CENTRE FOR RESEARCH, DOCUMENTATION AND PUBLICATION

UNDERSTANDING THE CURRENT STATE OF THE FINANCIAL SYSTEM IN KOSOVO AND ITS IMPLICATIONS FOR HUMAN SECURITY

Prishtina, Kosovo
December, 2015

Qendra për Hulumtim, Dokumentim dhe Publikim
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European Commission

Introduction

Currently, the banking sector jointly with government spending, are the only key source of injecting money into the Kosovo economy. Nonetheless the banking industry holds a dominant position within the financial system, especially in regard to lending activities for businesses and in regard to people's economic life, which by far is the key driver of growth acceleration and reducing unemployment. The Kosovo Pension and Saving Trust (KPST) on the other hand is the answer to individuals' safety net when they retire, which is a completely different concept from the Pay-As-You-Go system that is currently operating in many of OECD countries. Standing on analogous risks from regional countries, the banking industry in Kosovo faces less risk during their lending activities than banks in the region. As long as banks are the only institutional money injection for our economy, banks are the key driver for job creation, raising productivity and innovation. So far, interest rates on lending activities are very high while on deposits are very low. Sometimes interest rates on deposits do not cover even the inflation level so they have a negative return for depositors. Standing on the historical perspective of the banking industry where the Central Bank of Kosovo (CBK) was the only independent institution which designed the structure of the industry, CBK policy was to allow in the banking industry only strong and well capitalized banks in order to ensure stability within the system. Nowadays we have a very stable banking industry in terms of profits, capitalization and liquidity but as a consequence of this process of banking transformation we have very high interest rates even though the risks are lower in Kosovo than in countries of the region. Whereas on one side the KPST is a system with defined contributions where you pay for your own pension benefits, most of the money is invested abroad in the form of financial securities. Liberalizing the obligatory framework of the Kosovo pension scheme would create space for more competition within the pension system and as we know from the father of modern economics, Adam Smith, competition among entrepreneurs is the driver of innovation and cost minimization. Under the existing configuration we don't know if the Kosovo Pension and Saving Trust is operating at its potential in terms of costs and outputs (best investments allocation). The CBK should move in quickly in order to lower the criteria for bank licenses, in order to raise the number of banks in the industry. Also government should start working on a feasibility plan that would set up preliminary footsteps toward creating a Prishtina Stock and Bond Market through bringing back in Kosovo money of the KPST and the Privatization Agency.

Issue

This policy brief captures the evolution of the financial system with a precise focal point on the banking industry and pension fund in Kosovo, and its impact on the human security of the Kosovo citizens. We have further overviewed the evolution of the financial system society in comparison with structural financial transformation in countries such as: Czech Republic, Poland and Hungary. We have then analyzed the data collected via questionnaires with stakeholders involved directly or indirectly with the banking industry. Many research activities in the area of banking and financial system have mainly covered the insider problems of the banking industry (such as: profits, capitalization ratios, return on investments etc.). This is not what economic science and neither policy makers nor the Kosovo public should be worried about, as internal performance of the banking industry is part of the banking managerial performance (managers should be concerned). The issue that Kosovo citizens and economists should be concerned with is if the price in the banking industry is coming from the market competition or if banks are setting the interest rates on their own. It has been proven that the financial system should operate as a complete arrangement, creating a stock market which would enable all industries and within them all financial and nonfinancial institutions to operate inside one scheme, and that would make it possible for over liquid industries to be compensated from those that lack liquidity but have good ideas for investments. The present approach of the CBK and of the Kosovo Government considers stability within the financial system as the answer for prosperity. This approach has proven to be wrong, now that consequences from the stability are being carried on the shoulders of Kosovo businesses and Kosovo citizens through very high interest rates which are negatively affecting human security in terms of: economic security, health security, and food security, amongst other forms of human security.

