

# POLITICAL AND ECONOMIC INSTITUTIONS AND ECONOMIC PERFORMANCE: EVIDENCE FROM KOSOVO

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## Abstract:

*This study examines Kosovo's attempts to create efficient political and economic institutions while assuming that if these institutions cannot perform well and the market economy will also fail. Thus, the main aim of this paper is to understand the reasons behind institutional and economic failure. A qualitative research approach that we used is based on a longitudinal perspective and a set of secondary data which are analyzed by using Qualitative Content Analysis technique. Our findings suggest that the state-building period which was administrated by the international organizations created problems such as polarizations in views, duality and imbalance in power distribution and illegitimacy of the governing institutions. These problems are more or less reflected in other institutions in the following independence period. Moreover, due to continuing and deepening political fragmentation and tension amongst the local parties, attempts to create well-functioning and supporting institutions have not yet produced fruitful results. With such institutional performance Kosovo has not yet been able to create a functioning market economy and to overcome economic challenges.*

**Keywords:** *political institutions; economic institutions; economic development; Kosovo, qualitative content analysis.*

**JEL Classification:** *P20, O430, O10*

## 1. INTRODUCTION

In the literature on transition economies, numerous attempts have been made to examine the relationship between institutions and economic development (Knack and Keefer 1995, Keefer and Knack 1997, Keefer and Knack 1998, la Porta et al. 1999, Aron 2000, Efendic and Pugh 2007, Efendic, Pugh, and Adnett 2011, Sobel and Coyne 2011, Vitola and Senfelde 2015). By applying cross-country quantitative research approaches, these studies concluded that differences between the levels of economic development amongst countries could be attributed to the effectiveness of the institutions and certain country-specific mechanisms such as the protection of property rights, the rule of law, and the private sector development (Knack and Keefer 1995, Keefer and Knack 1997, Keefer and Knack

1998, la Porta et al. 1999, Aron 2000, Sobel and Coyne 2011). Along with the importance of the institutions in determining economic performance, the critical

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role of reforms in the reshaping of such institutions is also documented (de Melo, Denizer, and Gelb 1996, Roland 2000, Svejnar 2002, Redek and Sušjan 2005). However, the literature within the context of transition economies suggests that not all countries succeeded in building a competitive market economy due to the failure in implementing necessary reforms, in providing stable institutions, (Redek and Sušjan 2005) and in creating clear rules of the game (Burki and Perry 1998, Redek and Sušjan 2005). The path chosen by the government for the reforming process, and the speed and quality of the implementation of reforms are also of crucial importance in establishing a performing market economy (Redek and Sušjan 2005).

Studies examining the impact of institutions on economic development within the context of transition economies mainly focus on economic institutions such as reforms, levels of economic liberalization (de Melo, Denizer, and Gelb 1996) and on political, judiciary, financial, and regulative institutions (Svejnar 2002, Redek and Sušjan 2005). The findings of these studies support the early evidence that "institutions matter" for economic development, and therefore, institutional effectiveness determines the performance of the economy (Knack and Keefer 1995, Keefer and Knack 1997, Sobel and Coyne 2011). Therefore, one can assume that it can be assumed that if institutions fail, the economy will also fail.

However, in the literature, there is a gap with respect to identifying the factors and explaining the processes that generate inefficient institutions and lead countries to poor economic performance. This gap is also evident in examining the relationship between institutional change and economic development over time by using single country case studies (Chang 2011). Hence, this study attempts to contribute to the literature by investigating the institutional circumstances that led Kosovo to poorer economic performance in both state-building (1999-2007) and independence periods (2008 onwards). Alston (1996) and Alston (2008) argued that although quantitative measures might explain the causes or consequences of institutional change on economic performance, better explanations can be derived from qualitative studies using historical records as evidence. For this reason, this study was designed as a qualitative study to explain Kosovo's unique experience of designing, implementing and managing political and economic institutions by using multiple sources of documents which reflect the views of the main players that have shaped Kosovo's institutions since 1999. The scope of this study is therefore limited to the policy-makers'

attempts to design and implement political and economic institutions in Kosovo and to identify the reasons of the failure of creating well-functioning institutions.

The expected contributions of this article are threefold. First, as a newly independent state, Kosovo<sup>1</sup> is one of the least studied countries both amongst the Balkan and transition economies. Hence, it is hoped that this study will provide a ground and stimulate other studies on similar subjects. Second, compared to other transition economies, the case of Kosovo is unique where the institutions were built from the ground with the involvement of international actors led by the United Nations Mission in Kosovo (UNMIK) (Hehir 2009, Ernst 2011, den Boer and der Borgh 2011) that had full authority upon Kosovo's institutions (Gow 2009) during the state-building period (1999-2007) and a crucial role during the independence period (2008 onwards).

Third, many studies in the transition economies literature apply quantitative research approach by using cross-country data (e.g. Acemoglu, Johnson, and Robinson 2002, Rodrik, Subramanian, and Trebbi 2004, Hall and Jones 1999) or panel data (e.g. Efendic and Pugh 2015) We preferred a qualitative research strategy. To this end, we used secondary documentary data set and focused on a single-country since we suggest that there are many country-specific factors in explaining the success and failure of political and economic institutions that can only be understood within their own specific context. Moreover, qualitative studies based on secondary data allow the researcher to apply longitudinal research which is appropriate to examine the reasons for the failure of institutions and institutional change at a relatively long range.

The structure of this article is as follows. First, a brief literature review was performed regarding the impact of political and economic institutions on economic development. Second, information about the economic situation in Kosovo during the Yugoslavian period was provided. Third, the research method, the data and the findings are displayed. Fourthly, implications of the findings and a theoretical discussion are provided. Finally, conclusions and suggestions for the future researches are presented.

