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**KOSOVO ECONOMICUS: DOES VIABILITY MATTER?**

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## Abstract

It is argued that the size of Kosovo and the availability of productive factors are not decisive for the economic viability of Kosovo. Other criteria are, of which the trade regime and the quality of public governance are decisive. Both the economic history of Kosovo and the current political settlement do not guarantee that these criteria will be satisfied any time soon. The options for the final status of Kosovo cannot be expected to satisfy these criteria too. Finally, the regional economic situation does not really help and the same could be argued for the international efforts too. The final solution is indeed irrelevant, the movement towards it is all that matters.

## Introduction

There are some, more or less, informal debates going on about the viability of Kosovo in the economic sense of that word. The same question pops up in the case of Montenegro, Bosnia and Herzegovina (or parts thereof) and even in the case of Serbia proper. Some of the issues can easily be applied to the other countries in the so-called Western Balkans and indeed to most of the post-socialist Balkans. These discussions are informal because it is not made clear what is meant by “viability in the economic sense”. What can be gathered from the context is that by viability some fuzzy set of characteristics is being assumed; one that includes at least some degree of development, self-sufficiency, coherence, optimality, and self-governance. These characteristics have not been made as precise as they should be in order to check them against the reality of Kosovo. To partly contribute to a more focused debate, I will, in this paper, first, review some of the arguments about the “viability in the economic sense”. Then, I will look at some empirical discussions about the viability of small states and develop some criteria of viability. I will then check those against the description of the economic situation in Kosovo (both current and that in the past), and, finally, discuss some of the economic consequences of alternative political arrangements that Kosovo may be facing. I draw some conclusions at the end.

## Size Does Not Matter

In the recent years Alesina (together with a number of collaborators) has developed a theory of the size and number of nations.<sup>1</sup> The basic thesis is that the spread of free trade and democracy increases the number of states. Free trade between states makes the size of the state almost irrelevant while democracy leads to the stronger influence of the political preferences for specific levels, structure and financing of public goods.

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<sup>1</sup> See Alesina and Spolaore (1997) and Alesina (1998).

The argument in terms of free trade is straightforward. One advantage of a larger state is that it supplies its economy with a larger market. To the extent that “growth is limited by the extent of the market”, as Adam Smith argued, this may be advantages enough to suppress the possible centrifugal political forces that might exist in such a state. However, in the world of free trade, the advantage that goes with the size of a state disappears: small states can benefit from the world market and thus the political considerations may become more important than the economic ones.

There is an additional argument from free trade. In such a regime, every state has access to the full menu of world products that are produced by the world’s endowment of productive factors. As a consequence, the local availability of productive factors becomes irrelevant. Thus, the traditional debate about how rich in natural resources Kosovo is becomes irrelevant for the economic viability of this area, though not from the business and investment points of view.

If in addition to free trade democracy is adopted in a country or in a region, then these mainly political considerations will get the upper hand. Pressures will build up to increase the level of political autonomy of different territorial units, states, regions or provinces. The reason is straightforward: democracies represent the views of the majority, but local majority may be a minority globally and thus it may choose to separate and put up an autonomous political unit especially if this decision does not change the access of the new state to the outside markets.

Therefore, trade liberalisation and the rise of democracy make the size of a state less relevant for its economic viability. In a sense, it could be argued that, in these circumstances, states come into existence and perish on purely political grounds, the economic grounds being essentially irrelevant.<sup>2</sup>

## **Size Matters**

The argument that the extension of free trade makes the size of a state less relevant from the point of view of its economic viability does not mean that the size of a state has no economic consequences for the state in question. On the contrary, it has been argued on both theoretical and empirical grounds that size indeed matters in a number of ways.

One argument is that larger states, in terms of territory and population, tend to have smaller governments, in terms of the share of public expenditures in the country’s Gross Domestic Product (GDP). One reason given is that there are economies of scale in the production of public goods. For instance, the costs of security may be smaller on *per capita* basis for larger than for smaller states. The same may be true for other public goods.<sup>3</sup>

Another argument is that small states have larger governments because they face more frequent shocks because they tend to be more open precisely because they are small. As a consequence, they tend to rely on policies of fiscal adjustment and for this reason need larger budgets to stabilise the demand shocks than do bigger states.<sup>4</sup>

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<sup>2</sup> This is not to be taken to imply that in reality it is ever otherwise. It is just that in these circumstances, the importance of political considerations becomes even more important than they are in protectionist and non-democratic environments.

