http://www.assembly-kosova.org/common/docs/FrameworkPocket_ENG_Dec2002.pdf

88 Assembly of Kosovo [2001]. Op. cit. Chapter 5 [c].

89 Assembly of Kosovo [2001]. Op. cit. Chapter 8 [x].

90 UNMIK [2001]. ‘UNMIK Regulation No. 2001/11 on Value Added Tax in Kosovo’, 31 May 2001. Available at http://www.atk-ks.org/wp-content/uploads/2010/07/Regulation_2001_11.pdf

91 UNMIK [2001]. Op. cit. Chapter 2, Section 2, Paragraph 2.1.

and no customs duties were being collected – this marked a *de jure* establishment of Kosovo as a separate customs zone. The decision urged the FRY to add an annex to its previous Resolution to the Security Council of 4 May 2001 on the position of Serbian people and members of other non-Albanian communities in Kosovo, in which it stated a deep concern about UNMIK's decision. In the annex, the FRY authorities to the UN stated that “[t]he establishment of customs points at the administrative boundary of Kosovo and Metohija with central Serbia is giving cause for added concern among [Serb] citizens [living in Kosovo]”.⁹² Furthermore, Serbia considered UNMIK's decision to be in violation of UNSC Resolution 1244, adding that such policies, including fiscal policies, in Kosovo should be pursued in consultation with the Yugoslav authorities.⁹³ Notwithstanding the reactions by Serbia, the UNMIK Customs Services at the border crossing points with Serbia continued to function normally to a large extent, until Kosovo declared its independence in February 2008.

The context within CEFTA

On 27 July 2007, Kosovo together with five other countries of the Western Balkans became a full member of the Central European Free Trade Agreement (CEFTA).⁹⁴ CEFTA is based on principles of the free market economy along the lines of the Marrakesh Agreement Establishing the World Trade Organization (WTO).⁹⁵ In addition, the agreement aims to promote cooperation in areas of common interest based on equality, mutual benefit, non-discrimination and international law.⁹⁶ Given that Kosovo was not an independent state, UNMIK signed the ratification agreement on behalf of Kosovo on 19 December 2006. It is worth mentioning that UNMIK, on behalf of Kosovo, had already signed bilateral trade agreements with Albania (2003), Macedonia (2005), Croatia (2006), and BiH (2006) on behalf of the PISG of Kosovo, which all later became members of CEFTA. Kosovo and Serbia had never signed a bilateral trade agreement before. However, as soon as the parties became members of CEFTA, all the previous bilateral agreements were automatically cancelled in accordance with Annex 2 of CEFTA.⁹⁷ Serbia did not refuse Kosovo's membership of CEFTA for two reasons: first, the agreement was signed by UNMIK and not the Kosovo authorities; and second, Kosovo was represented by an UNMIK representative and not by someone delegated by the Kosovo authorities. This was done in accordance with UNSC Resolution 1244.⁹⁸

Kosovo's membership of CEFTA was seen as a good opportunity for the weak and small economy of the Kosovo. It was assumed that the weak private sector would gain experience in facing competition, thereby increasing its efficiency and improving product quality. In addition, Kosovo and the other members of CEFTA would be exposed to approximately 30 million customers without trade barriers. Furthermore, the agreement would prepare Kosovo for membership of the EU and the WTO. However, as Figure 4 below shows, Kosovo did not gain much market within CEFTA; on the contrary, its exports to the CEFTA members continued to decrease even after it became a member of CEFTA. In addition, the political disputes that unfolded between Kosovo and Serbia after the former declared its independence in February 2008 did not help Kosovo in gaining much from CEFTA and its potential access to this free trade zone.

92 UNMIK (2001). 'UNMIK Regulations – Annex to the letter dated 5 May 2001 from the Permanent Representative of Yugoslavia to the United Nations addressed to the President of the Security Council'. Available at <http://www.icj-cij.org/docket/files/141/15034.pdf>

93 'Kosovo and Metohija' is the Serbian government denomination for Kosovo.

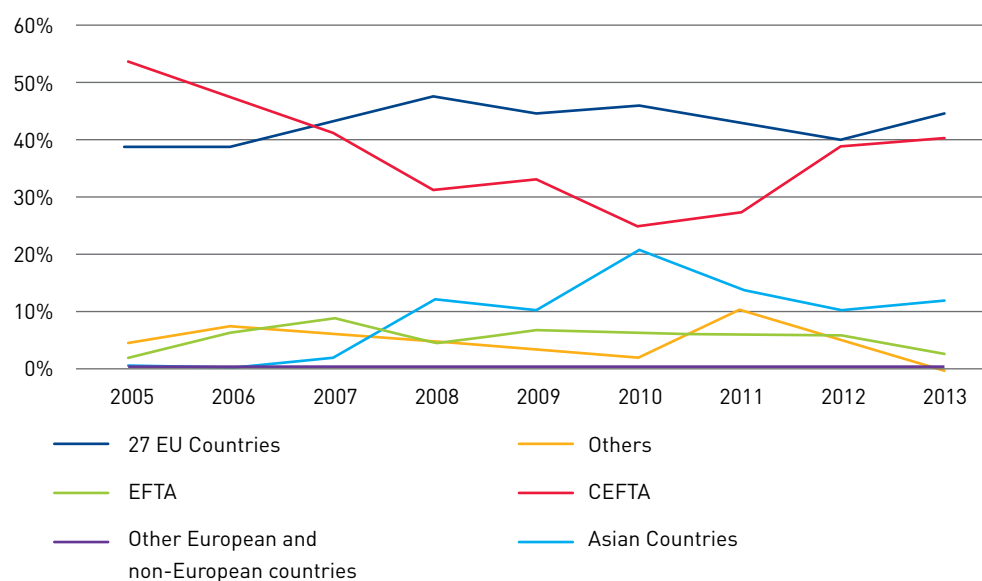
94 CEFTA was founded in 1992 by four Central European countries: Czech Republic, Hungary, Poland and Slovakia. Later on, other countries joined too such as: Slovenia (1996), Romania (1997), Bulgaria (1998), Croatia (2003) and Macedonia (2006). The last countries to join the agreement in 2007 were six south-east European countries: Albania, Bosnia and Herzegovina (BiH), Moldavia, Montenegro, Serbia, and Kosovo under the representation of UNMIK.

95 CEFTA (2006). 'Consolidated Version of the CEFTA 2006 – Preamble'. p. 2. Available at <http://192.232.255.119/~cefta/sites/default/files/trade/ANN1CEFTA%202006%20Final%20Text.pdf>

96 Ibid.

97 See reference to bilateral agreements being terminated on the date of entry into force of CEFTA in CEFTA (2006). 'Agreement on Amendment of and Accession to the Central Free Trade Agreement', Article 4, Paragraph 5. Available at <http://192.232.255.119/~cefta/sites/default/files/CEFTAMAINTEXT2006.pdf>

98 CEFTA (2006). Op. cit.

Figure 4: Kosovo's exports by region (2005–2013)⁹⁹

Note: EFTA refers to the European Free Trade Association.

After the declaration of independence

Two days after Kosovo's declaration of independence, on 19 February 2008, the border crossing points with Serbia 1 and 31 in the northern part of Kosovo were set on fire by Serb extremists supported by Belgrade.¹⁰⁰ The setting on fire of the border crossings is attributed to two main reasons: one concerns the symbolic gesture of refusing to live in an independent Kosovo; the second relates to the fact that they did not want to pay any VAT to the budget of an independent Kosovo. According to local Serbs and businesses, the collected sums of VAT at the border crossing points with Serbia would no longer go to Kosovo's Consolidated Budget under UNMIK, but to the budget of an independent Kosovo instead. As such, they considered that this would imply recognition of independence, which the Serbs wanted to avoid at all costs.¹⁰¹ This created a situation whereby the northern part of Kosovo became de facto a free economic zone under Serbia's rule, with very limited, if no authority at all of Kosovo over this part of its territory. After Kosovo's declaration of independence, and following the demolition of the border crossing points in the northern part of Kosovo, the Serbian government took the decision to exempt Serbia's economic operators (businesses) trading with the northern part of Kosovo from paying Serbian VAT too. In other words, not only were the Serbian businesses exporting goods to the northern part of Kosovo not paying Kosovo's VAT, but they were also refunded the Serbian VAT for all the products that entered the north, which set the stage for all sorts of smuggling activities.¹⁰²

In addition, ever since Kosovo's declaration of independence, the Serbs living in the northern part began defying even the limited authority wielded by the international community in the north, including that of UNMIK – and especially the EU Rule of Law Mission in Kosovo (EULEX), which the Serbs and Serbia itself constantly viewed to be in the service of a now independent 'Albanian state'.¹⁰³ Shortly after its declaration of independence, Kosovo established its own

⁹⁹ Kosovo Agency of Statistics (2013). Op. cit.