<sup>1</sup> Kosovo declared independence from Serbia in 2008. Since then its independence was recognized by over 100 countries around the globe. However, there are other countries from the region such as Serbia, Bosnia and Herzegovina, Greece and the rest of the world including Russia, China and Spain that still refuse to recognize Kosovo's independence

## 2. BACKGROUND AND A COMPARATIVE OUTLOOK OF KOSOVO'S ECONOMY

Historically, Kosovo's economy has always depended on mining and agriculture. Its main products were either directly exported mostly to Soviet Union or transferred to other regions of Yugoslavia as raw materials. Hence, Kosovo had never been a main production center during the pre and post-World War II periods in Yugoslavia. For example, the city of Trepca has rich lead, silver and zinc reserves and almost all of its mines were directly exported. Although in the first 5 year plans of post-war Yugoslavia efforts made to develop manufacturing production in Kosovo and over the years, investment in rubber, smelter and ferro-nickel plants were made, and a lignite burning power plant was built in near Pristina, Kosovo's economy had always been dependent and underdeveloped.

Agriculture is the other major industry for Kosovo's economy. Historically, Kosovo was important for cereal and meat production. In the 1930s, with the introduction of more fruit and vine cultivation, Kosovo's agricultural production base was broadened. In addition, subsistence farming continued as a mainstay of many family economies. Taking both agriculture and mining industries into account, Kosovo had never been a production center during the pre and post WW II Yugoslavia periods. Hence, even in Titoist Yugoslavia, Kosovo had the lowest levels of development and the average income of its residents was much less compared with the rest of the Yugoslavia (Pettifer 2005, p. 1-5), and as Table 1 indicates, there is not much change in its present situation.

Kosovo has the lowest per capita national income and highest unemployment rate compared to neighboring and other selected transition economies. It has the poorest exporting performance and cannot attract sufficient amount of direct foreign investment.

## 3. INSTITUTIONS AND ECONOMIC DEVELOPMENT IN THE LITERATURE

Institutions strongly affect the economic performance of countries by providing the rules and mechanisms in which economic transactions and exchanges occur (North 1990, Pejovich 1999, Harriss, Hunter, and Lewis, and 1995, Keefer and Knack 1997, Aron 2000, Engerman and Sokoloff 2005, Acemoglu and Robinson 2010, Acemoglu, Johnson, and Robinson 2005, Sobel and Coyne 2011). The definitions of institutions vary, such as "the formal and informal rules of the game in a society" or "the humanly devised constraints that shape human interaction..." (North 1990, p. 3). To reduce uncertainty, institutions build clear

rules of the game. They provide efficient measurement to enforce regulations (Furubotn and Richter 2010, Williamson 2009) through mechanisms that are exerted by the government (Sobel and Coyne 2011) including codified legal and political structures, written laws and other (Harriss, Hunter, and Lewis 1995).

The gap between poor and rich economies, and the reason why poor countries cannot 'catch up' (Keefer and Knack 1997) is related to the strength of the institutions that deal with the market (Harriss, Hunter, and Lewis 1995). Inevitably, if the market fails, the state also fails (Khan 1995). Therefore, institutions do matter, (North 1991, Keefer and Knack 1997) as they determine the performance of the economy, together with other factors such as the protection of property rights, and the costs of information that direct the economy into productive or unproductive activities (North 1990). These institutions are interconnected in three categories: a) the political institutions that represent the governance structure and individuals' rights; b) the economic institutions that ensure the effectiveness of the protection of property rights and contractual enforcement; and c) the other institutions that provide enforcement mechanisms such as judiciary and the police (Pejovich 1999).

Political institutions are "formal arrangements for aggregating individuals and regulating their behavior through the use of explicit rules and decision processes enforced by an actor or a set of actors formally recognized to possess such power" (Levi 2008, p. 405). The role of these institutions is to determine and modify individuals' behaviors and motives and to prevent individuals from acting independently from institutional interests (March and Olsen 1989, p. 4) by creating a hierarchy within the society in terms of having the right of decision-making and power of constraining inappropriate behavior (North 1990).

Political institutions have a strong impact over the economic ones, where individuals who hold the political power attempt to shape economic institutions and the distribution of resources in their favor. However, the way that they are organized, such as democracy, dictatorship or autocracy, determines the strength and nature of their relationship with economic institutions (Acemoglu and Robinson 2010, Acemoglu, Johnson, and Robinson 2005). Nevertheless, whatever forms they take, one lesson learned from the political systems is that they tend to survive by producing inefficient rules of the property rights to control powerful interest groups (Acemoglu and Robinson 2010).

Economic institutions are "collective choices, which are chosen and sustained by the state" (Acemoglu, Johnson, and Robinson 2005, p. 451). These institutions are designed to protect property rights and