Policy implications

In countries which have already approached the market values of "Lassies' faire", private property and price signals are constrained as to achieve these profound marketplace principles. But in order to reach these profound marketplace principles they need to ensure competition in each segment of economic life that is possible. Monopolies are always inefficient not just on cost minimization but also on output delivering and this paradigm is proven by data and also by basic microeconomic principles. In divisions of the economy such as water supply (natural monopolies) it is impossible to ensure competition because it is hard to have many operators of water supply in a particular area, in that case government set up regulators that control the prices. In the parts of the economy where competition is guaranteed, extra government interference in the market is confirmed to carry harm rather than benefits.

The financial system is considered as the key driver of inclining engines of economic growth. Some countries such as: United States of America and England are based on stock markets and banking sector to inject money into economy. Kosovo is solely based on the banking industry as the only source of financing business investments and part of private consumption of the population. Based on this limitation for Kosovo, it is very important that competition is ensured in the banking industry, in order for all the recourses which are mainly deposits within banks' balance sheets to be utilized efficiently.
Within the structure of the Kosovo financial system, in 2014, banks participated with 70.1% followed by the pension fund with 24.1%, and insurance companies with 3.1% etc.[1]The level of concentration in the banking industry has shown signs of declining since 2011 in terms of: assets, loans and deposits.[2]

Total assets in the financial system in 2014 were 4.5 billion Euros; assets in the banking system, 3.2 billion where loans participated with 1.9 billion and deposits with 2.5 billion.[3] In 2013 the deposits were in the range of 2.2 billion Euros while lending 1.8 billion Euros, reserves in the central bank were 209 million Euros and 391 million Euros were sleeping in the banking system[4].In 2014, the deposits that were not utilized within the banking industry were in the range of 376 million Euros, which shows over liquidity in the system. Lowering the criteria for more banks to get into the industry would enable that 391 million Euros to be utilized more efficiently as the key generator of innovation and productivity is competition. But, under the current steady state of the concentration level within the banking industry, it is impossible to be realized. Sometimes the interest rates on deposits do not compensate even for inflation levels or returns on deposits are negative.

1. Research Findings

1.1 Central Bank of Kosovo. The general intention of the Central Bank of Kosovo was to guarantee stability within the banking industry[5] but in the same line the stability within the banking industry was accompanied with a high level of concentration showed by HHI (market concentration index) that generates legroom for cooperative agreements within the industry. Kosovo is using Euro as its currency but it is not yet part of the euro zone so the decisions made by the European Central Bank do not affect the Kosovo monetary system. The CBK cannot control speeding up of inflation or deflationary episodes since it does not have any monetary instrument to inject or extract money from the system. In 2013 according to the CBK annual report 67.3% of the assets are concentrated in three banks[6], where almost all deposits and lending activities are realized from these three banks.

2. Kosovo restructuring of Financial System Compared to the Czech Republic Reform

A liberal approach was attained from the Czech Central Bank in the course of new bank entries in the economy; 13 banks were established in 1990, 13 in 1991, 17 in 1992, 10 in 1993 and 4 in 1994. All these new entries have occurred on a principle of constructing new incentives within the industry in order to ensure a competitive background in the direction of four major banks that were created from transformation of the Mono Bank.[7]Banking transformation in countries of Central and Eastern Europe were chased by the laissez-faire policy of license issuances on the banking industry in order to raise encouragement for new entrances, a number of which were engaged in unsound practices. The banking system in these countries contained lack of capitalization, and deficient familiarity in uncertain waters of free market paradigms.[8]

Table1[9]

Fiscal Costs of Bank Recapitalization	Czech Republic	Hungary	Poland
Main Part of the recapitalization program completed in	1997	1994	1996
fiscal costs up to the year indicated above in % of GDP in that year	8.9%	7.2%	1.6%
Fiscal Costs of the recapitalization program up to the year 2000 as % of GDP	11.8%	6.8%	1.4%

"According to the World Bank (2001) development indicators, in 1999 the spread among lending rates and deposit rates was lower only in 20 emerging market economies (on total of 127 emerging market economies) than the CEEC-3 (Czech Republic, Poland and Hungary) average spread which was 4.4%. The Czech Republic's interest rate spread of 3.1% was even comparable with that of the most industrial countries."[10] Most of the Czech banks got privatized through two forms: Joint-venture and through voucher scheme.[11]The lowest rate according to the table has appeared in the Czech Republic with the lowest spread, followed by Hungary. The cost of lending activities is mainly based on the key indicators which are nonperforming loans, where in Poland by year 2000 they reached the level of 7%, Czech Republic with 5.8% and Hungary with 3%.