<sup>3</sup> For a review see Begg and Wyplosz (1999).

<sup>4</sup> See Rodrik (1999).

Finally, there is an argument to the effect that smaller states tend to have larger governments because they are more homogeneous and thus tend to be more sensitive to the demands for the redistribution of income. Thus, small states rely more on the so-called welfare state than larger states do precisely because the level of diversity in the latter makes it more difficult to arrive at a consensus about the level of “social justice” that is appropriate for such a state.

There are empirical studies that show that what goes for small states does not go for so-called micro-states, i.e., states with less than one million inhabitants.<sup>5</sup> Any number of reasons could be put forward why this might be the case. One thing to notice is that these micro-states can be perfectly viable in the sense that they can be prosperous, enduring and stable. However, they tend to have smaller governments. This is obviously because they cannot hope to have all the functions that bigger states have or at least these functions cannot be performed in the same way and as fully as is the case with the bigger states. Thus, for instance, micro-states cannot hope to provide for external security in the same way in which this may be connected with some standard notion of a state. Thus, it is sometimes said that this or that small state is not really viable because it cannot do everything that a bigger state may do almost as a matter of course. But, of course, this begs the question as to what viability in fact is.

There are other ways in which the size of a state matters. For instance, a small state may be smaller, in one sense or another, than most multinational companies are. That may bring about quite peculiar relations between the business and political interests. On one hand, business interests may be much more important than political ones. On the other hand, the large companies may not be interested in “running the state” because their interests in that market may be quite limited. Whichever way the relationship is established, the social consequences for those living in a small state may be considerable. This may bring up the issue of the social viability of a small state in the way in which this issue does not arise in bigger states, at least not at the national level.<sup>6</sup>

These considerations lead to the following conclusions:

1. Size of a state does not necessarily matter for its viability as long as its economy is open, i.e., is liberalised externally and internally.
2. Size may matter for state’s viability if a state is diverse enough, in one sense or another, and if it is a democracy because the political preferences of the people living in different parts of that state may be incompatible.
3. Smaller states should be more open than are bigger states if they are to grow and prosper.
4. Smaller states may have to have larger governments for the purposes of stabilisation and distribution, but that may not be the case with the very small states because those may not be able to afford to have all the functions that a larger state has. Indeed, this is a relative matter and to the extent that a state is economically integrated it may choose to base its viability only on some public functions rather than on all of them.
5. Smaller states with a homogenous population (in terms of culture, income, or some other relevant characteristic) may have difficulties to adjust socially to growing integration, which is in the basis of their economic viability.

The stress on the significance of the size of a state is not excessive because this characteristic stands for a number of others that may be considered to be important for

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<sup>5</sup> See Easterly and Kray (1999).

<sup>6</sup> It is, however, well known that capitalism on the local or municipal level in large states may be quite similar to that which can be found in small capitalist states.

the viability of a state in the economic sense. For instance, it can be expected that a large state will be endowed with diverse factors of production and that it can supply a diverse set of products thus satisfying the needs of its consumers. Also, it may be expected that it will not be constrained by its geography, so that it will not be cut off from the world markets.<sup>7</sup> Thus, it is believed that the access to a sea is quite important for development and a small state may have more chances to be landlocked than a large one. On the other hand, the access to a sea contributes significantly to the viability of a smaller state.

For these reasons, it is important to concentrate on the size of a state. Indeed, size matters in a number of other ways and not only for economic reasons. Socially, politically and culturally, size matters in more ways than one, and as these factors have economic consequences, it matters for the economy of a state in these indirect ways also.

### **Economic Regime and Policy**

Other criteria than size, however, are also important. Those are connected with the functions that a state has usually to perform. Those are connected with the supply and the regulation of the economic regime and there are also those that are connected with economic policy, both in the short run and in the longer run. The latter include, among others, monetary, fiscal, and the policy of regulation. How are these policies connected with the viability of a state?