¹⁰⁰ Kosovo and Serbia maintain six official border crossing points. The two border crossing points 1 and 31 are in the Serb majority populated area of the northern part of Kosovo, while the other four border crossing points are in the north-east and eastern parts of Kosovo.

¹⁰¹ Authors' interview with a local Serb from the north, 20 December 2013, Mitrovica North.

¹⁰² Serbia's economic operators began using this opportunity by claiming that they had exported to the northern part of Kosovo on paper, but without doing so in practice, thus claiming VAT refunds for the value of the products they were claiming to export to the north.

¹⁰³ S. Kursani (2014). *Altering the Status Quo in the Northern Part of Kosovo after the First Brussels Agreement*. Available at [http://www.iksweb.org/repository/docs/Altering_the_status_quo_in_the_northern_part_of_Kosovo_Final_Shpend_Kursani_\(2\)_578268.pdf](http://www.iksweb.org/repository/docs/Altering_the_status_quo_in_the_northern_part_of_Kosovo_Final_Shpend_Kursani_(2)_578268.pdf)

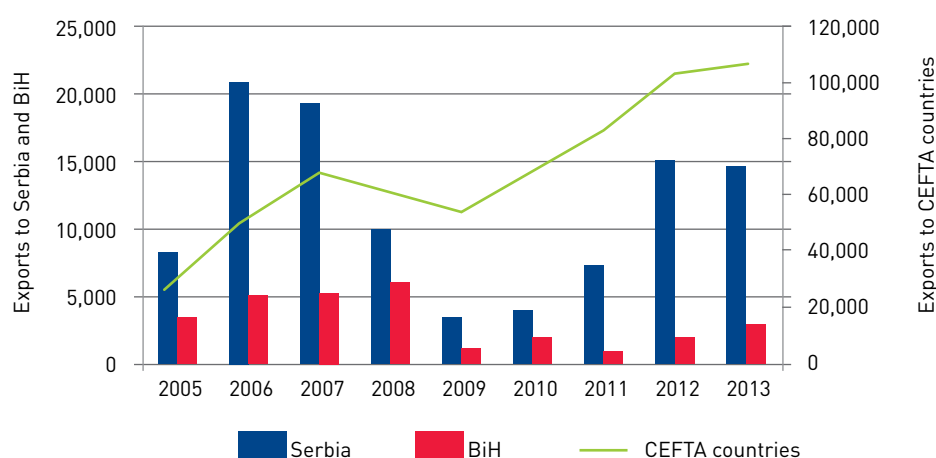
Customs Services, which meant that it took over all of UNMIK's executive authorities under the UNMIK Customs Services. In addition, as Kosovo adopted its state symbols, it began replacing all the UNMIK symbols with the new Kosovo symbols starting from June 2008, around four months after its declaration of independence. The Kosovo authorities changed the previously used UNMIK Customs stamp with the new Kosovo Customs stamp in December 2008 (see Picture 2), around 10 months after it declared its independence and around six months after it began replacing the old symbols with the new ones. As soon as Kosovo changed its customs stamp in December 2008, Serbia and Bosnia and Herzegovina (BiH) decided to block all imports from Kosovo on the grounds that such customs stamps were illegal and against the CEFTA.

Picture 2: Example of UNMIK stamps and the new Kosovo stamps used at the border crossing points



Even though Kosovo continued to be represented by UNMIK in the CEFTA, the change of customs stamps, according to Serbia and BiH, were considered a breach of the CEFTA. As a result, Serbia and BiH blocked their imports from Kosovo as well as the use of their territory as a transit route for Kosovo products. Kosovo's exports to Serbia fell by 65% in 2009, compared with exports in 2008 (see Figure 5). Throughout the period during which Serbia and BiH blocked Kosovo's exports, the latter lost €30 million in exports, representing around 4% of Kosovo's total exports for the period 2009–2011.

Figure 5: Kosovo exports (2005–2013)¹⁰⁴ (€ thousands)



¹⁰⁴ Kosovo Agency of Statistics (2013). Op. cit.

As Figure 5 above shows, although the blockade remained in effect until 2011, Kosovo's exports to Serbia did not completely stop in reality. This is because the Serbian Tax Authority operating in the northern part of Kosovo was issuing documents to Serbian businesses in Kosovo, and they were then able to export from Kosovo to Serbia. These goods were not registered as exports to Serbia transiting through the northern part of Kosovo since, as noted above, it was a de facto part of Serbia's economic zone; they were registered at the other border crossing points between Kosovo and Serbia being used by the Serb-owned businesses in Kosovo.¹⁰⁵ Serbia's decision to issue such documents to Serb-owned businesses in Kosovo was in direct conflict with the concept of Kosovo having a sole customs region, where only Kosovo authorities could issue such documents.¹⁰⁶

Kosovo, on the other hand, did not use the dispute resolution mechanisms provided by the CEFTA. According to Article 42 of the agreement (CEFTA), parties should first try to resolve disputes between themselves through consultations and cooperation in the Joint Committee. If the parties failed to resolve the dispute, after taking the steps foreseen in the agreement, then the Joint Committee would recommend the appropriate measures, although the parties would have the right to agree or disagree with those measures. If the parties considered that a solution had not been reached, after 90 days of the request for consultations, they could take provisional rebalancing measures. In addition, parties could request arbitration procedures. However, an arbitral tribunal could be established only if more than one member of the CEFTA filed a complaint for the same issue and for the same party towards which the complaint was addressed. If the arbitral tribunal was established, its decisions would be all binding. Kosovo did not follow these procedures; instead, the authorities in Kosovo sent letters of complaint to Serbian authorities, the European Commission and the Secretariat in Brussels.¹⁰⁷ The UN SRSG in Kosovo assured Serbia and BiH through an official letter that the change of customs stamp was in compliance with UNSC Resolution 1244 since it included only the word 'Kosovo' and not the 'Republic of Kosovo'.¹⁰⁸ However, the issue was never sent for consultation at the CEFTA Joint Committee. Kosovo used the rebalancing (reciprocity) measures only in 2011, as will be discussed below.

Finding a model: EU-facilitated negotiations between Kosovo and Serbia

Kosovo was unable to export to Serbia for more than two-and-a-half years until the agreement on the customs stamp was reached on 2 September 2011 in the EU-facilitated negotiations between Kosovo and Serbia that commenced on 8 March 2011. The EU-facilitated negotiations brought both parties around the negotiation table for the first time since Kosovo declared its independence. These negotiations were a political process, which in the beginning dealt with 'technical' matters. After five rounds of negotiations took place in Brussels, Edita Tahiri (negotiator for Kosovo) and Borislav Stefanović (negotiator for Serbia), on 2 July 2011, finalised three agreements on:¹⁰⁹ freedom of movement; civil registry books; and acceptance of university diplomas. The three issues on which the parties managed to agree did not touch on the issue of the northern part of Kosovo, and did not require any particular compromise from either party.¹¹⁰

The next round of negotiations, the sixth one in a row, had been scheduled for 20 July 2011; however, Serbia informed the EU facilitator, Robert Cooper, that they were not ready to join this round of the negotiations.¹¹¹ As noted in Cooper's letter, sent to both parties a day before the sixth

¹⁰⁵ Ibid.

¹⁰⁶ European Commission [2010]. *Kosovo 2010 Progress Report*, COM(2010) 660. Available at http://ec.europa.eu/enlargement/pdf/key_documents/2010/package/ks_rapport_2010_en.pdf

¹⁰⁷ GAP Institute [2011]. *Kosovo in CEFTA: In or Out*, Policy brief. Available at http://www.institutigap.org/documents/72590_CEFTAEng.pdf

¹⁰⁸ European Commission [2010]. Op. cit.