Table nr 2[12]

Lending Rates minus Deposit Rates to Non-banks: difference (in%-points) of the annual average of rates in % points

	1994	1995	1996	1997	1998	1999	2000
Poland	10.9%	11%	8.5%	7.3%	7.2%	6.9%	6.7%
Czech Republic	2.5%	2.6%	3.1%	2.8%	2.3%	3.1%	2.9%

Hungary	**7.1%**	**6.5%**	**5.1%**	**3.3%**	**4.2%**	**4.5%**	**3.9**

Note: Deposit rates are rates on the household's deposits excluding demand deposits.
Source: National Central Banks, OeNB

Establishment of the Stock Market in CEEC-3 (Czech Republic, Hungary and Poland) was commenced throughout the privatization process. The Czech Republic moved faster by creating the first stock market and listing companies in the same line with establishment of necessary regulative framework, whereas Hungary and Poland did the vice versa which proved to be a more successful model. The highest market capitalization in Poland reached the value of 31.4 billion USD, while Hungary clearly exhibited the highest total market capitalization of 29.5% in relation to GDP, by the end of 1998 and still quite small compared with advanced countries such as that of US, where equity market contains 152.7% of GDP and that of Germany with 63.1%, by the end of 2000. The Hungarian debt market is considerably larger compared to that of Czech Republic and Poland.[13] For the ex-soviet Union countries, it took more time to create stock markets. The Czech Republic was the first to create the Prague Stock Exchange and a secondary market. They engaged in trading of securities from voucher privatization and organized auctions. Slovakia followed by creating Bratislava Stock Exchange and a secondary market as well. Romania created "Rasdaq", its stock market and a secondary market too.[14]

Table 3- Participation of Bond and Equity Market as percentage of GDP[15].

	Poland	**Poland**	**Hungary**	**Hungary**	**Czech Republic**	**Czech Republic**
% of GDP	1997	2000	1997	2000	1997	2000
Equity Markets	8.6%	19.8%	33.2%	25.9%	27.2%	23.7%
Debt Securities in Local Currency (at nominal value)	15.1%	21.6%	28.9%	34%	13.6%	22.2%
Central Government	14.4%	19.2%	28.5%	33.6%	7.4%	14.4%
Publicly issued	11.9%	15.4%	17.8%	23.3%	7.4%	14.4%
T-Bills	6.4%	3.6%	7.1%	6.4%	4.2%	8.8%
T-Bonds	5.5%	11.8%	10.7%	16.9%	3.2%	5.6%
Privately Placed	2.5%	3.6%	8.0%	6.3%	0	0

Liquidity within the Security Market was detained through turnover intensity, piloted by Poland until 2000 with 19,452 million USD, followed by Hungary with 12,206 million USD and Czech Republic with 6,845 million USD. But based on the average turnover with the total market capitalization, the Hungarian stock market was the most liquid market.[16]Involvement of foreign investors on whole market capitalization in Czech Republic and Poland was in the range from 17% to 26%.The only exception was the Hungarian Stock Market where foreign investors participated with 68% in 1997 and ended up with 70.7% in 2000. We can say in a few words that the compounding structure of the equity markets in these countries was apprehended largely from overseas equity investments as strategic investors or portfolio investors'. [17]One supplementary input that countries hold within themselves is the debt ratio and the consequence that this sort of risk en route spread toward the banking industry; which shows the threat that a particular country is containing on the track to investors. Countries that are exceedingly indebted are more likely to bankrupt or not pay their debts on time.