**Table 1:** Comparative position of Kosovo in selected macro variable amongst selected transition economies

Country/Variables	2013	2014	2015	2016	2017
<b>Kosovo</b> *¶					
GDP p.c.a	3,877	4,054	3,574	3,697	3,893
FDI inflow net	371	199	343	243	324
Exportc	337	372	373	355	436
Unemploymentd (%)	30,09	35,30	32,90	27,5	30,7
Transparencye ,Max. 100	33	33	33	36	39
<b>Bosnia and Herzegovina</b>					
GDP p.c.	5,042	5,204	4584	4,808	5,108
DFI inflow net	313	544	371	272	434
Export	5,687	5,982	5,099	5,327	6,366
Unemployment	27,45	27,52	27,69	25,06	25,56
Transparency	42	39	38	39	38
<b>Hungary</b>					
GDP p.c.	13,667	14,201	12,483	12,820	14,224
DFI inflow net	-3,772	12,886	-4,919	69,816	-14,834
Export	108,014	112,536	100,296	103,071	113,382
Unemployment	10,18	7,73	6,81	5,11	4,16
Transparency	54	51	51	48	45
<b>Macedonia</b>					
GDP p.c.	5,211	5,469	4,834	5,163	5,442
DFI inflow net	402	60	296	549	430
Export	4,298	4,964	4,489	4,784	5,670
Unemployment	29,0	28,03	26,07	23,72	22,38
Transparency	45	42	42	37	35
<b>Albania</b>					
GDP p.c.	4,413	4,578	3,952	4,131	4,537
DFI inflow net	1,254	1,150	989	1,044	1,033
Export	2,331	2,430	1,929	1,962	2,261
Unemployment	15,64	17,49	17,08	15,22	13,86
Transparency	31	33	36	38	39
<b>Bulgaria</b>					
GDP p.c.	7,674	7,853	6,993	7,469	8,031
DFI inflow net	1,989	2,068	2,707	1,656	1,656
Export	29,510	29,386	25,778	23,087	30,181
Unemployment	12,94	11,42	9,14	7,57	6,16
Transparency	41	43	41	41	43
<b>Serbia</b>					
GDP p.c.	6,353	6,200	5,237	5,426	5,900
DFI inflow net	2,060	2,000	2,345	2,355	2,879
Export	14,610	14,843	13,378	14,851	16,959
Unemployment	22,15	19,22	17,92	15,26	14,05
Transparency	42	41	40	42	41

\* Exports and Unemployment data for Kosovo collected from national sources, others international as indicated. <sup>a</sup> World Bank (000, USD); <sup>b</sup> World Bank (net annual inflow, 000,000 USD); <sup>c</sup> Trade Map-Int. Trade Stats. (000,000 USD); <sup>d</sup> UN, <sup>e</sup> Transparency International.

enforce the contracts that determine transaction and transformation costs (North 1990). Property rights mean “the rights of individuals over their own labor and the goods and services they possess” (North, 1990, p.33). Contractual enforcement, on the other hand, is “the rules that regulate contracts between ordinary citizens...between creditors and debtors or a supplier and its customers” (Acemoglu, Johnson, and Robinson 2005, p. 995). Hence, contractual enforcement as an

economic institution arranges any business transactions between two parties (North 1990, p. 5). For example, transaction costs are determined by how property rights are protected, whereas, production costs are determined by how effective contracts are enforced (North 1990, p. 33). Consequently, these institutions encourage/discourage innovation and production at the national level (Acemoglu, Johnson, and Robinson 2005), and they have determining effect

**Table 2:** Classification of Economic Institutions

Function	Example	Typical Formal Regulating Agency
Property Rights	Inheritance law Intellectual property rights Patents, copyrights	Probate registry Patent Office
Facilitating Transactions	Standards; contract law; dispute arbitration, public information on markets; Auditing and accounting conventions; Banking conventions; Insurance	Standard Bureaux; Civil courts; Arbitration Councils; Market Information Agencies; Professional associations; Bank Regulatory Agencies
Business Organizations	Law of companies and bankruptcy; Competition policy; Employment regulations	Register of companies; Commission on monopolies & mergers; employment tribunals

**Source:** Adapted from (Wiggins and Davis 2006, p. 3).

over economic development (Aron 2000). Supporting institutions are also important, and without them, main institutions cannot perform efficiently (Mair, Marti, and Gainly 2007). Additionally, the creation of a performing market economy depends on how well the institutions define and enforce rules of the game (Burki and Perry 1998, de Melo, Denizer, and Gelb 1996; Sobel, Clark and Lee 2007). Similarly, various studies examining Western Balkan economies also suggest that the failure to build clear rules of the game hampers entrepreneurship and lowers the ability to contribute to economic development (Williams et al. 2017, Krasniqi and Mustafa 2016, Aralica, Svilokos, and Bacic 2018) and prevents inward foreign investment (Dauti 2015, Estrin and Uvalic 2014).

Apart from political and economic institutions mentioned above, there are other factors which have strong effects over a country's economic performance. Amongst these are the accumulation of human and material capital, presence of skilled labor force and entrepreneurial talent, (North and Thomas 1970) and the ability of using advanced technology and producing efficiently (North 1990, Keefer and Knack 1997, Aron 2000, Acemoglu, Johnson, and Robinson 2005, Acemoglu and Robinson 2010). Furthermore, providing an uncorrupted legal system, (Boettke and Coyne 2009) building an independent judiciary system, and forming an effective government that encourages productive activities (Sobel, Clark, and Lee 2007) and reduces poverty (Redek and Sušjan 2005) by developing a competitive private sector are also important for achieving higher economic performance and creating wealth. However, any government intending to provide a fair access to finances (Burki and Perry 1998), a better fiscal policy (Bevan and Estrin 2004), and a fair competition environment (Smallbone and Welter 2001) inevitably needs to introduce radical institutional reforms. Such reforms which aim to build well-defined rules of the game must be inclusive of

all institutions and must be implemented consistently and simultaneously (de Melo, Denizer, and Gelb 1996, Pejovich 1999). However, proposing and implementing such difficult institutional reforms are unlikely to be successful in transition economies due to the lack of legitimacy, political will and stability (Dewatripont and Roland 1992).

Economic institutions mainly have potential effects over three factors that determine economic performance of a country by; a) attracting more investment both nationally and internationally; b) increasing technical innovation; and c) making economic and business organizations more effective and efficient (Wiggins and Davis 2006).

## 4. RESEARCH METHOD

### 4.1. Justification of the Research Strategy

In this paper, we relied on a qualitative research strategy and single country case study for several reasons. Firstly, Kosovo represents a unique case depending on its position of creating institutions as a newly independent state amongst other transition economies. Secondly, with respect to understanding complex situations such as the state-building, and gaining national independence, a qualitative case analysis has a better potential of reflecting the views of different actors and stake-holders in detail. Thirdly, there are ample quantitative research in the areas of transition economies, and therefore, we argue that qualitative researches can provide some alternative understandings (Stake 1995, Yin 2011).