The discussion of the monetary viability of a state has been mainly coached in the terms of the theory of the optimal currency area.<sup>8</sup> A state should have its own currency if it can be described as an optimal currency area. Such a state may not only have its own currency, but it may also rely on flexible exchange rates with the other currencies. There is no reason here to go deeper into these issues.<sup>9</sup> It is enough to say that the fact that a state is not an optimal currency area does not necessarily imply that it should not have its own currency or that it has to rely on fixed exchange rates with the other countries. Indeed, most of the countries in the Balkans cannot be considered to be optimal currency areas, but that does not necessarily mean that they should give up their local currencies. Also, the fact that they may indeed join a currency union, as the standard theory of optimal currency areas would suggest, does not mean that they are not viable as states.<sup>10</sup>

The significance of the fiscal regime and policy for the viability of a state in the economic sense is another matter, however. It is difficult to have a viable state that cannot pay its own bills and has to depend on one or another source of aid. Of course, the fiscal viability of a state is not always easy to determine. A state may be in default on its foreign and its domestic obligations (as is currently the case with Serbia), but that may be temporary. Also, a state may rely on aid for a while until it manages to put up a viable fiscal system and starts running a viable fiscal policy (as is the hope in Bosnia and Herzegovina). But it is obvious that a long-term dependence on external sources or on the confiscation of domestic resources (either through high inflation or through defaults) will rise serious questions about the economic viability of a state.

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<sup>7</sup> On the importance of geography for development see Galup and Sachs (1998).

<sup>8</sup> The classical statement is in Mundell (1968).

<sup>9</sup> The idea has become controversial with the author though less so with the other practitioners of international economics and international political economy

<sup>10</sup> This implies that monetary sovereignty does not belong to the proper notion of the sovereignty of a state.

Finally, the policy of regulation may be important for a state, especially if the state is small. The issue here is one of efficient allocation and of corruption. Regulation has become extremely sensitive as the experience of privatisation in transition countries underlines the problems that are associated with it. More often than not, laws and other regulation will be drawn not so much with the public interest in mind, but in conformity with the so-called special interests. There is no doubt that the economic and indeed every other viability of a state depends very much on whether it can present an image of an agency that serves the public interest or rather the opposite image of the one that is captured by special interests, i.e., whether it is seen as fundamentally corrupt or not.

Therefore, the key to the viability of a state in the economic sense, at least as far as economic policy is concerned, is centred on its fiscal regime and policy and on the quality of its laws and regulations. These two basic political functions of a state constitute, together with the other aspects of regime and policy, the composite characteristic of public governance, the quality of which is certainly central to the viability of a state. Most of the criteria of viability have to be found there rather than in the more traditional ones that are connected with the abundance of the factors of production and the optimality of the economy in question.

### Criteria of Viability

From the above, the following, certainly incomplete, list of criteria of viability in the economic sense<sup>11</sup> can be derived:

1. Openness – the smaller the state the more open it should be, both in terms of foreign trade regime and in terms of actual level of foreign trade.

This is especially true for developing states. They have to borrow money to upgrade their production and have to pay for those with growing exports so that their external sector has to be relatively big as a share of those states' GDP.

2. Diversity – the smaller the country (up to a point) the more homogenous it should be.

This is a variant of the concept of optimality, but as it is not to be expected that a small state would be an optimal trading or currency area, the weaker concept of homogeneity has to be used. However, it is difficult to define homogeneity as a number of quite different and incommensurable dimensions may be involved.<sup>12</sup> Still, whatever it is and to the extent that it may present problems for the political viability of a state, it will be more visible in a small state than in a large state (but that may be sensitive to the development of the means of information). In other words, *ceteris paribus*, a smaller state is more sensitive to diversity than a larger state. This sensitivity may not directly threaten the viability of the state, but it will influence its policies. In general, it may be argued that a small, heterogeneous state would have to be open and rely heavily on consensual types of decision-making.

3. Responsiveness – the smaller the state, the more democratic it should be.

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<sup>11</sup> Viability in political, social and other senses is not discussed here, at least explicitly.

<sup>12</sup> Here I do not have in mind primarily the ethnic or similar criteria of diversity. I have in mind the diversity or rather homogeneity of public preferences as well as of the production structure. Discussing the issue of ethnic (whatever that may be) homogeneity as a condition for the viability of a state (at least in Europe), Timothy Garton Ash (1999) argues that the share of the majority ethnic group in total population should be at least 80% for that state to be politically viable. He gives no reason why this should be so and how are the exceptions to that rule, that certainly exist in Europe, to be explained.