Government debt (as percentage of GDP) in Poland was 82.9% in 1993 and then declined to 38% in 2000; Hungary had 88.7% of Debt/GDP ratio in 1993 and ended up with 55.5%. Only the Czech Republic was operating in low levels of debt with 15.6% in 1993 and it remained almost the same in 2000. The debt was mainly held in foreign currency. In Poland, in 1993, the level of debt denominated in foreign currency was 78.1% while in 2000 it was reduced to 47.7%. On the other hand debt denominated in local currency inclined through years by starting with 21.9% and reached 52.3%. A different story followed the Czech Republic where debt denominated in foreign currency was 45% in 1993 and was reduced to 6.8% in 2000 and on the other side debt denominated in local currency raised sharply from 1993 (54.9%) and ended up 93.2% in 2000.[18] It was understandable that the Czech Republic, Poland and Hungary were trying to reduce the debt denominated by foreign currency because of a weak competitive economy and restrictions on capital flows, while the financial institutions are young and weak, so they elegantly controlled their approach on debt level and as well as debt structure.

Table 4- Ratio of Central Government Debt to GDP (in %)[19]

	1993	**1997**	**2000**
Poland	82.9%	46.9%	38.7%
Hungary	88.7%	62.9%	55.5%
Czech Republic	15.6%	10.7%	15.1%

2.1 Risks that banks are opposed to, during their lending activities in Kosovo. In 2011, the average interest rates in the banking industry were in the range of 14.5% compared to the 10%[20] in countries of the region. So, interest rates in Kosovo on lending activities were for 41.5% higher than in regional countries. On the deposit side, average interest rates were 3.5% compared to regional countries which were in the range of 4.5%. Basically, in the region, interest rates on deposits were higher by 28.6%. Fundamentally, if the interest rates on lending activities reflect the risk of our economy then the market mechanism is working only for loans not for deposits. If these risks that banks are opposed to during their banking operations in Kosovo exist, then the normal question to be asked is why banks are not raising interest rates on deposits since they are operating with our money.

According to the performance ratios in 2011, ROE (Return on Equity) of the banking industry in Kosovo was in the range of 14.5% and the regional average was 4%, while ROA (Return on Assets) on Kosovo banking industry was 1.4%, the regional average was 0.4%.[21] Basically ROE in Kosovo was higher than in regional countries for 262.5%, so shareholder investments had a 262.5% bigger return on investment in the Kosovo banking sector than in regional countries'. While ROA was for 250% higher in Kosovo than in regional countries, there could be multifactor reasons why ROA is higher than the regional average. A part of the reason might be the dominant position that some banks have in the industry. When you calculate the weighted arithmetic average then the highest turnover of the assets was realized in two banks. In this case it doesn't mean that people working in the Kosovo banking industry are working harder, more productive and simply smarter than the regional average on utilizing the assets. If the real ROA would have been a significant indicator in capturing assets' utilization than banking industry would not face over liquidity within it.

As we can see from the experience of the Czech Republic, Poland and Hungary, fixing the financial system, in terms of functioning as a whole competitive system where the stock market compensates the banking industry, is more an economic talent than knowledge of basic free market principles. Kosovo followed the pathway of market economy on a privatization course just barely, throughout selling state and social owned enterprises to particular investors instead of trying to orient these public assets into a stock and bond market, a complicated synthetic financial system which creates better outcomes for the future economic panorama of Kosovo. The Czech Republic, Poland and Hungary inherited a monetary system from the past (national currencies and accumulated savings) which enabled them to create stock markets, but Kosovo could have channelized Diaspora funds, Kosovo inhabitants' savings, money of the KPST and the Kosovo Privatization Agency to build a stock market.

2.2 Exchange rate risk. Kosovo uses Euro as an official national currency and as a result deposits and lending activities are realized in Euro in our banking industry. Countries of the region such as Serbia, Macedonia and Albanian have their own national currencies and they accept deposits and realize lending in both, Euro and national currencies. In this case fluctuations of exchange rates might harm banks in regional countries but not in Kosovo.

2.3 NPL (Non-Performing loans). In December 2012, in Kosovo, NPL-s were on the range of 7.5%, in Montenegro NPL-s were in the range of 17.6%, and in Serbia in the range of 18.6%. At the same time these countries had 40% lower interest rates than Kosovo.[22] When you have low NPL-s, as a rule, you deal less with the judicial system and therefore essentially Kosovo has lower risk than other regional countries.