### 4.2. Data

We used different sets of documents which represent the positions of international and national organizations that have played roles in shaping and governing

the political and economic institutions in Kosovo (see, Appendix Table A1).

#### 4.3. Data analysis technique: Qualitative content analysis (QCA)

Selected documents provided by different organizations comprise the data of this study. These documents are rich in nature, cover both state-building and independence periods and reflect the views of different sides (Coffey 2014) that played major roles in Kosovo's state-building and independence causes. Hence, by taking our research strategy into account, a Qualitative Content Analysis (QCA) is suitable for the purpose of this study. This data analysis technique is common in qualitative research settings and has been used in different disciplines (Graneheim and Lundman 2004, Skeith and Gonsalves 2017) and there are different definitions of it (Hsieh and Shannon, 2005). For this study, QCA defined as a technique for analyzing qualitative (non-quantified) data through the systematic classification process of coding and identifying themes or patterns to provide interpretation and understanding of the phenomena under study. Although there are various ways of applying QCA (Hsieh and Shannon, 2005), here we preferred pre-determined categories derived from the literature as described below. In this way, the main steps followed are: a) describing the material; b) defining the categories; and then, c) doing the coding. The categorization should be made directly in accordance with the aim of the study (Bowen 2009).

To do this, firstly, a critical literature review should be carried out in order to perform categorization.

Secondly, the documents collected for the study must be read and examined to decide which texts or parts of texts should be included in the analysis. Then, the links between categories, texts and ideas should be established carefully. All these steps should be in accordance with a well-defined and planned process (Mayring 2000). They will enable us to understand the data used (Schreier 2012) and how the data are reduced systematically, divided into coding frames, then into sub-categories, categories and the main category (Elo and Kyngäs 2008). By doing such categorizations and coding, it is possible to avoid a larger amount of material and 'cognitive' overload and to ensure that the collected material is suitable and that the diversity is secured by using different sources of documents (Schreier 2012, Schreier 2014).

#### 4.4. Trustworthiness of the Research

Trustworthiness is an umbrella term which includes credibility, dependability, conformability and transferability (Nowell et al. 2017, Coskun 2017). Credibility entails the internal validity and refers to building accuracy of findings and interpretation of these findings (Tobin and Begley 2004). Dependability questions the integrity and consistence of data collection, analysis and interpretation of a research (Lincoln and Guba 2013). This process requires the authors to be self-critical and accessible for internal and external dialogue (Tobin and Begley 2004). Conformability means avoiding any misconceptions and any interpretive imagination (Tobin and Begley 2004). Transferability, on the other hand, denotes to the generalizability of the study to other settings (Tobin and Begley 2004).

**Table 3:** Trustworthiness of this study

<p><b>Credibility</b></p> <p>To ensure internal validity and to avoid misinterpretation of the findings, we used direct quoting from the documents and discussed our findings with colleagues. The documents are accessible through official websites (Coskun 2017). If necessary, translation was made from Albanian into English.</p>
<p><b>Dependability</b></p> <p>Here, reflexivity required the authors to be self-critical (Tobin and Begley 2004). During the process of selecting documents, analyzing and interpretation of findings, the authors tried to ensure the neutrality by putting aside the ideological and other beliefs that might affect the research. However, in qualitative research paradigm, it is obvious that no researcher can guarantee to be fully objective.</p>
<p><b>Conformability</b></p> <p>Findings are directly quoted from the text to assure that they are free from our biases. We divided these findings into two periods to make some clarifications and comparisons.</p>
<p><b>Transferability</b></p> <p>We argue that findings of this study can be applied into 'political science', 'business management', 'property rights theory' and other similar contexts.</p>

**Figure 1:** Main Category, Category, and Sub-categories

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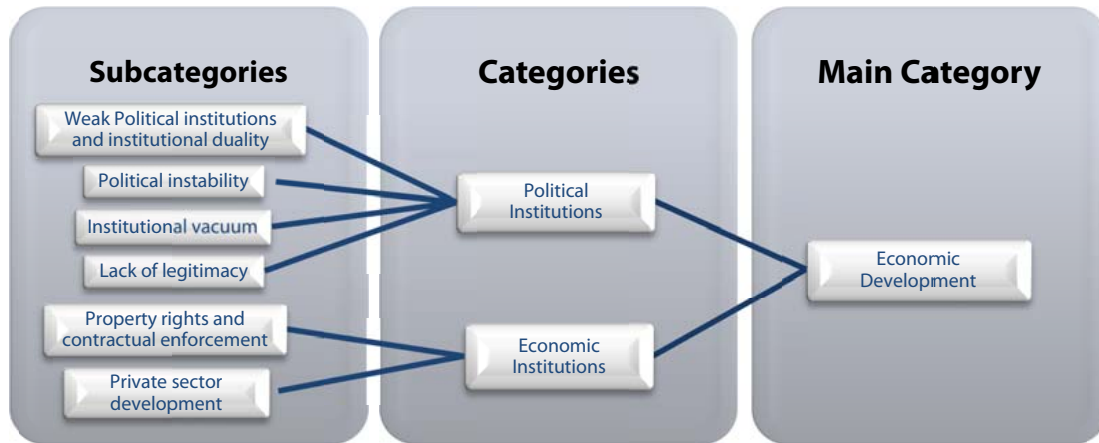


Figure 1 shows the steps we followed to analyze the data. Depending on a critical literature review, we firstly identified four sub-categories for the “political institutions category” and two for the “economic institutions category”.

**5. FINDINGS**

After reading and examining relevant documents, we found that there were such ample amounts of documents that they repeated each other in many cases.

Hence, we eliminated some texts that contained repeats or that were not directly related to the categorization. Then, we read the rest of the documents again and identified the quotes that were suitable and directly connected to the sub categories, and categories. Two measurements we applied in our preference of quoting were: Firstly, it should be as short as possible, and secondly, it should be powerfully connected with the category it resembles. Table 4 and Table 5 display the quotes.