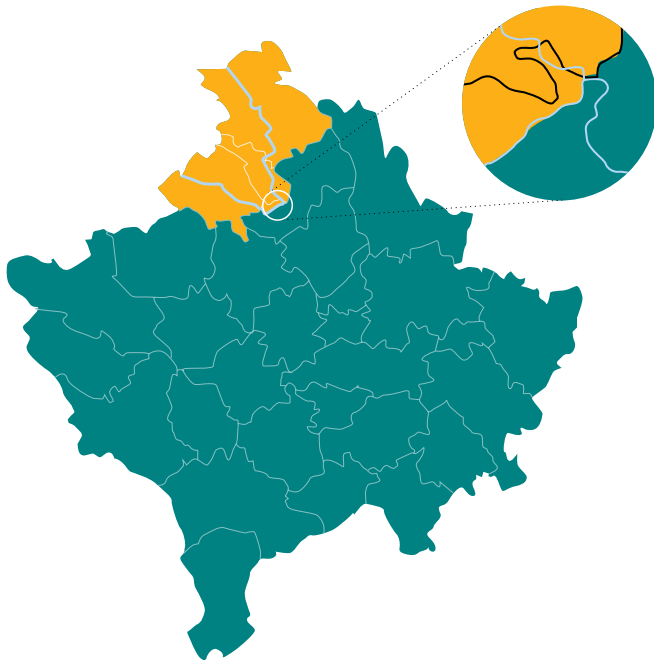
¹⁰⁹ 1st meeting held on 8–9 March 2011; 2nd meeting held on 28 March 2011; 3rd meeting held on 15 April 2011; 4th meeting held on 17–18 May 2011; and 5th meeting held on 2 July 2011.

¹¹⁰ S. Kursani [2014]. Op. cit.

¹¹¹ B92 [2011]. 'Better prospects for agreement in September', 20 July 2011. Available at http://www.b92.net/eng/news/politics.php?yyyy=2011&mm=07&dd=20&nav_id=75533

round of negotiations, he had to cancel the meeting “as it became clear that no agreement would be reached”.¹¹² Serbia’s reluctance to continue with the next round of negotiations was due to the fact that the talks would touch on issues concerning the status quo in the northern part of Kosovo, which Serbia was keen to keep as it enjoyed overwhelming influence in that area.¹¹³ These issues included, among others: regional trade and free movement of goods; telecoms and energy issues; car licences, which were also discussed during the previous rounds of negotiations, but on which no agreement was reached. Any agreement on such issues would, in one way or another, alter the status quo that persisted in the northern part of Kosovo for two-and-a-half years.

Picture 3: Map of Kosovo, with northern part (in orange)



Given that Kosovo wanted to reach an agreement on the free movement of goods, in order to remove Serbia’s blocking of Kosovo products, and since Serbia wanted to postpone such an agreement, one day after the meeting was cancelled, the Kosovo government decided, on 20 July 2011, to apply reciprocity trade measures against Serbia.¹¹⁴ Executing such a decision was not a problem for the four border crossing points with Serbia in the north-east and eastern parts of Kosovo. However, it was a problem at the two border crossing points (gates 1 and 31) in the northern part of Kosovo, where Kosovo had very limited, if no, authority and presence. EULEX was the sole authority present at the two border crossing points in the northern part of Kosovo. The Kosovo government asked EULEX to implement the government decision and block the incoming products from Serbia entering Kosovo; however, EULEX refused to do so. This left the Kosovo government with no alternative but to move ahead and implement the measure on its own. Accordingly, the government sent its Regional Operations Special Units (ROSU) to take over the two border crossing points in the north. This led to clashes between the ROSU and the local population supported by parallel security structures installed by Serbia in the northern part of Kosovo, which resulted in the killing of one ROSU member.

The EU wanted to prevent such a situation by facilitating talks between the parties to resolve any disagreement in a peaceful manner, that is, at the negotiation table. Therefore, on 26 July

112 European Union (2011). ‘Press statement: EU facilitated dialogue – next round of talks postponed’, Brussels, 19 July 2011. Available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/123964.pdf

113 S. Kursani (2014). Op. cit.

114 Tema Online (2011). ‘Kosova nis reciprocitetin, bllokoi mallrat e Serbisë’, 20 July 2011. Available at <http://www.gazetatema.net/web/2011/07/20/kosova-nis-reciprocitetin-bllokoi-mallrat-e-serbise/>

2011, the Head of the CFSP, Catherine Ashton, issued a statement “that the efforts must focus on resolving the underlying issues through the EU facilitated dialogue. The dialogue is the only way forward to solve the issue of customs stamps and to re-establish free trade in both directions”, without much additional instruments at her disposal to resolve the conflict.¹¹⁵ The next day, on 27 July 2011, a number of Serb organised criminal groups damaged one of the border crossing points in the northern part of Kosovo; as a result, the KFOR German troops present in the area reacted by taking control of the situation, thus preventing further deterioration of the security situation.¹¹⁶ The fact that Serbia wanted to maintain the then existing status quo in the north was confirmed when the Serbian negotiator, Borislav Stefanović, himself came to the northern part of Kosovo and encouraged the local Serb population to prevent Priština’s attempts to establish its authority there.¹¹⁷ Stefanović used his visit to also meet with the KFOR German troops and agreed with them that these troops would remain at the border crossings in the north until 15 September 2011.¹¹⁸

Steps towards removal of mutual trade blockade

Germany, as one of the key EU member states and one that is increasing its political influence over the Western Balkans, played a key role in restoring the situation and preventing further escalation. At a meeting with Serbia’s then President, Boris Tadić, held in Belgrade on 23 August 2011, Germany’s Chancellor, Angela Merkel, pressed the former to renounce Serbia’s intentions to maintain its influence in the northern part of Kosovo and to resume the negotiations with Kosovo on issues that were left to be discussed. Given that Serbia was keen to accelerate its way through the EU accession process, Germany was able to change Serbia’s course with reference to the EU conditionality instruments of the accession process. On 2 September 2011, only 10 days after Chancellor Merkel met President Tadić in Belgrade, the negotiations between Kosovo and Serbia resumed and the agreement on free movement of goods and the customs stamp was reached. Finally, Serbia agreed to allow the Kosovo Customs stamp to be used for imports from Kosovo, which led to the Kosovo government lifting the trade reciprocity measure it had imposed on 20 July 2011.¹¹⁹ The parties finally lifted their mutual trade blockade on 16 September 2011, ending the 58-day reciprocity measures applied by Kosovo. It should be noted that this agreement did not please the local Serbs in the northern part of Kosovo. They rightly suspected that such an agreement would alter the status quo, which would be to their disadvantage as Kosovo authorities would increase their presence in the area. Their contempt resulted in the establishment of dozens of roadblocks to prevent Kosovo government personnel (police and customs officers) from entering the north. As a result, Kosovo was only able to dispatch its customs officers to gates 1 and 31 in the north by air transport, assisted by EULEX helicopters – a situation that lasted for around a year.

Impact of reciprocity measures with Serbia

During the 58 days of reciprocity measures applied by Kosovo, Serbian imports were mainly replaced by imports from the other regional countries. Figure 6 below shows Kosovo’s import portfolio for the third quarter of each year between 2008 and 2012. As the figure shows, imports from Serbia during the third quarter of 2011, during which the reciprocity measures applied, represented only 5% of Kosovo’s total imports, compared with 11%–12% of imports in the third quarter of the previous three years. Besides some of Kosovo’s other trade partners, such as the EU, which are not shown in this graph, but which could have substituted Serbia’s imports to Kosovo as well, it is clear that Macedonia played a significant role in substituting these imports to

115 European Union (2011). ‘Statement by the spokesperson of EU High Representative Catherine Ashton on the situation in northern Kosovo’, Brussels, 26 July 2011. Available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/124060.pdf

