

The European Banking Union and Western Balkan Countries – Kosovo

PhD (C.) Shkëlqesa Çitaku

University of Pristina “Hasan Pristina”, Kosovo

Abstract

All Countries in Western Balkans aspire membership in the European Union, but they face different challenges in terms of lack of the appropriate factors as vital requirements for catching up with the rest of the European Union. Financial stability, diverse economies, tax regimes, macroeconomic stability, are common efforts throughout the region.

The long-term challenge remains the risks posed by financial instability, although the governments in the region remain committed to reforms. Meanwhile, banks in the Western Balkan Countries continue with a moderate level of non-performing loans rather than lending to the real economy, as another risk from financial sector fragility. However, the importance of the international strong support has helped to prevent bank failures, especially in late 2008 when several countries were faced with significant deposit outflows of their banking systems. The Banking Union as an integrated financial framework is based on the three basic pillars: Single Supervisory Mechanism, Single Resolution Mechanism and Common Deposit Guarantee Scheme. The European Banking Union transferred important powers from the Member States to the EU and had significant implications for the internal market. Since in the EU, there are two groups of countries (participants in the Banking Union and non-participants EU Member States) there is a need for strong harmonization and well-functioning of-European Supervisory Authorities.

From the perspective of Western Balkan Countries, the positive development on cross-border coordination was the signing in October 2015 of a memorandum of understanding between the European Banking Authority (EBA) and the supervisory authorities of the banking systems in five of the six Western Balkans countries (excluding Kosovo). This non-binding agreement established a framework of cooperation and information exchange to strengthen banking regulation and supervision of banks operating in the EU and in the region. The Western Balkans countries have committed to provide the EBA with regular updates on developments in their banking systems and to bring their own regulatory and supervisory standards and institutional arrangements in line with those in the EU.

Keywords: Banking Union, financial stabilization, Western Balkan Countries, Kosovo.

Introduction

The European Banking Union goes a step further since it adds new components such as the Single Supervision Mechanism conducting by European Central Bank (ECB) and the Single Resolution Mechanism to the European legislation. They are complemented with the Single Rulebook, which aims to provide a single set of harmonized prudential rules that must be respected by all Member States and all credit institutions within the EU. The Banking Union introduces a centralized governance framework and centralization of the powers of the supervision of the financial market. Moreover, the establishment of the European Banking Union with single oversight and resolution of banks in the Eurozone Member States created the

new legal framework for preserving financial stability of the EU Single Financial Market.

Western Balkan countries have chosen integration with the EU to have sustainability and long-term economic prosperity to their citizens. They have undertaken structural reforms; legal and regulatory reforms around this process; opened their markets to goods, services and capital from the EU. Also these countries still offer attractive investment opportunities: they have, in general, better demographic dynamics and are geographically closer to Europe than other emerging markets. This political and economic integration has naturally led to financial integration.

The main focus of national authorities should be to facilitate the allocation of capital to more productive sectors, by providing the right incentives, structural reforms, legal environment, tax policies, and economic stability. This requires a common understanding with banks operating in the region. Banks are and will remain profit-maximizing entities. Nevertheless, they should be more attentive to long-term trends, because they have a stake in the sustainable development of the economy.

The positive development on cross-border coordination was the signing in October 2015 of a memorandum of understanding between the European Banking Authority (EBA) and the supervisory authorities of the banking systems in five of the six Western Balkans countries (excluding Kosovo). This non-binding agreement established a framework of cooperation and information exchange to strengthen banking regulation and supervision of banks operating in the EU and in the region. The Western Balkans countries have committed to provide the EBA with regular updates on developments in their banking systems and to bring their own regulatory and supervisory standards and institutional arrangements in line with those in the European Union.

Currently, key challenges to financial stability in the Western Balkan area comprise non-performing loans, slow growth of credit to the economy, the problem of fiscal finances, and the exchange rate stability. Their nature and magnitude are directly related to the growth problem and the private sector approach to consumption, savings and expectations. The banking sector has seen reducing the debt due to required financial stability measures of the European banking authorities.

The financial sectors of the Western Balkans are at different level of development. The financial systems are bank-oriented, with banks accounting for over 90 percent of financial institutions asset in most of the countries, while institutional investors (insurance companies, investment funds and pension funds) and capital markets are at low level of development.

The commonality of Balkan's financial system is large presence of foreign owned banks. Precisely, foreign owners account for about 90 percent of total assets of banking sector. Most of the foreign banks come from European Union, mainly from Austria, Italy, France, and Greece. So, the improvements in banking and non-banking sectors were mainly held by foreign parent financial institutions. Thus, the financial integration supported financial development of host countries and their economic growth. Until the last financial crisis the benefits of foreign bank entry were not doubted. However, the costs of the integration became evident shortly after the financial and economic crisis in EU started.