**Table 4:** The QCA Results for the “Political Institutions” Category for the State-Building Period (1999-2007)

<b>Sub-Category: Weak Political Institutions and Institutional Duality</b>
“The Security Council, in its resolution 1244 (1999), has vested in the interim civil administration authority over the territory and people of Kosovo. All legislative and executive powers, including the administration of the judiciary, will, therefore, be vested in UNMIK” (U1:8).
“Economic policymaking...remains fragmented, visionless, and hobbled by failures in both Kosovo’s internal and external environments...from the Kosovo...business community to impose different import duties on raw materials and consumer goods are currently unheeded, both because policy responsibility is split between UNMIK and the PISG and because differentiating the duties would require a new layer of administration, vulnerable to abuse and corruption”(ICG2:38).
“UNMIK is now devoting most of its energy to producing a sufficiently convincing façade of standards implementation to allow Kosovo to pass the test that will open the final status process...Rather than orienting on state-building, UNMIK is mainly working toward its own escape strategy” (ICG3:28).
<b>Sub-Category: Political instability</b>
“As UNMIK advances the process of preparing for substantial autonomy under its mandate...This remains difficult owing to the highly fractionalized and fragmented political landscape along personal, as well as political and ethnic lines...The primary source of tension is the apparent inability...to reach agreement on co-governance, which has turned the initial...commitment to “constructive opposition” into non-cooperation in many areas...is a clear reminder of the continuing mistrust between the major Kosovo political players” (U7:1:2).
“...the Assembly has reverted to adopting declarations and decisions in areas which are clearly outside its responsibility in accordance with the Constitutional Framework. Among them was the Assembly’s approval of a recommendation of its Committee on Judicial, Legislative and Constitutional Framework Matters...Special Representative immediately declared the Assembly’s decision to be beyond its competence and without validity and effect...” (U18:3).
“Tensions between the governing and opposition parties have intensified...It is obvious that a further deepening of political rancor would impede movement towards the initiation of the political process needed to determine the future status of Kosovo” (U23:2).

<p>"These economic issues also have a directly political dimension, one that affects all aspects of structural and institutional development in Kosovo. Potential investors have been deterred by the fact that they do not know which jurisdiction will finally apply. They need to have confidence that a future change in political status would not put their investment in question or fundamentally alter the environment where they would be doing business. Controversies over ownership have a similar deterrent effect" (ICG1:ii).</p>
<p>"...Mutual distrust between the two leading parties...is distracting politicians from seeking a consensus position for the approaching negotiations on final status" (ICG3:I).</p>
<p>"Relations between the main Kosovo Albanian political parties have been strained and tensions between them mounting..." (EU1:10).</p>
<p>"...there were several cases of violence with political overtones" (U14:7).</p>
<p><b>Sub-Category: The lack of legitimacy</b></p>
<p>"...the process of internationally managed privatization in Kosovo is both unique and crystallizes central tensions of contemporary international state-building...Internationally led privatization in Kosovo gives rise to questions as to the legitimacy and legality of state-building when it interferes with the target's sovereignty and right to self-determination, as well as calling into question the appropriateness of state-building's economically liberal template"(KN:14).</p>
<p>"...Regardless of their genuine democratic legitimacy, the competencies of the PISG to express the will of the people of Kosovo in political decision-making processes are limited and subordinate to the powers of the Special Representative of the Secretary-General (SRSG). The SRSG has retained key "state-powers", such as foreign affairs, justice, public order and macro-economic development" (K:v).</p>

**Table 5:** The QCA Results for the "Political Institutions" Category for the Independence Period (2008-Onwards)

<p><b>Sub-Category: Political Instability</b></p>
<p>"...the polarization between government and opposition continued. Normal parliamentary functioning was prevented... including through the use of violent means by opposition members..." (EU13:4).</p>
<p>"Following the ruling of the Constitutional Court...the President of Kosovo stepped down and new elections were called for December...The election process was challenged from the constitutional perspective and the Constitutional Court played an important role through the way it exercised its responsibilities...a new President was elected in line with Kosovo's constitution. This period was marked by limited results on the reform agenda" (EU8:3).</p>
<p>"...the past year brought serious challenges due to the ongoing deep polarization between the government and the opposition. Divisions over issues such as the border demarcation agreement with Montenegro and the Dialogue with Serbia, dominated Kosovo's political agenda, leading to a protracted political stalemate..." (EU13:6).</p>
<p><b>Sub-Category: Institutional Vacuum</b></p>
<p>"The failure to constitute the new legislature smoothly and in a timely manner has been a setback. The new government and the Assembly will need to re-energize Kosovo's reform agenda. Both institutions need to build on the existing political consensus in Kosovo on EU integration" (EU11:2).</p>
<p>"...political leaders seem to lack interest in reforms, and the parliament does not thus far have the means to force the government to better assess the auditor's findings, find those who committed the mistakes or violated criteria, and take clear measures..." (BT14:30).</p>
<p>"...due to political inertia, lack of capacity and often inefficient administration, reform concepts were not implemented as readily as intended...government failed to implement an anti-corruption policy that led to convictions in cases of high-level political corruption...Political cooperation to speed up the reform process was often inhibited by disagreements" (BT14:29).</p>
<p>"The ongoing political polarization between the government and the opposition strained governance in Kosovo. There were also increased tensions in the governing coalition. Challenges in strategic planning at the centre of government hindered delivery on EU-related reforms and key areas of governance..." (EU13:8).</p>

As displayed in Figure 1 along with the "political institutions" category, second category is the "economic institutions". We applied the same procedure to our

documents to identify most suitable texts which resembled this category. Table 6 and Table 7 display the relevant quotes.