116 S. Kursani (2014). Op. cit.

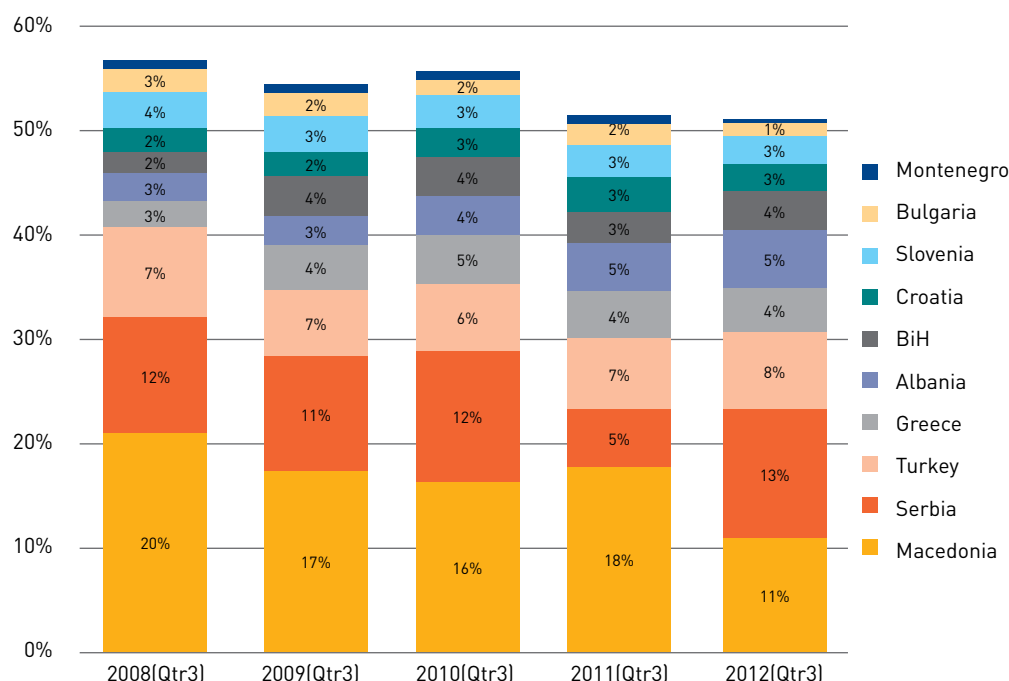
117 Ibid.

118 B92 (2011). ‘Belgrade: KFOR stepped outside UNSCR 1244’, 28 July 2011. Available at http://www.b92.net/eng/news/politics.php?yyyy=2011&mm=07&dd=28&nav_id=75662

119 European Union (2011). ‘Press statement: EU facilitated dialogue – Agreement on Customs Stamps and Cadastre’, Brussels, 2 September 2011. Available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/124501.pdf

Kosovo. Imports from Macedonia during the third quarter of 2011 represented 18% of Kosovo's total imports compared with 16%–17% in the third quarter of the previous two years.

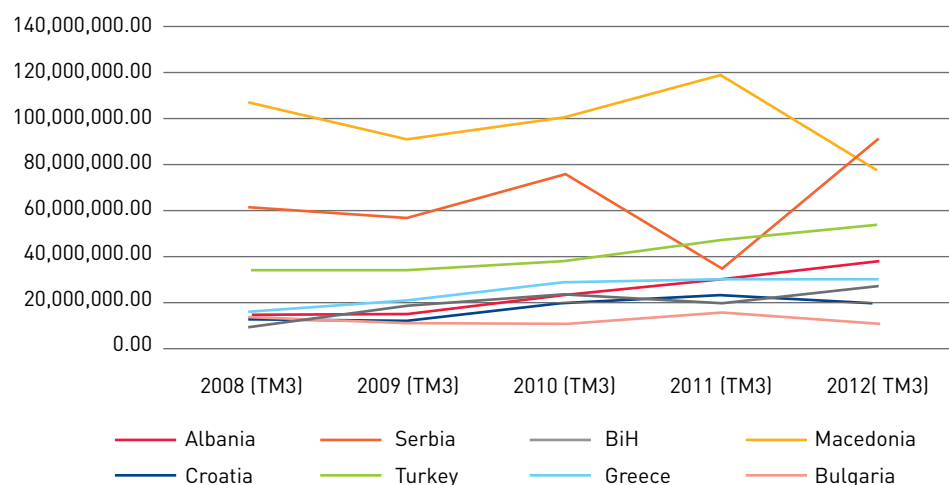
Figure 6: Impact of trade reciprocity with Serbia on Kosovo's total imports for third quarter of year (2008–2012)¹²⁰



Moreover, regarding the volume of imports, Figure 7 below shows a sharp decline in imports from Serbia during the third quarter of 2011 – that is, from around €80 million in the third quarter of 2010 to below €40 million in the third quarter of 2011. It is clear that there are two countries in the region with which Kosovo registered a sharper increase in import volume during the third quarter of 2011 – namely, Macedonia and Bulgaria. Imports from Macedonia during the third quarter of 2011 rose to €120 million from around €100 million in the third quarter of 2010, while imports from Bulgaria exceeded €15 million during the third quarter of 2011 compared with around €10 million in the third quarter of 2010. Therefore, it could be said that imports from Macedonia and Bulgaria substituted the imports from Serbia during the application of the reciprocity measures not only relative to all imports, but also in absolute terms, because as soon as the reciprocity was lifted, the import figures for these two countries dropped to their previous lower levels in the third quarter of 2012, while imports rose from Serbia.

¹²⁰ Authors' own calculation based on Kosovo Agency of Statistics data.

Figure 7: Impact of trade reciprocity with Serbia on Kosovo's total import volume for third quarter of year (2008–2012)¹²¹ (€)



An agreement that would work

It is worth mentioning that, although Kosovo and Serbia agreed on the free movement of goods and on customs stamps, and even though the Kosovo authorities were installed at border crossing points in the north, the local Serb population and businesses smuggled products from Serbia into Kosovo via “alternative roads”.¹²² They did so because they did not want to go through customs checkpoints of the independent Kosovo authorities and wanted to avoid paying customs. Moreover, during this period, the Kosovo authorities at the border crossing points in the northern part of Kosovo were merely playing the role of monitoring officials; the real executive power for customs services at the two border crossing points in the north rested with members of EULEX, who often did not implement orders from Pristina. This meant that many products were imported into Kosovo without the collection of VAT or other customs duties in accordance with the CEFTA. In other words, the agreement on free movement of goods that was reached with Serbia on 2 September 2011 did not translate into meaningful revenue for the Kosovo budget because the Kosovo authorities were not collecting these duties at the two border crossing points in the north.

During the subsequent rounds of negotiations, at the end of 2011, the concept of Integrated Border Management (IBM) was discussed as “a way forward to find a European solution for crossing points”.¹²³ The agreement on the IBM was essential for Kosovo because it needed to establish an official border crossing that Serbia would have to respect – one that would allow Kosovo to set proper border control for its northern part and to collect VAT and other customs duties, as with the other border crossing points. A preliminary agreement on “the EU developed concept of integrated management for crossing points (IBM)”¹²⁴ was reached at the eighth round of the technical dialogue between Edita Tahiri and Borislav Stefanović. This meant “that the parties [would] gradually set up joint, integrated, single and secure posts at all their common crossing points”.¹²⁵ The agreement also stipulated that EULEX “[would] be present in line with its mandate”.¹²⁶

¹²¹ Authors' own calculation based on Kosovo Agency of Statistics data.

¹²² Kosovar Institute for Research and Development (2012). *Autonomy for the Northern Part of Kosovo: Unfolding Scenarios and Regional Consequences*, Policy Paper Series 2012/05. Available at http://www.kipred.org/advCms/documents/46046_Autonomy%20for%20the%20northern%20part%20of%20Kosovo%20-%20Unfolding%20scenarios%20and%20regional%20consequences.pdf

¹²³ European Union (2011). 'Press statement: EU facilitated dialogue – Positive resumption', Brussels, 21–22 November 2011. Available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/126265.pdf

¹²⁴ European Union (2011). 'Press statement: EU facilitated dialogue – Agreement on IBM', Brussels, 2 December 2011. Available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/er/126544.pdf

¹²⁵ Ibid.

¹²⁶ Ibid.