Responsiveness stands for the ability of the state to reveal legitimately the political preferences of its population. Smaller states may be more sensitive to corruption and to the capture of the state by special interests. To the extent that this is the case, legitimacy is more important in a small state than in a larger one. In current political circumstances, legitimacy is secured the best in democracies.

4. Public governance – legality and rule-based policy generally should be conducive to the viability of a state in the economic sense.

This criterion is, again, more important for smaller states because they tend to have bigger governments, *ceteris paribus*. Therefore, bad public governance makes it more likely that the state will indeed fail to deliver the desirable economic policies.

5. Self-government – a state is more viable if it offers opportunities to all its inhabitants.

This is not to be confused with either the concept of sovereignty or with the concept of self-sufficiency, as both are not directly applicable to the notion of viability in the economic sense. But, a state cannot be viable in the economic sense if it cannot provide for a decent level of employment. Indeed, it may be argued that smaller states, for a number of reasons, should have lower unemployment rates than a bigger ones to be economically viable.

Some of these criteria could be formulated in the either-or manner, but are in fact to be taken in degrees. This is so also because it is not the case that these criteria are to be seen as either necessary or as sufficient conditions for viability in the economic sense. Obviously, an autarky, like the former socialist Albania, is not to be judged to be viable, but that does not mean that it did not provide for some kind of economic life of its citizens. In that sense, economic viability is almost trivially satisfied by more or less every political entity. Therefore, economic viability has to be defined more precisely. The criteria listed above taken together imply an economic system that is sustainable, self-governable and developing. Thus, it may be the case that a state may in fact fail, not only politically but economically too, if it does not satisfy some or all of these criteria. In other words, the criteria listed above allow for economic non-viability as well as for viability.

How is non-viability to be defined? One way is by pointing to an example. Certainly Kosovo today is an example of a non-viable political entity. It fails to satisfy any of the above criteria under any reasonable interpretation of those. This is pointed out here only in order to be made clear that the question of the viability of Kosovo in the economic sense is not to be tested simply by inspecting the current economic situation in Kosovo. Indeed, the above criteria should be checked against the reasonable expectations about the economic development of Kosovo given the circumstances as they are now, given the economic potentials and given the political circumstances in which Kosovo will most probably find itself in the future.

### **Kosovo as It Is**

The description of the current economic circumstances in Kosovo is not an easy one because it has still to be based more on anecdotal than on proper statistical evidence. It is however clear, as has already been stated, that, as a political entity, it is currently not economically viable. This conclusion can be arrived at even without checking the current situation against the list of characteristics drawn up above. Clearly, the key goal in Kosovo is its economic reconstruction and Kosovo cannot finance it on its own. In addition, even the day to day functions of the public institutions have to be financed from

international aid. Finally, Kosovo lacks almost all the instruments necessary for self-governance.

The more detailed description will not change the above judgement. Though the resourcefulness of the population in Kosovo has impressed the international observers, it is undoubtedly the case that not even quite elementary needs can be satisfied without the international help and aid. Thus, aid is needed to get the population through the winter in terms of housing, heating, food and of course all the other social and public services. In the following years, it is contemplated that quite significant investments will have to be made in more or less all the productive economic sectors as well as in the utilities in order to put Kosovo on the path of sustainable development.<sup>13</sup>

At this moment, however, it is not at all clear whether Kosovo is economically viable even in the limited sense of the ability to absorb in the proper way the international and domestic efforts at reconstruction. This is so because of the still precarious security situation in Kosovo, but also because of the lack of legal and legitimate institutional infrastructure. Both obviously cannot be substituted with either institutional or monetary aid.

This problem is aggravated by the fact that there are quite a number of uncertainties that surround the current security, political and economic arrangement in Kosovo. The basis of the current effort is the resolution by the Security Council of the United Nations which, however, does not provide for a clear-cut resolution of the political status of Kosovo. Even if it can be assumed that the current mandate of the international presence in Kosovo could be prolonged as long as it may happen to be necessary, the uncertainty about the final status of Kosovo will weigh heavily on its economic viability.