**Table 6:** The QCA Results for the “Economic Institutions” Category for the State-Building Period (1999-2007)

<b>Sub-Category: Property Rights and Contractual Enforcement, Transactions</b>
“A key task in the development of a free market system is the creation of a mechanism to protect the concept of private property...There are approximately 2,100 property claims currently under investigation...” (U7:8).
“...the illegal occupation of property, including agricultural land and commercial property continues to affect individuals’ rights to property and hamper economic development, the returns process and the establishment of the rule of law” (EU1:18).
“Use of the courts to resolve property issues remains underdeveloped. Corruption and uncertainty over property rights remain a major impediment to economic activity, due partly to Kosovo’s final political status being unresolved and partly to disputed land registries or missing business cadaster...the deficient rule of law is hampering business development” (EU3:27).
“Protection of property rights is fundamental both to facilitate returns and for Kosovo’s economic development...a fundamental obstacle to effective protection of property rights is the lack of a strategic, coordinated approach based on the rule of law” (U20:13).
“The Kosovo Property Agency was established...as an independent body and successor to the Housing and Property Directorate...the function to receive, register and assist the courts in resolving conflict-related private immovable property claims (including those related to agricultural and commercial property) to enforce the related decisions and to administer abandoned properties (U25:19).
“Courts need clear guidance on the mandate of the Kosovo Property Agency over conflict-related property claims...” (U29:16).
<b>Sub-Category: Private Sector Development and Business Environment</b>
“A private sector development plan has been developed and considerable progress has been made in drafting the necessary legal framework. In addition, the establishment of credit schemes for SME is advancing with the support of World Banking and EU” (U3:23).
“The economy is showing signs of a vibrant recovery, and preparations are continuing to revitalize and reform the private sector and to continue the development of a market economy” (U4:1).
“Private sector growth has benefited from generous inflows of funds from donors and the sizeable international presence, as well as remittances, primarily from Kosovo Albanians living abroad, thought to value €780 million per year” (U11:3).
“...Privatization is seen as an important means of generating economic development...The key aim is to attract investment...” (U11:3).
“...The privatization process represents a step along the road to a functioning market economy, and the interest which has been shown by regional and international investors in Kosovo is encouraging” (U17:15).
“...differences of view emerged as to the legal basis for the process and the operational policies governing the privatization of socially owned enterprises in Kosovo. After several weeks of dispute, the Kosovo Trust Agency Board...decided...to resume the privatization of all 23 enterprises ...” (U18:11).
“...Boycotts or non-attendance of meetings of the Board of the Kosovo Trust Agency (KTA) led to the inability of the Board to take decisions. Local board members also opposed adjustments to the operational policies of KTA to counter possible collusion and the involvement of organized crime in the privatization process...” (U19:13).
“Thirty waves of privatization have been launched by the Kosovo Trust Agency...with 545 new companies derived from the sale of assets of 312 socially owned enterprises. A total of 335 sales contracts have been signed and an additional 156 are pending signature” (U31:16).
“...International officials quickly made it clear that large-scale privatization of Kosovo’s enterprises would be the main economic strategy of the state-building operation. Accordingly, from 1999 to 2008...a massive privatization programme was incepted, shaped and managed in Kosovo by international state-builders” (KN1:12).
“...the nine years of internationally managed privatization as the main economic strategy of the comprehensive international state-building project in Kosovo has not improved the situation for the 44% living in poverty, the 14% living in extreme poverty, 28 or the 58% of women and 30% of men without employment...” (K:1).
“...socially-owned property still remains a mystery for the international officials involved in this issue” (K:v).

Sample evidences about the general outlook of the economic institutions in Kosovo during the independence period are provided in Table 7. Property rights and contractual enforcement problems remain as the major obstacles to the economic development of the

country. Corruption, lack of finance, underdeveloped infrastructure, weak sanction of law, unfair competitions are other issues impeding the establishment of a functioning market economy.

**Table 7:** The QCA Results for the “Economic Institutions” Category for the Independence Period (2008-Onwards)

<b>Sub-Category: Property Rights and Contractual Enforcement</b>
“...the institutional and legal framework has been strengthened but has led to limited progress in practice in the area of property rights...” (EU5:16).
“The weak enforcement of the property-related legislation is the major obstacle to protect and enforce property rights...” (EU7:18).
“Corruption, criminal activities and uncertainty over property rights remain major impediments to economic development. In general, use of courts for enforcement of contracts remains underdeveloped, while at the same time courts continue to face a heavy backlog of pending cases” (EU4:30).
“...The difficult and costly legal enforcement of contracts and prevalent corruption continued to hamper the business environment” (EU7:27).
“Weak enforceability of contracts remained one of the main concerns of companies and investors in Kosovo...” (EU8:28).
“Enforcement of intellectual property rights remains very weak...” (EU5:32).
<b>Sub-Category: Private Sector Development and Business Environment</b>
“The main barriers encountered by businesses in Kosovo remain the lack of a reliable supply of electricity, limited access to finance and insufficient rule of law...” (EU7:40).
“The most serious barrier in this category is unfair competition...fiscal evasion is considered to be close to 40%...followed by corruption...road crime and thief barriers...issues that relate to competition, or barriers to competitors’ non-competitive practices...” (R4:9:13).
“Services are the key component of Kosovo’s private sector. Enterprises tend to be very small and mostly family-run...The obstacles to private sector development are numerous, ranging from a weak rule of law, corruption and unfair competition to unstable electricity supply, unskilled labour force as well as difficult and costly access to finance” (EU9:18).
“...survey results show that ‘high cost of financing’...followed by ‘corruption’...lack of state subsidies’...competition non-fair... non-functioning judicial system...” (R5:31).
“A large informal economic sector, widespread corruption and weak rule of law are the main barriers to a functioning market economy in Kosovo...the complicated and costly procedures for opening or licensing a business function as an incentive to push economic actors toward the informal market...the informal economy persists and remains an important challenge for the country’s economic growth” (BT12:17).