An additional technical protocol for IBM needed to be signed by both parties in order to initiate the implementation of this agreement; however, Serbia kept delaying its implementation for more than a year. Even Kosovo's then Foreign Minister, Enver Hoxhaj, voiced these concerns at the UNSC meeting on 14 May 2012, reiterating that Serbia was not signing the technical protocol on IBM implementation.¹²⁷ Minister Hoxhaj believed that Serbia was doing this because it was still trying to retain its influence in the north and even partition Kosovo at its north.¹²⁸ The issue of the lack of implementation of the 2 December 2011 agreement on the IBM was also discussed at the fourth round of the negotiations held at the level of prime ministers. On 17 January 2013, the then Prime Minister of Kosovo, Hashim Thaçi, and the then Prime Minister of Serbia, Ivica Dačić, met for the fourth time, discussing the issue of IBM implementation.^{129, 130} Serbia's prime minister was persuaded to move on with the implementation of the agreement only after Kosovo's prime minister agreed in principle that the collection of VAT and customs duties at the two border crossing points in the northern part of Kosovo (gates 1 and 31) would be allocated for the four Serb majority municipalities of the northern part of Kosovo.¹³¹ Around a month later, both parties reached an agreement on the technical protocol for the implementation of the IBM on 24 February 2013.¹³² Kosovo signed the technical protocol on 28 February 2013, while it took Serbia an additional six months to sign the protocol. Kosovo eventually began collecting taxes at the two border crossing points in the northern part of Kosovo from mid-December 2013, and ever since this has continued to work normally and in accordance with the agreements reached between Kosovo and Serbia since 2011.

Summary

- With the establishment of UNMIK in Kosovo in June 1999, a decision was taken to abolish the FRY customs regime on the grounds that the regime was weak and outdated. In the beginning, UNMIK considered trade between Kosovo and Serbia as internal trade, and no customs services were set at the border crossing between Kosovo and Serbia until 2011.
- The UNMIK Customs Services became fully operational in mid-2001 when it passed a regulation on the Constitutional Framework. This was the period when UNMIK and the self-governing institutions in Kosovo passed a regulation on VAT, which had to be collected at the border crossing points. This made Kosovo a separate customs zone from Serbia, thus treating trade between the two as external trade. However, no customs duties were collected for imports from Serbia.
- Kosovo never had a bilateral free trade agreement with Serbia. However, on 27 July 2007, Kosovo together with five other countries of the Western Balkans, including Serbia, became full members of the CEFTA. Kosovo was represented by UNMIK.
- When Kosovo declared its independence in February 2008, the border crossing points with Serbia (gates 1 and 31) in the northern part of Kosovo were set on fire by Serb extremists supported by Belgrade. Serbs in the northern part of Kosovo refused to live in an independent Kosovo and did not want to pay any VAT towards the budget of an independent Kosovo.

127 Kosovo Ministry of Foreign Affairs [2012]. 'Minister Hoxhaj: The duplicity of Serbia', 14 May 2012. Available at <http://www.mfa-ks.net/?page=2,4,1238>

128 Ibid.

129 As mentioned previously, Serbia was dragging the implementation of IBM, as it would substantially change the status quo in the North by undermining Serbia's influence that it had maintained through its "open and free" economic zone.

130 European Union (2013). 'Statement by the EU High Representative Catherine Ashton after the fourth meeting in the framework of the EU-facilitated dialogue', Brussels, 17 January 2013. Available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/134784.pdf

131 S. Kursani [2014]. Op. cit.

132 European Union (2012). 'Press statement: EU facilitated dialogue – Agreement on Regional Cooperation and IBM technical protocol', Brussels, 24 February 2012. Available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/128138.pdf

- After independence, Kosovo began adopting its state symbols, replacing all the previously used symbols under the UNMIK heading with new symbols. In December 2008, Kosovo replaced the UNMIK Customs stamp with the new Kosovo Customs stamp. This led Serbia and BiH to block their imports from Kosovo and to prohibit Kosovo businesses from using their respective territories as a transit route for Kosovo's exports to third parties.
- In response, Kosovo applied 58 days of trade reciprocity measures with Serbia and BiH, running from 20 July 2011 until 16 September 2011. This ended when the parties reached a provisional agreement on free movement of goods and customs stamps. Serbia was pressed to accept Kosovo Customs by Germany, a key EU member state.
- Nonetheless, although the trade blockade was lifted by both parties, Kosovo still did not collect VAT at the border crossing points in the north. This finally changed when an additional agreement on the IBM and a subsequent agreement on the technical protocol for IBM implementation was reached and signed in 2013.
- Trade relations between Kosovo and Serbia were finally regulated and trade principles began to be implemented as agreed starting from December 2013.

Cyprus: The Green Line Regulation

Natalia Mirimanova

The Cyprus Chamber of Commerce

Interview with Leonidas Paschalides

NM: What is the meaning of the Green Line Regulation for the re-rapprochement of the two communities on the island of Cyprus?

LP: The Green Line Regulation (GLR) is an EU regulation that came into force when Cyprus acceded to the EU in 2004. The regulation stipulates that products that are manufactured in the Turkish-Cypriot (TC) community either wholly, or which have such an added value to be considered Cypriot, can cross the divide and can be sold to the Republic of Cyprus (ROC). However, they need to be accompanied by a document issued by the TC Chamber of Commerce, which certifies that the products are of Cypriot origin. After a year of discussions between us and the TC Chamber of Commerce, in 2005 reverse trade also became possible. A special procedure needed to be formulated for the Greek-Cypriot (GC) products to cross the Green Line into the TC-controlled territory because the GLR only concerned products coming from the TC community to the ROC, not the other way around.¹³³ The GLR does not foresee this trade simply because the EU cannot issue regulations for an area in which the *acquis communautaire* is suspended – namely, North Cyprus. Therefore, after discussions with the TC Chamber of Commerce, we put forward the argument that one-way trade does not work and that there should be two-way trade. The TC Chamber of Commerce intervened and convinced their authorities to issue a regulation permitting trade of GC products to the TC community. In effect, these regulations of the North mirror the EU's GLR.

NM: How did the EU react to the decision of the TC community? You said that for legal reasons, it did not include this trade in the Green Line Regulation.

LP: The EU cannot issue a regulation for a non-EU area. The EU has nothing to do with this. As long as the authorities in the North allow for reverse trade to take place, this is fine. Because it mirrors the GLR, they also ask for an accompanying document for the GC goods, certifying that the products are of Cypriot origin; on this occasion, the document is issued by my Chamber, the Cyprus Chamber of Commerce and Industry. As a result, because we are issuing accompanying documents, both chambers became involved in the GLR. To issue these certificates, we keep an account of the type and volume of goods that are traded between both sides.

In terms of obstacles to trade from ROC to TC, there are two major obstacles. One is the fact that we have to charge value-added tax (VAT), which is actually a cost for the TC buyer as they cannot claim back VAT. This is because we do not consider that we are trading with another country – that is, we are not exporting, in which case VAT would not be charged. My Chamber and the government have asked the European Commission (EC) if we can address the issue of this VAT because it raises the cost of products. However, the EC has said that we cannot remove the VAT levy as long as we consider that these products are not exports. Thus, we are obliged to add VAT to the price of the ROC products that cross to the North.

¹³³ Article 5 of the GLR prescribes that goods sent to areas not under the effective control of the ROC government should cross freely, should not be subject to export formalities – hence no export refund should be paid on agricultural goods and processed agricultural products.

On the other hand, TC authorities consider this trade to be import-export, which raises another problem. When the GC goods cross to go to the North, they are charged with duties in line with the TC rules because, in their mind, they are importing these products. This results in an additional load on the GC product if you consider the 19% VAT and duties of about 25%–30%, which make the price uncompetitive.

NM: Do the TCs call this a custom duty?

LP: Yes, they consider it a custom duty.

The other obstacle is that every TC who wants to trade with a GC has to secure a permit from their authorities, which is not foreseen by the GLR, but which is a condition demanded by the TC authorities. However, the permit is not always given because the TC community is trying to protect its own production. So sometimes this permit is not given, in which case no trade can take place for this consignment. It is not a GC company, but a TC company, that has to get the permit.

NM: So how would you assess the economic rationale for this trade? Does it have a more important symbolic, rather than economic, value for both sides?

LP: This observation is partly right. However, the trade is more important for the TC community than for the GC community. This is reflected in the balance of trade, which is five-to-one in favour of the TCs. In other words, they sell to us five times more than we sell to them.

NM: Is it beneficial to the consumers in the ROC? What is the demand for TC products?