Looking at the current situation more concretely, the economic non-viability of Kosovo can be expressed in the following way:

- people rely on international aid even for their everyday subsistence,
- the trade and current account deficits, which are not precisely known at this point in time, have to be financed from international donations,
- public services are financed also from international sources,
- recovery of all economic activities, except when it comes to trade and some services, is yet to happen.

The barriers to reconstruction and recovery are easy to determine. Checking against the criteria of viability listed above, it is obvious that:

- Kosovo is not an open economy, but an aid and subsistence economy,
- it is not homogeneous because of a number of conflicts that persist and do not seem to be disappearing quickly,
- the responsiveness of the institutions is practically non-existent because the entity is run in paternalistic manner,
- public governance is poor or non-existent due to quite a number of factors that will be discussed in more detail below, and
- self-government does not exist either *de facto* or *de jure*.

This judgement, i.e., that Kosovo is currently not economically viable should not come as a surprise. Indeed, the current international financial involvement is pretty much presumed on it. It is also not the case that Kosovo is a striking exception in the region. Most of its neighbours are also not economically viable, though often to a lesser degree than Kosovo. This is true of Albania, Bosnia and Herzegovina, Montenegro and Serbia, and to a lesser extent of Macedonia too. In fact, most of the region is on shaky grounds

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<sup>13</sup> For details see World Bank (1999).



when it comes to the economic viability. However, this regional aspect of viability will be picked up later in this paper.

### **Kosovo as It Was**

Viability is path-dependent. In other words, if a country was economically viable, it can be expected that it will remain viable. Of course, the case of former Yugoslavia is a counterexample, in some sense. This is, however, not the case for all the successor states of former Yugoslavia. Though economic viability is not necessarily assured for some of those, it seems to be the case that some of them have proven that indeed they have inherited a viable economic system from former Yugoslavia.<sup>14</sup> Again, looking backwards, it can be argued that these then republics of former Yugoslavia had viable economic systems even when they were members of the Yugoslav federation.

This does not seem to have been so in the case of Kosovo. Most of the disequilibria that exist now have been present in the past too. This is not the place to review the economic history of Kosovo. However, there is no doubt that most of the criteria of viability listed above were not satisfied by Kosovo throughout the post-World War II period. This is not to say that there was no development and growth in Kosovo in that period.<sup>15</sup> On the contrary, quite a marked transformation went on there in the last fifty or so years. However, this economic development was excessively dependent on certain features of former Yugoslavia that made that country in the end politically non-viable and thus also economically non-viable.

For one thing, Kosovo depended on the rest of former Yugoslavia for budget-support. Though it is difficult to say how much of total public expenditures in the province were financed from the Serbian and the Yugoslav budgets, a conservative estimate would put that at more than 25%. Thus, Kosovo was not fiscally viable.

For another thing, the unemployment rate was constantly higher in Kosovo than in the rest of Yugoslavia reflecting the high rate of population growth. As a consequence, the outward migration from Kosovo was significant in the whole period.

Finally, Kosovo depended a lot on the transfers from abroad, on workers' remittances, to close the gap in its trade within former Yugoslavia and with the outside world. These remittances have continued to play the key role in the nineties and are to be expected to continue to play a significant role as they also continue to do in the rest of the so-called Western Balkans.

Other criteria of viability were also not satisfied by Kosovo in the past for reasons that are quite important. To quickly clarify what I mean, I will make a comparison between the development in the other former-Yugoslavia republics with that in Kosovo. One can distinguish between two types of post-Yugoslav developments. In the case of Slovenia and Macedonia, there was certain continuity in the process of nation building in former Yugoslavia and in the years after these countries became independent. Certain, though much more tenuous, continuity can be detected in the political development of Croatia and even in the case of Montenegro. In the case of Serbia and Bosnia and Herzegovina, there was a discontinuity that led to the sharp change in the process of

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<sup>14</sup> As I argued in Gligorov (1994), former Yugoslavia was conducive to the process of nation building that was going on in the republics of which it consisted.

<sup>15</sup> Some information can be found in Riinvest (1998)..

nation building in Serbia and Bosnia Herzegovina (in the latter case it may be more appropriate to speak about the process of nation destruction rather than building).