## 6. DISCUSSION

Our findings suggest that attempts made to establish efficient political and economic institutions in order to create a functioning market economy in Kosovo has not yet produced the expected results as the business environment faces major institutional barriers. The failures of creating performing institutions and making necessary reforms that support these institutions produce a vicious cycle: when institutions are weak, the rules of the game cannot be defined and

enforced, and when there are no clearly defined and well-enforced rules, the market economy cannot perform, and when there is no a performing economy, institutions cannot be powerful enough to clarify and enforce the rules. This vicious cycle has been re-producing itself since the beginning of Kosovo’s struggle to become an independent state. As a result, the main problems pertaining to the institutions and the economy of Kosovo remain more or less the same.

### 6.1. *Dysfunctional Institutions and a Failed Market: An Examination of Kosovo's State-Building Period*

The main difference between Kosovo and other transition economies is its experience of approximately eight years' state-building period which was led by several international organizations and actors. This unique situation together with other country-specific factors have so far created long-lasting problems that local and international actors found extremely difficult to cope with. During this period, the main governing body was the United Nations Mission in Kosovo (UNMIK) which started with a peacekeeping mission and managed the state-building process with full authority and immunity. This mission had four pillars: the United Nations High Commissioner for Refugees (UNHCR), the Civil Administration under the UN, the Organization for Security and Co-operation in Europe (OSCE) with an 'institutional building' mission, and the Reconstruction and European Development lead by the EU with the mission to transform the economy. This unique structure and missions were questionable since the beginning, and the UNMIK administration lost its legitimacy mainly due to the delays in defining Kosovo's final status.

After the general elections in late 2001, a Kosovo Assembly and a Government (PISG) were formed as the legitimate governing bodies to which the authority was gradually transferred by UNMIK administration. This created institutional duality, one with full authority of decision making, UNMIK, but with no *de facto* power, whereas PISG with *de facto* and *de jure* legitimacy, but lacked the authority of decision making. Therefore, the polarization between local and international actors started with the competence seeking and moved into the final status talks. Because of this duality and polarization, 'the governance turned out to be fuzzy' as the consistent negotiation process turned to be unfruitful (Ernst 2011, p. 127). As a result, the balance of power between local and international actors changed in favor of the locals due to their informal power. Furthermore, the policy convergence occurred when these actors had common policy field and resources to reach their goals (Brosig 2011).

Due to political polarization and the differences in goals between two sides of the governing bodies, the reforms to create a functioning market economy were based on *ad hoc* plans. The governing institutions were dysfunctional and their decisions were contradictory. The internationally-led privatization process was the first example of such anomalous decisions. The problems, such as the weak legal basis on

identifying the legitimate owner of the properties, the conflicting views of local and international actors with regards to the model of privatization, and the absence of a clear plan to manage this process, caused long delays in privatizations. As a result, the value of the State-Owned Enterprises and the quality of attracted investments were reduced in many aspects. At the end of this process, Kosovo became one of the poorest countries with highest unemployment rates in Europe. Its economy is based on imports and unable to supply for the national and international markets.

### 6.2. *Implications for the Independence Period*

After Kosovo's declaration of independence in 2008, apart from the economic difficulties, other major problems were firstly, to form a coalition government between highly polarized political parties, and secondly, to carry out technical talks with Serbia, and to complete the demarcation of border with Montenegro. With ill-formed institutions and highly polarized political climate, overcoming with such difficulties was almost a mission impossible. Political instability was so intense that four national elections were held between 2007 and 2017, and all the governments were formed as 'large coalitions.' The average lifecycle of these governments was less than three years, and the average time consumed to build a coalition was six months. Thus, institutions operated in a vacuum without a strong political support behind them. At the same time, this institutional vacuum influenced the normal functionality of the governments negatively, and important decisions such as introducing a new fiscal package were delayed. Without strong public support, the governments were unable to make decisions to fulfill the political agenda related to the 'statehood' and were incompetent to make consistent reforms in the economy.

Powerful interest groups were also intentionally delaying or hindering the implementations of reforms and efficient policies. Such behavior of interest groups can be explained by the "inefficient institutions model" (Acemoglu 2006). According to this model, interest groups prefer inefficient policies in order to distribute resources in a way of securing their interests and survival. In the case that institutional change occurs, these groups attempt to influence the change process again in accordance with their interests (Acemoglu 2006). Opposite groups may also attempt to change the institutions to gain access to *de jure* political power (Acemoglu and Robinson 2010, Acemoglu, Johnson,

and Robinson 2005) by organizing protests and blocking institutions to function normally. In Kosovo, such moves from interest groups and the opposition,

increased the concerns about the “state-hood” agenda and led to unproductive activities, high unemployment rates, and poverty.