LP: This trade is carried out between businesses. A business will only trade with another as long as it is profitable. If the price is competitive and the quality is good, they will trade. If not, they will not. This is a universal rule. Someone in Ukraine buys products from Austria if they get them at the required price, quality, etc. Businesses think along these lines. If, for example, a GC can bring plastic bags from Italy for a cheaper price and of better quality than those bought from TC, he/she will not buy from them – they will get the goods from Italy.

One more issue – as far as TC products are concerned – is that the goods coming into ROC need to comply with EU standards because ROC is a member of the EU. For instance, if they send electrical products, there are EU standards concerning these and the TC producer has to make sure his/her products comply.

NM: Does the TC Chamber of Commerce check the compliance of the TC products with the EU standards?

LP: No. Chambers are not in a position to check whether products comply with standards. They only certify that the products are Cypriot. Therefore, in the case of electrical and other products where compliance with EU standards is required, the TC manufacturer has to provide certificates from companies that certify compliance with standards to show that their products comply. This is provided for in the GLR. The authorities of the ROC have the right to test if they have any doubts that products from the TC companies are not compliant with these standards.

NM: Have you ever experienced abuses?

LP: Yes. There have been a few cases where products from the TC community have been found not to be compliant with EU standards. In such cases, the products are not allowed to enter the ROC market.

NM: If there is direct competition between GC and TC companies, and a GC company wants to prevent a TC company from importing products to the GC territory, can they do it?

LP: No, they cannot prevent it. To prevent this, they need to provide solid evidence that there is something wrong with a TC product. If they cannot provide such evidence, there is no way to prevent the trade.

NM: Which body checks this?

LP: It depends on the product. For construction materials, for example, the body responsible is the Ministry of the Interior. For foodstuffs, it is the health services, etc. For agricultural goods, it is the Ministry of Agriculture.

NM: Do you think that, in these cases, TCs trust this expertise? Do TCs trust and accept expertise issued by the ROC ministry? Do they comply with it? Is it an authoritative body for them? Have there been complaints or examples of the TC side accusing GC of unfair practices? Do TC bodies check the quality of GC products – do they have a reciprocal procedure?

LP: The ROC does not issue the certificate; they find international organisations. They do not accept the authority of the ROC to issue certificates for their products. The ROC does not have access to TC factories, etc.

NM: You mentioned that it is the relevant ministries who look into complaints?

LP: Suppose that construction products come from the TC community to the ROC. If ROC authorities have suspicions that the products do not comply, they will take a sample and analyse it.

NM: And what if they say the products do not comply?

LP: If they say that, the products are not allowed to cross.

NM: Is this acceptable for TC companies?

LP: They accept it because this means that EU regulations have been applied. We are members of the EU – they are not the regulations of Cyprus, they are EU regulations.

NM: From your point of view, how does it influence the quality of trade and products traded – is the spectrum becoming more diverse? Is the quality of products traded improving?

LP: I cannot give you an opinion on whether the quality is better. I have no information on this and Chambers are not monitoring it. However, we are having far fewer problems than in the beginning because TC companies are realising that their products have to comply with standards. In the beginning, they did not pay attention to this and there were cases where goods were returned. Now they are much more careful and they play by EU rules, so there are fewer problems. The great majority of TC products are compliant. There are a couple of cases every year, no more than that.

NM: Are there people in the business community in the ROC who are against the GLR?

LP: There are people in both communities against this – both on the GC and TC sides. When we say they are against it, they cannot do anything about this trade. The companies that are against trading with the other side will simply not trade with the other community. It is a free market – nobody can force a private company to trade with anybody.

NM: Is there an increase in the number of companies on both sides trading across the Green Line?

LP: No, it is not increasing due to a number of reasons. One reason is all the procedures that companies have to go through – business people do not like having to go through bureaucratic procedures to trade. A second reason, as far as GC products are concerned, is the obstacle posed by VAT, duties and permit issues – problems that inhibit trade. In addition, one has to consider that in recent years, we have been facing an economic crisis, not only in Cyprus but all over the world. As a result, trade has gone down in many countries, and the GLR trade could not remain unaffected. Cyprus, the ROC, is buying less from abroad, not just from the TC community, but generally from the international community, compared with the situation in economically better times. The TC community is also facing economic problems, so it is buying less.

NM: Looking into the future, when we think of the reunification as a possible solution to the conflict, what would be your forecast based on the level of trade today? Would reunification boost trade between the sides?

LP: Yes, definitely. If there is reunification, Cyprus will be united, there will be one market and it will be much easier for all. If there is a solution, a TC company that manufactures plastic products will not sell their products to a GC; they will sell directly in the market.

NM: So the TC community will get legal access to the world market. From the perspective of relations between the two communities, including between business communities, will the intra-island trade be lower because the TC community can trade with the rest of the world?

LP: Yes, if there is a solution, they will be free to trade with anyone they like.

NM: Looking back and thinking politically and from the peacebuilding perspective, was it the right decision to facilitate trade between the two sides? There are two main points of view on this. One view is that the legalised trade simply reinforces the status quo and legitimises the separate nature of the TC community, almost making it feel like a state. The other, opposite, view is that by facilitating business contact, it brings the sides closer.

LP: My view is that any activities which contribute to bringing the two civil societies closer together are useful activities. So I believe that business trading in general does contribute to improving relations, not between politicians, but between ordinary people. Business people are part of civil society, so any activities that contribute to bringing them closer together are useful.

The Chambers of Commerce, my Chamber and the TC Chamber of Commerce, are doing everything they can to boost relations between the business communities. However, we are realists. Our efforts are stimulated when the political environment is conducive. When it is not, we are affected too. When the political climate improves, it helps us; when it does not, it affects us adversely. We have to keep trying and that is what we are doing, both Chambers.

The Turkish Cypriot Chamber of Commerce

Interview with Kemal Baykalli

NM: What is the meaning of the Green Line Regulation for the rapprochement of the two communities on the island of Cyprus?

KB: Unfortunately, the contribution of the Green Line Regulation (GLR) to rapprochement has been rather limited. To understand why this is so, we need to be aware of the political and economic background. The GLR was brought into force in 2004 at a time when Greek Cypriots (GCs) became a member of the European Union (EU) under the title of the Republic of Cyprus, which has jurisdiction over the Southern part of the island only. The GLR aimed to regulate the crossing of people and goods from the “areas not under the effective control of the government of the Republic of Cyprus” (a definition used by the EU for North Cyprus). The regulation made it possible for the Turkish Cypriots (TCs) in the North to sell certain products to the Southern part of the island. It was hoped that trade between both communities would contribute to rapprochement on the island. It is true that 2004 was an important milestone in the peace process because that was the year when a comprehensive United Nations plan was placed on simultaneous referenda on both sides, and was accepted by the Turkish-Cypriot (TC) side but rejected by the Greek-Cypriot (GC) side. Therefore, the international community found itself in a situation where the side that rejected the peace plan was accepted into the EU, and the one that wanted to resolve the problem and become an EU member was left out. So, automatically the Green Line became a *de facto* border for the EU. We must acknowledge that neither the GCs nor the international community would call it a border because this would be against their official position of non-recognition of Northern Cyprus. So, they had to establish a system where the crossing of goods and people is regulated. We know that, in theory, the entire island is in the EU, but the *acquis communautaire* is suspended on the Northern part of the island. As a result, we have a complicated legal situation.