2.4 Contract enforcement. Doing Business Report of the World Bank shows the time it takes for the judicial system to execute a contract. For instance for the two cities that were part of the study, Prishtina and Prizren, it took an average of 420 days to execute a contract, while cities from regional countries, such as: Krushevc (720 days to execute a contract), Belgrade (635 days), Nikshic (545 days), Podgorica (545 days), and Vranje (540 days).[23] Essentially, contract enforcement in Serbia and Montenegro necessitates more additional time to be executed than in Kosovo and they have lower interest rates in lending activities than Kosovo. The regional average is 521 days to enforce a contract, and Kosovo is below that average.

2.5 Public Debt. This is a key indicator of economic stability for a country. The recent Greek debt crisis showed that public debt is important for the security that banks have during their lending activities. High levels of public debt associated with budget austerity influenced the banking industry to stop lending into the Greek economy. Kosovo public debt is the lowest in the region, with 5.6 % in 2011 (compared to Albania, 60%; Macedonia, 28%; Montenegro, 45%; Serbia, 45%), but also the lowest in Europe, (Portugal, 120%, as of 2011) and Greece with 161% of public debt in 2011, according to the Moody Index. Essentially still this risk is lower in Kosovo than in regional countries. Debate within economic science more or less is about questioning the history of the economy. Economic history shows that public debt is a very important element in risk management for the banking industry, when deciding on lending activities. Kosovo debt is in Euro, and some of the regional countries have an immense fraction of their debt in Euro while they operate with their national currency, which generates supplementary risk due to exchange rate movements and sometimes the weak international competitive economy.

2.6 Kosovo Competition Authority. According to Article 13 of the law on competition (KCA- Kosovo Competition Authority, mergers of the companies that would harm the competitive environment on a

particular industry, are explicitly not permitted[24]. Despite regulations and legislation that protects markets from mergers and joint ventures, the banking industry is by now already highly concentrated.
In 2008 only one bank had around 40% of the market share in terms of deposits and 38% of total assets, and the three largest banks accounted for 89% of the market share,[25] which shows that only one bank had a dominant position in the market. In 2005, total assets of the banking sector were 984 million while only the two biggest banks in Kosovo had 644 million Euros; consequently the two biggest banks had 65% of the market which shows again the dominant position by two banks in the industry. The law on competition shows that two operators shouldn't have more than 40% of the market share, unless justified by other competitors in the market. In 2012 overall industry assets were 2.83 billion while only the two biggest banks had 1.4 billion which is almost 50% of the market. In 2013 they had almost 49% of the market share[26] [27]. According to the KCA, five operators within a sector should not have more than 70% of the market unless the price is justified by other competitors.[28] So the question is, if the dominant position of certain banks has been justified, and if the KCA has a justification for these dominant positions in the industry?

Survey with 600 businesses. According to the survey with 600 businesses realized by the Riinvest Institute, companies declare that: cost of financing and access to finance are among the strongest barriers of doing business, and obtaining loans with high interest rates destroy development projects within companies. According to the survey, 95% of the SME-s did not apply for a loan because of the unfavorable conditions for financing projects[29]

3. The Kosovo Pension and Saving Trust (KPST)

The Kosovo Pension and Saving Trust (KPST) is an organization under the control of the CBK, while the internal strategy of investment and her core operations are regulated through the Parliament of the Republic of Kosovo. The majority of recourses accumulated by KPST are invested abroad, mainly on financial markets of developed countries.

Graph No 1.[30]-Overall KPST price fluctuations

Based on an allocation strategy of the KPST, where the majority of money has been invested in shares, we can conclude that Kosovo pensioners are highly exposed to the boom and busts of financial markets. According to the basic finance paradigms, stock markets are unstable. This volatility of financial markets from time to time has been produced by itself and occasionally it has been a reflection from real economy, but in the end both these systems influence each other.

As we can clearly see in 2008/09, there has been a huge decline on average stock prices of KPST, mainly because of the 2008 housing bobble in the United States. KPST in that time had around 51.2% of the portfolio invested in shares. Because of the world financial collapse there were huge unrealized losses that occurred to the Kosovo Pension and Saving Trust (they were correctly entitled unrealized losses since simply the price has dropped down), in the range of 88 million Euro's.[31] There are two types of risks that KPST is opposed: market risk and diversifiable risk.