In the case of Kosovo, the process of nation building was less continuous throughout the post-World War II period.<sup>16</sup> In the nineties, the shadow president of Kosovo, Ibrahim Rugova, followed the policy of continuity, relying on the institutional resources inherited from former Yugoslavia. Given the overall position of Kosovo as a province in Serbia in the nineties, a set of parallel institutions developed which again had hard time to acquire legitimacy due to the fact that they could not rely on legal institutions. This policy failed, however, for variety of reasons, and Kosovo has to start the process of nation building more or less from scratch.

As a consequence of these series of failures at nation building, Kosovo faces quite challenging tasks in its attempt to establish itself as a self-governing entity with the appropriate institutions of public governance. Given the history of failures, there is no guaranty that this time around it will be successful. Indeed, the chances should be evaluated realistically, because the current process of nation building is to develop in circumstances that may turn out to be quite similar to those that the province faced in former Yugoslavia and in Serbia. Today as before, Kosovo will have to develop at least partly as a parallel polity and society. The circumstances may change, but they may also prove to be even more challenging then they were before.

In any case, this brief survey of the economic viability of Kosovo in the past points to the fact that, unlike in the case of some other former-Yugoslavia states, Kosovo cannot rely on favourable path-dependence in its institutional development. Indeed it may have to face the continuation of unfavourable political circumstances. Because of that, the process of nation building may not be smooth and successful. It is not really warranted to presume that Kosovo will prove to be economically viable given the history of failures and given the current political circumstances.

## **Kosovo as It Could Be**

Not only viability, but non-viability is path-dependent too. Still the case that Kosovo has never been a viable economic entity does not necessarily mean that it could never be. For this to happen, however, some of the economic listed above have to be satisfied. Also, some political conditions have to be satisfied. That this is the case can be made clear by pointing to the experience of Bosnia and Herzegovina. There, the political conditions are certainly such that they do not provide for economic viability, and indeed this is still economically a non-viable state. Reading the documents of the Dayton agreement, it becomes obvious that the provisions made there do not meet the criteria for economic viability even if those were to be strictly implemented. It is, however, generally recognised that four years into the Dayton peace process, the implementation of the agreements has been incomplete at best and has failed if assessed realistically.

Looking at the existing projects for the reconstruction and the future development of Kosovo, it is fair to say that those presume but do not imply the future economic

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<sup>16</sup> The literature on that is large. There is no point to review it here.

viability of this political entity. For Kosovo to have a viable economy it has to satisfy at least two conditions out of those listed above:

First, it has to be integrated with the economies in the region at least in terms of trade and financing.

Second, it has to be a democracy, i.e., a system of popular sovereignty has to be put in place and institutionally secured.

The second condition cannot be satisfied as long as Kosovo is not a state or is not included in a state. This is not the place to enter the discussion on what is a state and what is meant by sovereignty. However, democracy is impossible without the sovereignty of the people and that sovereignty has to extend at least to the legislative branch (how it should extend and what is the relationship between the national and the international law is another matter).

The first condition is not satisfied now and it is difficult to see how it is to be satisfied in the near future given the unresolved conflict between Kosovo and Serbia. Given that the current political settlement does not resolve this conflict and does not even give an indication as to how this conflict is to be resolved, it is to be expected that the first condition will not be satisfied in the near future too.

It is of course possible to speculate about the economic viability of Kosovo under possible political arrangements. Those speculations would also clarify further the possible economic developments in this political entity.

Albanisation. It is possible that with or without the formal political integration between Albania and Kosovo the latter will be albanised in the sense that the economic and the political regime as it exists in Albania today may prevail in Kosovo too. This warrants a discussion of the economic viability of Albania, which cannot be entered into here. Still, it is safe to say that Albania is certainly far from being an example of an economically viable state. On more or less all the counts of viability mentioned above, Albania fails. However, Albania has an advantage over Kosovo in that it is formally a state. So, chances are that the albanisation of Kosovo will produce even less economically viable state of affairs than in Albania itself.

This does not mean that the possible greater Albania, consisting of Albania proper and of Kosovo, may not be economically viable. As argued at the begging of this paper, more or less any political unit may be economically viable if it satisfies certain conditions, some of which have been discussed above. However, a rather long process of nation building should be envisaged during which the economic viability of the new state cannot be assumed.