**Table 8:** Summary of Institutional Situations in State-Building and Independence Periods in Kosovo

Periods	Political Institutions	Economic Institutions
State-building (1999-2007)	<ul style="list-style-type: none"> <li>- Institutional duality</li> <li>- Lack of administrative institutions</li> <li>- Inadequacy of UNMIK in managing state-building process</li> <li>- Fragmented political landscape along political and ethnic lines</li> <li>- Tension and distrust between foreign and local administrative bodies and the ruling and opposition parties</li> <li>- Legitimacy problems of international bodies directing state-building process</li> </ul>	<ul style="list-style-type: none"> <li>- Lots of property claims under investigations</li> <li>- Illegal occupations of properties</li> <li>- Corruptions and uncertainty over property rights</li> <li>- Deficiency in rule of law hampering business activities</li> <li>- Weak rule of law unable to protect property rights</li> <li>- No clear guidance for the Courts on mandating property rights</li> <li>- A draft legal framework created for developing the private sector</li> <li>- Efforts made to create a market economy</li> <li>- Privatization considered as a key success factor to attract investment and create a functioning market economy</li> <li>- Differences amongst different parties on privatization issues.</li> <li>- Boycotts and non-attendances make privatization body impotent however, major privatizations made.</li> <li>- Although privatization declared as the main economic strategy of the state-building period it made no improvement in poverty and employment problems of ordinary people.</li> </ul>
Independence (2008-to day)	<ul style="list-style-type: none"> <li>- Polarization between the ruling and opposition parties</li> <li>- Non-functioning parliament due to violence</li> <li>- Political instability delays reforms</li> <li>- The new government and the Assembly and the opposition fail to re-energize reforms</li> <li>- Tensions in the ruling coalition hinder delivery on key areas of governance</li> </ul>	<ul style="list-style-type: none"> <li>- Limited improvement in protection of property rights</li> <li>- Corruption, criminal activities and uncertainty over property rights remain</li> <li>- Use of courts for enforcement of contracts remains underdeveloped</li> <li>- Costly legal enforcement of contracts, and corruption hamper the business environment</li> <li>- Insufficient infrastructure, limited access to finance, insufficient rule of law are the main barriers for business</li> <li>- Unfair competition, prevalent fiscal evasions prevent business</li> <li>- Small enterprises run by the families are the common form of business and they are in a disadvantageous position by any means.</li> <li>- Complicated and costly procedures for opening or licensing a business enlarge the informal sector.</li> </ul>

**Table 9:** Comparing Themes Representing State-Building and Independence Periods

Themes characterizing political institutions		Evaluation
<i>State building period</i>	<i>Independence period</i>	
duality of power, lack of institutions, political fragmentations, distrust between foreign and local bodies, illegitimacy	polarization, non-functioning institutions, delaying reforms, failing government, violence	<ul style="list-style-type: none"> <li>- During the state building process main conflict and tension occurred between foreign and local bodies. In independence this was between local interest groups.</li> <li>- From lack of institutions to non-functioning institutions, it is evident that although some institutions are formed it will take time to make them functioning</li> <li>- From legitimacy problem to violence problem: Discussion over the legitimacy of foreign bodies lessened as the local Assembly and the government established. However, fragmentation and factions are still prevalent.</li> <li>- It is expected that for functioning political institutions more time needed and without them economic development cannot be succeeded. The question is that without a certain level of economic development can any institution be successful and sustainable?</li> </ul>
Themes characterizing economic institutions		Evaluation
<i>State-building period</i>	<i>Independence period</i>	
property rights, deficient and weak rule of law, corruption, privatization, market economy, poverty and unemployment	property rights, enforcing contracts, rule of law, Unfair competition, unsuitable business environment, informal sector	Although limited improvements made, there is not much differences between two periods. Unresolved property rights remain one of the main issues. Expected results from privatization are not realized. Corruption, unfair competition, weak rules of law, difficulties in enforcing contracts are main impediments to create a powerful private sector and a functioning market economy. As a result, informal sectors emerge around some privileged elites and this worsen the legitimacy problems of formal institutions.

## 7. LIMITATIONS AND SUGGESTIONS FOR FUTURE STUDY

This research has two limitations that we acknowledge. The findings of the study are limited with the available documents which do not allow us to directly investigate the causal links between political and economic institutions and economic development. Second, this study focused only on formal institutions. For a more comprehensive analysis of institutional environment in Kosovo, it would be advisable to examine the impact of informal institutions on institutional efficiency and economic development. We suggest that further analysis of judiciary and regulatory institutions will be useful. Single-country studies with qualitative research strategy focusing on institutional issues in different countries will also contribute to the literature. We also suggest that the connection between a country's historical background and its institutional and economic efficiency should be modeled and investigated.

## 8. CONCLUSION

Our research implies that severe political polarization in both state-building and independence periods

was the main reason for delays in making important decisions and increasing the efficiency of institutions. As a direct or indirect consequence, Kosovo's economy remains one of the poorest in the region. The inability of political institutions to set up priorities in relation to reforms on the one hand, and consistent polarization between local and international actors during institution-building period and between local political groups after the independence period are reflected on other institutions. Under these conditions, not only the main ones but also the supporting institutions have not yet been created or made well-functioning. Hence, weak protection of property rights and contractual enforcement, the failure of privatization process, and the failure of building a suitable climate for the private sector make it highly difficult for Kosovo to create a functioning market economy in the mid or maybe the long-term. Nevertheless, one should notice that the duration of 15 years is a relatively short period for creating an independent state and making its institutions functioning. Kosovo needs time to overcome its historically rooted social and economic problems.

**Table A1:** Sources and Types of the Documents Used

1999-2007
<b>United Nations Mission in Kosovo;</b> selected reports from 1999-2007. For each year the number of reports published varied from two to four reports (Coding, U).
<b>International Crisis Group (ICG);</b> Various reports (Coding, ICG).
<b>European Commission;</b> Kosovo progress reports; 2005, 2006, 2007 (Coding, EU).
<b>Riinvest Institute;</b> Various reports (Coding, R).
<b>KIPRED;</b> "The United Nations Mission in Kosovo and the Privatization of Socially Owned Property; A critical outline of the present privatization process in Kosovo." 2005 (Coding, K).
<b>GLPS and BIRN;</b> "Panic Selling; Evaluation of challenges and main problems of privatization process in Kosovo." 2016 (Coding, GB).
<b>Knudsen;</b> "Privatization in Kosovo: The International Project 1999–2008, 2010." (Coding, KN).
2008-2016
<b>European Commission;</b> Kosovo progress reports: 2008; 2009 2010; 2011; 2012; 2013; 2014; 2015; 2016. (Coding, EU).
<b>The Bertelsmann Stiftung's Transformation Index (BTI);</b> 2010; 2012; 2014; 2016 (Coding, BTI).
<b>RiinvestInstitute;</b> Various reports (Coding, R).

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