3.1 Market Risk. This is mainly coming from the market, movements in the stock market of developed countries or because of the economic crises that a particular developed country is facing and that is reflected on the stock market. That is a risk that KPST cannot stay away from, for the simple reason that is hard (impossible) to foresee the future since the future depends on the choices that are not made in terms of: government spending, consumer actions and investment feelings from the businesses.

3.2 Diversifiable Risk. This is the risk coming from the internal diversification of the portfolio, plunked on the capacity of the KPST to diminish the pressure that is coming from the market risk. Up to 2009, the risk level captured by the general formula which incarcerates correlation, weight and standard deviation, was in the range of 3.87% while weighted average return in the range of 9.9%. In 2014, the risk level decreased to 2.38% so a decline for 38% while weighted average return was in the range of 9.2%. Even the correlation coefficient (which shows how strong assets are moving together) has reduced to a level of 43% since 2009.[32] It is apparent that KPST has been reflecting a lot on the recent financial meltdown concerning the activity that is in charge to do (reducing diversifiable risk) but a huge level of risk on the market still remains, for the simple fact that most of the assets are invested in common stocks. Standing on the elementary finance paradigms and laws, when the company goes bankrupt the shareholders get mostly nothing in the end, and in this case these are all the Kosovo pension contributors.

3.3 Portfolio allocation of Kosovo Pension and Saving Trust. In 2008 when the financial crisis occurred, a large amount of the money was managed and invested by Vanguard Company through investments in common stocks. The other part was managed by Schroder Company in bond investments, roughly 22%, and a small fraction was invested in Kosovo in the form of deposits.[33]

3.4 Investments Opportunities in Kosovo. The Law on Kosovo Pension and Saving Trust does not fashion any legal constraint on investing in Kosovo, it only limits investments on financial assets with high liquidity (so you can buy and sell any time you need to realize that operation) and on markets with no asymmetric information and no moral hazard.[34] Kosovo does not have a stock market where the pension fund could be investing; the single financial instruments are deposit certificates from the banking industry and government bonds. Even if Kosovo creates a stock market, there are three problems that will be accompanied with the potential "Prishtina Stock Market". First, how to deal with the problem of asymmetric information where the majority of the companies in Kosovo show fake financial statements (in that case, the majority of stock or bond prices will not mirror the deep-seated principles of the companies, so they will be speculative prices)? Secondly, how to deal with liquidity problems within the stock market when the system from both sides, buyers and sellers, hesitate to be engaged in transactions (this situation would require incarcerating financial synthetic instruments which are very complicated to be managed through the Kosovo capability)? And thirdly, how to deal with over-liquidity within the financial system where banks will not lend their entire accumulated deposits after deduction for reserves in the CBK (which has been happening throughout these years)? In that case the potential Prishtina Stock and Bond Market would have been the only instrument to utilize this over liquidity.

The government is proposing a guarantee fund for loans[35], which might impact reduction of interest rates in the banking industry but that is reasonably difficult in the current steady state situation that the banking industry is operating nowadays. This fund could have even superior impact if the fund would be implemented for the entire financial system where the potential Prishtina Stock and Bond market would be part of it. It is fairly tough to detain if a particular financial industry is having over liquidity based on competitive conditions of the industry. As long as we are not sure if the banking industry is a competitive industry, we also do not know which is the utilization capability of banking assets (mainly deposits). It can be that the over liquidity is coming as of the dominant positions of a few banks in the system.

3.5 Pay as you go system. Many people consider that the “pay as you go” system is based on trust, which is basically a system where the current productive part of the population pays for the current retirees’ pension coverage. This is utterly dissimilar from the current pension system that Kosovo has (In KPST you pay for you own retirement).