Protectorate. It is possible that the current political status of Kosovo is extended into the future and it is run as a *de facto* protectorate. In that case, one can be sceptical about the economic viability of Kosovo. There is no logical necessity that a protectorate cannot be economically viable, but the odds in this case are rather unfavourable. This scepticism casts doubts over the programmes for reconstruction and development of Kosovo which effectively assume away that this will be a self-governing political entity.

European integration. Not only in the case of Kosovo but also in the case of Albania, Bosnia and Herzegovina, Macedonia and even in the case of the other post-socialist Balkan countries, economic viability is presumed on their membership in the European Union. This option has to be treated with care.

It is certainly true, as argued in this paper, that integration is an important condition for the economic viability of a small nation. However, in the case of the European Union, the accession to the membership in the Union is conditional on the aspiring state being economically viable. That requirement is meant to serve as an incentive for the candidate states to run policies and introduce reforms that would be convergent with the European Union. In that, they can be expected to be helped by the Union, but it is not the case that the Union would be ready to take over the obligation to govern the process itself.

Because of that, it is essential to evaluate how strong is the incentive for integration in the case of Kosovo? Given the enormity of the task, it is fair to say that the prospect of Kosovo becoming a member of the European Union is a distant one (and it remains distant even if Kosovo joins Albania at some point). Thus, it can be safely concluded that the strength of the incentive of the prospective membership in the European Union for the current political and economic decisions in Kosovo is very small indeed. Thus, it should not be expected to contribute all that much to the viability of this province.

Independent state. This is not politically a viable option. It is not viable in the sense that it is time-inconsistent. What it means is that the today's commitment to an independent state of Kosovo will prove to be non-binding and thus unstable once this independence is achieved. At that point, the preference for integration with Albania will be politically preferable. Thus, this is really not a separate option and whatever was said about albanisation applies here too.

Other options. There are other options that are one or the other variant of the already discussed options. It can be noticed that the option of Kosovo remaining a part of Serbia is not considered because it is not politically realistic. This fact is not inconsequential for the economic future of Kosovo, however. As has been argued above, a small state can hope to be viable in the economic sense only if it is an open economy, i.e., if it is integrated within its region at least in terms of trade and financing. In the case of Kosovo, the additional consideration is the history of economic integration with Serbia and also the natural advantage of the access of the Serbian markets for Kosovo's products. That may not be seen as all that important at this moment because the economy of Kosovo is not even at the level of subsistence economy at this point. However, once production recovers, the availability of local markets will become quite important. Thus, in the future, the normalisation of relation with Serbia may be quite important for the economic viability of Kosovo.

This survey of the consequences of alternative political arrangements for the economic viability of Kosovo leads to a rather pessimistic conclusion that this may not be easily achievable. Indeed, bad or unresolved political problems can cast a long shadow over the economic prospects of a country. In the case of Kosovo, this is even worse because it is not at all clear how is it to become a state or a part of a state. All the other alternatives, as argued here, fall short of securing economic viability for Kosovo.

## **Regional Aspects**

If a region is economically viable, parts of that region are economically viable too. This may not be true literally, but it is close to being true. It seems reasonable to assume that it would be easier for Kosovo to prosper economically if the Balkan region is prosperous too. Unfortunately, this is not the case. The Balkans is still a depressed area. Indeed, the neighbouring countries of Albania, Montenegro, Serbia and Macedonia are practically the very centres of the depression. This being the case, the viability of Kosovo depends significantly on the viability of these other countries too. This is a rather distant prospect at this point. The economic take-off in the region can only come with the significant influx of foreign investment, but the area keeps attracting aid and aid agencies, rather than entrepreneurs and businesses.

Looking at the effects of aid and reconstruction efforts, the danger is there that Kosovo will be another aid-dependent economy rather than a self-sustainable and self-governing one. Though the amounts of money that are earmarked for Kosovo are not huge and are not being disbursed regularly, they are still significant taking into account the level of economic development of Kosovo. If the money spent on the consumption of the forces and agencies operating there are taken into account, there is no doubt that this is a serious shock to the local economy.