Of course, at the time, we thought that the GLR was initiated as an initial step to help the TCs increase commercial and economic contacts with the EU to help end their isolation, as suggested by the EU Council in 2004 following the outcome of the referenda. Therefore, it was regarded quite positively by the TC community. However, we should also remember that this was not the only regulation proposed – two others being financial aid and direct trade regulations. Financial aid is self-explanatory – its aim was to help the TCs improve the economy in order to prepare them for future settlement.¹³⁴ But the direct trade regulation¹³⁵ was controversial because the Commission proposed that after the passage of the Direct Trade Regulation, the TC community would be able to trade with the rest of the EU, meaning that goods could be sent from the TC to the EU directly and not via the GC territory – for example, from the ports of North Cyprus to Hamburg or any part of the EU. The goods would be able to enter the EU through European ports of entry with a special regime abolishing many duties and customs – in fact, as if they were a customs union product. This initiative was challenged and blocked by the GC side on the grounds that this would strengthen the political status of the TCs. Within this framework, the GLR remained the only tool for trade between TC and GC. While the Direct Trade Regulation was effectively blocked, some argued that the GLR could be used to send goods to Europe via the ports in Southern Cyprus. In theory, once goods cross to GC, they are within the EU and can go anywhere. However, it is not that simple in practice because

134 €259 million in financial aid was approved by the European Council on 27 February 2006 to assist the TC community to develop their economy. See overview of TC community. Available at http://ec.europa.eu/cyprus/turkish_cypriots/index_en.htm

135 European Commission (2004). ‘Proposal for a Council Regulation on special conditions for trade with those areas of the Republic of Cyprus in which the Government of the Republic of Cyprus does not exercise effective control’, COM(2004) 466 final, Brussels, 7 July 2004. Available at <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2004:0466:FIN:EN:PDF>

in order to sell TC goods through the Green Line and to any place in continental EU, one has to establish a company in the South and address value-added tax (VAT) and other issues. It is not practical or easy for a TC business person to establish a company, do the paperwork and then send goods to the South and from there to elsewhere in the EU. We do not know whether there has been such practices, but we have heard that there have been some cases. It is also important to note that under the GLR, only certain indigenous products are eligible for trade. This means that the goods that were imported to North Cyprus will not be able to cross through the Green Line into the GC community. Even the products that were produced in the customs union territory cannot go through the Green Line. Even if I buy German goods and then want to resell to the South, they will not cross over. There are also other limitations. For example, processed food products cannot cross to the South because they need to be inspected by health authorities. Because of the political situation on the island, it is not possible for the health authorities to cross over to inspect our products, and of course they would not recognise our health authorities. Therefore, we are still pushing for a new mechanism to solve this problem. TC vehicles still cannot cross to the South on the grounds that the road-worthiness documentation would not be recognised in the South. But leaving all technical difficulties aside, I think the main problem is that trading with TCs is still a taboo within the GC community. Even today, you still cannot find a single TC end product on the GC supermarket shelves, and GC newspapers still refuse to accept ads from TC companies. Moreover, those GCs trading with TCs prefer to keep a rather low profile; they do not want to be recognised as a company trading with the TCs. So this is the general picture.

NM: Did the attitude towards the GLR change since it had been introduced? Do TC business people still think it is useful? Is the GLR still perceived positively?

KB: Nobody is against it, but it is still seen as quite a limited tool. The contribution of Green Line trade to our economy is quite marginal. This is partly because our economy is mainly service based and indigenous/raw products have a limited market in the South. So, even if you produce something, you cannot process and sell it – the context inhibits trade. Nevertheless, there are business people who have established business relationships selling some basic materials to the South for almost 10 years. To sum up, we are happy that the Green Line trade opportunity is there, but we find it limited. Moreover, EU regulations are always taken with a pinch of salt because they remind us of promises that were not kept. When we said ‘yes’ in 2004 to the UN plan, the EU Council passed a resolution to end the isolation of TC after two or three days. It was a commitment, but it has been 10 years since then with no drastic changes. The GLR is not enough to bring about sensible change.

NM: The TC side took reciprocal measures to the GLR to protect their own market. What were these measures and do they operate effectively?

KB: Before the introduction of checkpoints by the TCs in 2003, there was almost no contact between both communities. A year later, the GLR was passed so we had to start the trade from scratch. Following the introduction of the GLR, the TC side passed a new law so that similar trade could take place in the opposite direction. Accordingly, the buyer must apply to our trade department and get permission. Since we can only sell indigenous goods, the same is true the other way around. Currently, Turkey is our only exit to the world since our foreign trade takes place through the ports in Turkey. Most of our competitive advantage is lost due to the lack of direct access to the international markets and the high transportation costs owing to the aggressive policy implemented by the GCs towards the usage of our ports. This means that there is unfair competition between the traders of both communities since the GCs enjoy all the benefits of recognition and EU membership. That is why our internal regulations ‘mirrored’ the GLR with an addition

of extra permission to be granted by the trade department in order to leverage the unfair competition.

NM: How does the issue of non-recognition feature in all these arrangements? Would GCs apply to TC authorities as if they were a different country?

KB: If a GC wants to sell to a TC from South to North, a TC partner has to be found and then the TC buyer asks the TC trade department for permission. The application must include an accompanying document from the Chamber of the GC community – namely, the Cyprus Chamber of Commerce and Industry – proving that it has been produced in the South. However, if permission is not granted by the TC trade department, even if it is a local GC product, the trade will not take place. Since the GC government does not recognise the North as a separate country, trade from South to North is regarded as internal trade and they charge VAT. But since the government in the North regards it as an import, our authorities also charge VAT. This reduces the competitiveness of goods to be traded from the South.

NM: So a GC business person does not have to apply to the TC trade department for permission?

KB: No, but the buyer – that is, the TC business person – should apply. Apart from permission, the GC Chamber must issue an accompanying document. The trade department in the North is responsible for all imports to the North – not only from the South, but from anywhere in the world. To be able to export to the North, one has to obtain permission from our trade department. It is the normal procedure. The only difference is that permission must be secured for each trade deal separately.

NM: You said that the GLR is marginal from a business point of view. Are there economic reasons for this or are there other obstacles? Do you think this will change?

KB: There is always room for improvement. That is why we are trying to facilitate trade across the Green Line. For example, we proposed that the custom union products be included in the trade, meaning that if we import something from France, Germany, the UK, etc., we should be allowed to sell it through the Green Line to the South if one can find a good customer and strike a good business deal. We also requested a special mechanism to be designed for the health and hygiene inspection of foodstuffs, so that we could sell processed food to the South. We are not a major industrial or manufacturing-based economy, but we have foodstuff products in the North that we could sell to the South. If there was a special health certification procedure, we could develop a mechanism to enable such trade. Currently, we can sell fish to the South and potatoes, which require sanitary certification from the EU. The regulation itself does not address such details, but it is the implementation that is the problem. The same goes for commercial vehicles. Therefore, there are ways to do it if there is a will. There is room for improvement. It could be better.

NM: What sectors in the TC economy could benefit most from the GLR and the possibility to trade with or through the South?

KB: Currently, we have mainly construction materials, fish, raw and unprocessed vegetables, and some handmade products, which constitute the biggest portion of our trade. Opening doors for processed food would create some opportunities for existing markets.

NM: What about direct trade – is the opportunity still on the table? Has there been any progress?

KB: The direct trade issue has been highly politicised by the GCs on the grounds that it would lead to strengthening the status and thus recognition or indirect recognition of the TC government. In fact, it would only regulate how the TC goods would enter the EU markets. This matter turned into a legal battle in the EU as well. It failed to come into force since decisions should be taken unanimously in the EU. Following the Lisbon Treaty, which meant that commercial issues no longer required unanimity, the Commission passed the Direct Trade Regulation to parliament, saying that it was a trade regulation and therefore did not require every country to approve it, effectively removing the veto power of the GCs. So GC went to the legal service and claimed that this matter was not a commercial matter, but was something to do with Protocol 10 of the Accession Treaty of Cyprus to the EU,¹³⁶ which temporarily suspended the *acquis communautaire* in the North. In other words, they claimed that the Direct Trade Regulation requires unanimity. Since no agreement was reached on this issue, the Direct Trade Regulation is now on hold at the Conference of Presidents, a mechanism of the parliament that decides where an issue should be discussed. In reality, it became a political issue requiring the political consent of the GCs.

NM: Hypothetically, if there were a Direct Trade Regulation in force, what would this do to the relationship between TC and GC? Would TC immediately turn away from GC economically, preferring to trade with the rest of the EU?

KB: Unfortunately, the registered economic interaction between both communities is rather limited. The GLR produces an annual €3 to €4 million in trade. The official trade the other way around is also limited, particularly due to the double VAT issue. The main benefit to the GC economy is from TC consumers crossing daily to shop and spend money in the South. The opposition of the GCs is more political than economic. In fact, I imagine that should TC have better relations with the rest of the world and trade with the EU directly, this would enhance the economic ability of the TCs, hence making intra-island cooperation more productive. But that would mean discovering new fields that could be economically viable, fields which are maybe not used today. Maybe we could find a new market and jointly develop it.