According to the demographic evolution of the world population (where population growth is one of the input engines of long run economic growth), population growth is declining, impacted by different causes such as: cultural, economic, family planning etc. This is an important factor to be considered in the “pay as you go” pension fund system. According to Thomas Piketty, the European population growth fell by half (only 0.4% inclines) from 1913 to 2012. Incline in life expectancy is not enough to compensate a huge decline in the birth rate. On the other hand, there has been a huge increase in the population growth in certain countries. In the early 20th Century, Egypt had around 10 million people and now it has around 80 million, while Nigeria and Pakistan had around 20 million people (early 20th century) and now they have more than 160 million. Projections for Europe 2012-2050 are that population growth will decline by -0.1%.[36]According to the World Bank projections on population growth, Greece population until 2050 will be: 50 % above age 65 while only a fraction of the population (around 20%) within ages 18-65. Same goes for Serbia and other regional and European countries.[37] This means that in a “pay as you go” system, it will be a huge burden for the people within the productive age to maintain those that will be in the pension schemes. That is why we can assume that European countries will enhance its “open doors policies” towards more countries, for specific professions and maybe more than that, in order to counterbalance the aging population. Therefore, Kosovo risks losing her professional labor force in years to come, since it does not offer enough employment opportunities for young people who are willing to work. This is why there must be radical changes in the Kosovo economy and one of them should be pushing new financial reforms as a way out for reducing poverty and unemployment, and a way to keep its young human capital in country.

As it is, around 32% of the Kosovo population is under the age of 15, 6.5% above age of 65 and the other part, around 60% of the population, is in the productive age, within 15-65.[38] Essentially this is an enormous potential for the Kosovo economy in terms of growth booming and productivity, since productivity mainly comes from young people positioning into work. Even if Kosovo will move toward a “pay as you go” system, it would not create problems comparing with what currently western countries are experiencing with an aging population. The only problem with Kosovo to move toward with the “pay as you go” system would be the high level of unemployment which exacerbates future outcomes of the system.

4. Impact of Financial System on Human Security

4.1 Food Security. The overall poverty rate in Kosovo, according to World Bank was 45% till 2005/06 and extreme food poverty was 15% until 2008.[39] According to the Kosovo Agency of Statistics (KAS), the unemployment rate in Kosovo in 2014 was in the range of 35%, considering female unemployment is significantly higher than male unemployment.[40]While the average salary is around 346 Euros[41], every year the prices are rising and the purchasing power is declining. Based on the aforementioned facts, it is safe to say that Kosovar citizens lack access to assets and assured income and therefore lack the purchasing power, which further perpetrates a risk of limited economic access to basic foods. Based on this outlook, there are still significant numbers of families and children in Kosovo which are facing serious nutrition deficiencies. A fraction but a significant step towards solving this issue is the ability to fix the financial system, which would allocate those funds that are by now sleeping in the banking industry to be invested in the economy and as an effect to employ people and reduce poverty in the country. Food security is an issue beyond left and right economic models. The fact that there are still huge discrepancies between the "haves and have nots" in Kosovo while the banking industry is paying millions of Euros as dividend and not paying a single cent as tax on dividend is and should simply be unacceptable, not just for Kosovo institutions but for the taxpayer as well. In order to reduce poverty, it is not enough to identify the financial system needs to be fixed but also it requires political will to actually go through with it. We have to remember that a young population living in poverty is exposed to poor health, poor education and therefore inability to find a job in the future, which would only add to a vicious cycle of lack of human security.

4.2 Economic Security. As above mentioned, the unemployment rate in Kosovo in 2014 was in the range of 35%, with female unemployment significantly higher. This means that the Kosovo economic environment does not offer its citizens a guaranteed basic income through productive work. Kosovo has no unemployment benefits, a very limited and inadequate form of coverage for maternity benefits. The new labor law has very symbolic financial coverage and has only exacerbated female unemployment. Kosovo has no child benefit scheme either. Kosovo has social schemes supporting martyrs, invalids, veterans, members of the Kosovo Liberation Army (KLA), sexual violence victims of the war, civilian victims and their families, people with disabilities, and social cases[42]. This gives an enormous economic uncertainty for groups uncovered by any above mentioned scheme, such as the unemployed or any other group which face daily basic needs problems but can't find themselves in any of the upper mentioned groups. There are pros and cons under the existing pension scheme that Kosovo has within the KPST. First, it is decent in the sense that you pay presently for your future gains, which raises the incentives for an individual to work harder and become more productive in order to get higher wages and as an end result to participate more in the pension plan, so the potential payback will be compensated via present efforts. But the current system of KPST raises also huge uncertainties for the people, because almost all their money is invested abroad and their future benefits depend on current and future economic-financial performance of the countries where money is invested. Secondly, because investing in financial securities requires deep professional knowledge of the field and this fact incarcerates additional uncertainty on current pensioners and current contributors of the pension scheme.