The effects of this shock on the neighbouring states are similar to those in Kosovo, though the degree of the shock may vary. On one hand, the structure of the local economies is changing rapidly in the direction of de-industrialisation and the growth of services and the increase in the share of agriculture. On the other hand, incomes of the population are being supported through aid and the consumption of the international people. The key problem with these developments is that these sources of income and employment may become necessary conditions for the viability of the local economies. In other words, they may not be viable once aid and international presence have to be discontinued.

In this context, the regional approach of the European Union and also of the so-called Stability Pact has yet to make a difference. These initiatives are still structured in such a way that security issues are more important than the developmental ones. The same is true for the international efforts in Bosnia and Herzegovina. Because of that, they cannot be expected to have a decisive influence on the economic viability of either the particular states in the Balkans or of the region. It is to be hoped that they will develop in that direction, but it is difficult to see at this moment how is that to be done.

### **Kosovo as It Should Be**

There is a difference between discussing the issue of Kosovo's economic viability while taking into account the national and international constraints and looking at it as if these constraints can be changed. It does not make sense to slip easily from the one into the another. In this case this would be theoretically extremely easy indeed, because all one needs to say is that Kosovo should choose such a political and economic arrangement that satisfies the criteria for economic viability. But how is this choice to be made is really the key issue. In the current circumstances it is not even clear whose decision is it to make? And even if the decision-makers could be identified, it is still not clear whether there is a valid procedure for this kind of decision making and whether the international procedure of decision-making, if it were to be found, could be trusted to produce a decision, let alone a satisfactory decision. For the latter, there has to be an agreement

between the countries and peoples directly concerned, a consensus in the region, and an international approval. In that case, Kosovo can be afforded the political status that may enable it to start building the regime and policy infrastructure for a viable economy.

Such an agreement is not in the making at this point. The second best solution is to let the process of nation building to proceed and to try to influence it so that it will develop in the desirable direction. The issue here is whether the international community has the necessary instruments of influence. The set of conditionalities that the European Union, the International Financial Institutions and the other international and regional organisations and initiatives have at their disposal is not sufficient to guarantee the positive result and may not even be consistent and coherent. Thus, the process of nation building in Kosovo and in Albania may not converge to economic viability, at least within the relevant time horizon.

Climbing down one more step closer to reality, it should at least be expected that the process of restructuring would proceed in a reasonable manner. This is in keeping with the current approach of the international community to put off the resolution of the most fundamental problems and to concentrate on security and reconstruction. This approach, as already stressed, presumes that Kosovo will not be economically viable for quite some time and looks for solutions that are appropriate for such a situation. In that context, it should be expected that trade, financial, monetary, fiscal and regulatory regimes and policies should be designed that would approximate the criteria for economic viability if they would not immediately satisfy those. It is too early to say whether the steps taken so far are in conformity with such an aim.

These comments were intended to highlight the fact that normative thinking about Kosovo is a messy affair. Decisions have to be made about the monetary system, about the fiscal system, about the trade system, about the legal systems and the like, which almost by design exclude the first best solutions. In such circumstances, it would be at least desirable that those who are going to bear the costs make the decisions. This is also excluded more or less by design. Thus, only paternalistic solutions remain, and those are as a rule inferior even if a determined and benevolent despot makes them. In this case, however, the determination is questionable, benevolence is difficult to define and there is a plurality of despots. It is undoubtedly challenging in these circumstances to advise on what should be done.

## **Conclusion**

In this paper, I have argued the following:

First, the size of an economy is not relevant for its viability at last in a world of free trade and democracy.

Second, size matters for the way that the economic viability can be achieved and may constrain the design of the economic system.

Third, a small state or economic area like the Kosovo one has to be open, homogeneous, democratic, accountable and self-governing.

Fourth, that Kosovo does not currently satisfy these criteria and has never satisfied them in the past.

Fifth, that the current political set-up and the most likely future developments will not guarantee that these criteria of viability will be satisfied any time soon.

Sixth, that the countries in the region and the region as a whole may be facing the problems of economic viability, though for different reasons.

Seventh, that international aid and overall effort are constrained in the same way as the Kosovo and have additional problems of their own.

Eighths, that outside of the utopian world, it is difficult to advise any of the actors about the best course of action.

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