The idea of TC putting their goods onto ferries and sending them directly to the EU is of course very exciting. Even today, we can sell to Europe. We have never stopped direct trade with the EU. But the problem, which the Direct Trade Regulation aims to solve, is how our goods are treated when they reach European borders. Currently, our products are treated as third-country products and they are not subjected to any preferential trade arrangement. This reduces their competitiveness. The Direct Trade Regulation aims to allow us to be treated as if our goods were of EU origin, reducing the costs for us and making our products more competitive.

NM: Are we talking about a 15% to 20% decrease in duties and tariffs if the Direct Trade Regulation is enforced? What is your estimate of the profit potential of direct trade?

KB: We do not have any figure. Until 1994, we were able to sell our products just like any European Community (EC) country. The GCs filed a lawsuit at the European Court of

¹³⁶ Council Regulation (EC) No 866/2004 on a regime under Article 2 of Protocol 10 to the Act of Accession. Available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32004R0866R%2801%29>. Green line application form is available at <http://www.ktto.net/wp-content/uploads/2014/12/mensebelgesiappli.pdf>

Justice on the grounds that the official commercial certification of our authorities should not be recognised, and they succeeded in making our exports ineligible to benefit from the trade regime we used to enjoy. This decision was a major blow to our external trade because, up until that time, Europe was our main trade partner. Besides the economic loss, it also damaged the ability of the TC producers to keep up with the new practices, technologies and requirements of the European markets. The Direct Trade Regulation should not be seen as merely an income-generating tool, but also in terms of its potential to contribute to the competitiveness of the TC economy as a means of closing the gap between the two economies on the island prior to a settlement. It would help our manufacturers to increase their standards and it would allow development of entrepreneurship by creating new opportunities in our community.

NM: In terms of business development or economic development of TC in the North, which destination is the most profitable in terms of markets – the EU or Turkey?

KB: We need to remember that Turkey is also in the customs union, so EU institutions and rules affect our relations with Turkey as well. Currently, we enjoy close commercial cooperation with Turkey, especially in our main sectors – namely, tourism and higher education. But if the Direct Trade Regulation comes into effect, we expect our exports to Turkey to be affected positively with this.

NM: Is there any special agreement between Turkey and the Turkish Republic of Northern Cyprus (TRNC)?

KB: There is no customs union between the two economies. But Turkey is in the customs union with the EU. Remembering that the Southern part of Cyprus is in the EU, one can see the difficult situation of our economy being squeezed in between.

NM: Is it then possible to send TC goods from the North into the EU via Turkey, changing the certificate of origin?

KB: Turkey needs to abide by the rules of the customs union agreement with the EU. This means that the same rules apply to our products entering into Turkey. There is a possibility for Turkey to nationalise our products by reissuing papers at Mersin, and some of our trade takes place in this manner. The biggest disadvantage of this system is that it affects our competitiveness by increasing the transport costs and bureaucracy.

NM: In terms of services, does this relate to the Green Line in any way? Can you sell your services across the Green Line?

KB: If we are talking about, let us say, information technology (IT) services, there is not much favourable market potential for our service providers. Employment opportunities did exist for skilled labour, but that was affected negatively after the economic crisis of the GCs. In terms of selling tourism services to the people coming through the ports in the South or to the GCs, it is not very favourable either since our tourism industry is regarded unfavourably by the GC administration due to the potential competition as well as property disputes over where some of our hotels are located. There are some people who cross over, coming from Larnaca Airport in the South and entering the TC area, staying in our hotels, doing some shopping, but I do not think that this affects the flow drastically. Most tourists come from Ercan Airport in the North. Nowadays, it is possible for EU citizens to enter the island via any port and to travel throughout the island easily. But I think that if we look at the figures, most of our tourists and students come from the North.

NM: Is there a sense of inertia?

KB: Partly, and if you are a student you are more likely to come from the North because you are going to spend a couple of years here, so you want to have your papers in order according to the rules of the North and it might be problematic for you to come from the South. Our tourism agencies try to bring people from all destinations, but I think everybody feels more comfortable if they do not have to cross the Green Line. The GC apparatus is designed to work against TC tourism on the grounds that I mentioned above. Of course, there is also this outdated belief regarding the need to contain our economy as a means of containing the separation of North Cyprus. In fact, the economic embargoes laid down by the GCs help to alienate the TCs further.

NM: For instance, can TC professors teach and sell their services to GC universities, or can IT companies from Famagusta sell their services to the GC clients?

KB: We try to increase cooperation, bi-communal business cooperation. I am sure that some business links have already been established. But these services are not easy to detect anymore. You come, you do something and get money, but the current systems are not designed to convince people to do more trade. Getting the information is always a problem. The issue of non-recognition gets in the way in terms of dealing with invoices and recognition of paperwork. This is not conducive to bi-communal business cooperation, although the two Chambers of Commerce are trying to increase this.

NM: Some would say that all these Green Line arrangements are a game, that they have no economic rationale, are not market driven and are politically driven. What is your assessment?

KB: The GLR was initiated out of necessity. We wanted to use it in a positive way. I think that we can still use it in a more beneficial way. The reason it was invented is not important. It is a tool which is highly underused and I think that there is room for improvement. We also have to remember that Cyprus is a very small island; the market size is small and both economies produce similar outputs. It is not the case that there are market differentiations, whereby we can sell and enjoy this differentiation. Maybe this is also a natural border – we are talking about a small area, everybody produces similar things and does similar things. So whether the GLR is political, out of necessity or economically viable, that is another discussion. I think we can find ways to improve it because this is the only thing we have. Looking at the bigger picture, I think we need to concentrate on solving the problem once and for all. Instead of competing against each other for a share of the market, let us make sure that everybody can benefit from it; let us enjoy tourism cooperation, higher education cooperation. You asked about the university professors. We TCs are the ones who have established our university sector as an important economic sector. We have nine universities at the moment. They do not recognise our universities, but the diplomas are recognised internationally. So it is a political problem even with regard to single cases sometimes.

NM: How did the recognition happen? Did you enter the Bologna system?

KB: Unfortunately, we are not part of the Bologna system. This is one of the reasons why we believe there is an embargo against the TCs. It is not physically possible for us to be part of the Bologna process. It is not possible for us to be part of the postal union process; for instance, it is not possible to have a separate internet extension. Taiwan is not a recognised country, but it still has its own country code, its own internet code. All of our universities are accredited through the Turkish accreditation system, which is internationally recognised throughout the world, meaning that our diplomas can be recognised internationally.

NM: What about Green Line trade disputes?

KB: We do not have an arbitration system at the moment. We try to address all of our disputes in good faith. This was one of the projects recently initiated to establish some kind of arbitration mechanism to resolve disputes, but it is a costly business. While the Chambers are researching the possibility of establishing a more formal dispute mechanism system, we need to see whether it is legally possible and economically viable.

Conclusions

This volume presented a unique collection of analyses of regulatory frameworks that have created an enabling environment for economic exchange to take place. Although the cases of China and Taiwan, Kosovo and Serbia, and Cyprus differ from each other, they demonstrate certain common characteristics – for instance, a common external normative and/or (geo)political framework, economic expediency, institutionalisation of trade regulation and support of the private sector.¹³⁷ These factors have led to agreement on the legal framework and enabled trade arrangements.

None of the three conflicts is likely to see a final political-territorial formula that would be acceptable to all in the near future. However, it is clear that progress has been made in terms of strengthening local and regional security, restoring freedom of movement of people and generally ameliorating tense relationships. Each conflict follows its own trajectory, which cannot be replicated in other cases. However, efforts by all sides and by external actors to normalise the situation through trade facilitation – whereby obstacles to the movement of people, goods and capital have been gradually removed – have already yielded impressive outcomes. Trade is being slowly de-politicised, market laws reinstated into the conflict system and, as a result, the search for solutions expanded. Meanwhile, individuals and companies can attend to their business interests, create jobs, generate income, and develop technologies and skills in a less strained political environment.

In the Georgian and Abkhaz context, analysis of these various strategies could contribute to the establishment of mutually acceptable rules to regulate trade across the Ingur/i in the absence of a political solution to the conflict. Studies conducted to understand economic relations across the Ingur/i¹³⁸ demonstrate an economic case for regulation. In particular, a provisional Georgian-Abkhaz legal framework could help to regulate economic activities across the conflict divide and make them more transparent, in turn creating a new impetus for peace talks.

¹³⁷ Please see Executive summary for details.

¹³⁸ Ibid.

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