The "pay-as-you-go" system could create an enormous relaxation for the existing employees and unemployed individuals, since the new generation will be paying their benefits in the future. It is a simple scheme which generates less information misunderstanding among individuals that lack familiarity with the financial investments but it is more risky on prospect of demographic changes, mainly in cases of a declining populations and high structural unemployment for long periods of time.

Finally, inability to provide a basic income for your citizens, through productive work or safety nets only perpetrates further the political tensions in the country and potentially even the ethnic tensions, both crucial in the human security of those who live in Kosovo.

4.3 Health Security. Health insurance in Kosovo is funded by the state budget. Nonetheless, the economic climate, a big part of which is the financial system elaborated above, is very weak, resulting in a weak state budget and therefore a budget allocation process that is based on “state budget ability” and not the real needs of the institution. The healthcare system faces the same situation, where public money allocated to the Ministry of Health and the healthcare system as a whole is done on a “state budget ability to cover bases” and not on a “need bases”. This has created a healthcare system which has very limited capabilities to treat adequately the health of all the Kosovo patients. While for purely economic reasons, a lot of Kosovars are using the public health care system, a lot of them are going for further medical treatments abroad, especially those with serious illnesses. The Government of Kosovo has allocated around 3 million Euros for abroad healings.[43] Nonetheless, it is a usual occurrence to hear and see fundraising events and calls for “abroad healing donations” for people/children with serious conditions. It is worth mentioning that all this is actually linked to the financial system. So far, the interest rates in the banking industry in Kosovo have been higher for around 40%, while interest revenues of the banking industry in 2013 according to the annual report of CBK were 198 million in income from the interest rates. If the interest rates would have been similar to the regional countries, more than 50 million Euros would be in the hands of Kosovo inhabitants and business pockets, and as a result, this would have generated better overall economic security, therefore better health security.

Conclusion

As long as the financial system is an input driver of growth, by the fundamental reality that it is the only financial industry that injects money in the Kosovo economy, which enables financial security for people and businesses in terms of investments and daily operations, restructuring it is more related to leadership “know-how” than a science. Based on the economic history of ex-Soviet Union countries such as Poland, Czech Republic and Hungary, fixing a financial system is a long journey with a lot of ups and downs that require day by day improvements. It is not sufficient to spotlight only the banking industry though. The financial system as a whole must be competitive, where each industry within itself must compensate each other (flow of funds from one industry to the other) in order to not allow what Kosovars are facing now, over liquidity in the banking industry.

The financial system as it is, all things considered, creates enormous uncertainty among Kosovars in terms of economic security. People have ideas, businesses have plans, but under the current state of the financial system and particularly the banking industry, it is impossible to activate the engine of Kosovo economic growth.

Recommendations for policy change

- Liberalize the mandatory framework of the pension scheme but at the same time keeping Kosovo Pension and Saving Trust as a public monopoly.

- Create a state bank which would pressure the banking system to lower interest rates on lending activities and raise interest rates on deposits.

- Create Prishtina Stock and Bond Market via funds of Kosovo Pension and Saving Trust and the Privatization Agency.

- Re-introduce the tax on dividend, not just to create social equality but also since not taxing the dividend did not have the expected impact in encouraging foreign direct investments.

- Investigate through the “Competition Authority in Kosovo” in order to find out if the interest rates reflect the fundamental risks of our economy or they are based on speculations.

- The Kosovo Pension and Saving Trust should be legally constrained by the Parliament of the Republic of Kosovo on their portfolio allocation (reducing investment level on common stocks).

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