Also, the privatization of the Western Balkan countries' banking sector has greatly contributed to strong financial and capital markets' integration with the EU: major EU banks today own 75-95 percent of banking assets. Today, the Western Balkans are especially vulnerable to the effects of the Eurozone because of the high degree of 'Euroisation'. Montenegro and Kosovo have adopted the euro as legal tender without the approval of the European Central Bank, Bosnia and Herzegovina has a currency board which ties its currency to the euro, while the other Western Balkan countries have pegged their currencies to the euro (all except Serbia and Albania) and have little room for maneuver as a large proportion of domestic liabilities are denominated in euro.

Given the high dependence of the Western Balkan economies on the EU, factors that have made them vulnerable to the global economic crisis – including trade openness, economic, financial and banking integration – are precisely the factors that will reinforce growth. For the moment, however, economic reforms in the Western Balkans looks extremely fragile, in view of the unfavorable short-term economic prospects in the core EU member states.

Regional financial and economic cooperation is important prerequisite of political cooperation and thus, factor of stability and prosperity of Balkan countries. Some similarities among the countries related to mutual aims towards European integration, harmonization of legislation as well as common heritage related to market, regulations and languages among most of the countries (Network of Parliamentary Committees for Economy and Finance of the Western Balkan countries, 2013) make achievement of cooperation easier.

Due to these strong financial and economic linkages of the Western Balkan with the euro area, European policies and regulations, macroeconomic and macro prudential intervention have authentic real-time impact on economies giving way to new challenges. The coordination of macroeconomic and macro prudential measures within the Euro area will continue to exert macro stability pressures on the Western Balkan. Therefore, it is important for the economies of the Western Balkan to know, in advance, and understand the EU's legal, institutional and regulatory developments in the financial system and possibly have an opinion on the potential impact and unintended consequences that such developments may have on their economies.

Therefore, the EU Banking Union is a very important step towards further integration and coordination between home and host authorities. The establishment of the centralized supervisory authority will facilitate the information exchange between supervisors, creating a more efficient communication between home and host regulators by reducing the complexity of dealing with multiple national supervisors and regulatory bodies. The ECB should play an important and constructive role, whereas non-EU supervisors must be granted the opportunity to express their views on EU financial policy decisions affecting their domestic financial stability, before the actual decisions are taken. The effective functioning of supervisory colleges is also considered a very important issue, where countries with systemic EU subsidiaries may address their supervisory concerns.

It is at the benefit of the ECB, and other monetary and supervisory authorities and EU authorities to bring the Western Balkan Countries on board of discussions

considering: the ECB has a large theoretic and empiric expertise on financial stability, monetary and economic analysis; however, the Western Balkan Countries may have a more precise and direct view of potential side effects on their economies; discussion to design the process allowing enough time for authorities to implement legal and regulative amendments to complement EU regulation and adapt its institutional structures in timely manner.

The euro area and the Western Balkan economies will be ultimately part of the same political economic and monetary union. Despite current hardships, the EU political and economic integration agenda remains committed in this goal. Under current circumstances, regional cooperation and communication becomes a necessary objective of the Western Balkan integration process, at least for the banking and financial market reform. It would be much easier for the EU authorities to adopt and address the concerns of the Western Balkan Countries as a single group rather than individually.

Kosovo

Kosovo is in the process of adopting the Basel Capital Framework, through the ongoing Project for Implementation of Basel Framework, as well as for the further harmonization of the Banking Supervision Framework with EU Directives that regulate this field. The Central Bank of Kosovo (CBK) has prepared the Advisory Letter with the intention to initiate the implementation of ICAAP – Internal Capital Adequacy Assessment Process for banks that operate in Kosovo.

From January 2008, the Bank has been complying with and reports based on Basel II requirements at the Group level covering credit and market risks. The implementation of Basel II requirements ensures a better management of the capital.

European Central Bank (ECB), with the support of the EU has officially launched a program of technical cooperation with central banks in the region, including the Central Bank of the Republic of Kosovo (CBK), the Bank of Albania (BoA) and Bank of the Republic of Macedonia (NBRM). Main goal of this program is preparing countries' central banks in the region to join the European System of Central Banks (ESCB).

The technical cooperation program of the European Central Bank with the central banks of countries in the region will provide the CBK determining changes in preparation to join the ESCB until the Republic of Kosovo to become a member of the Union European.

The regional conference entitled “Initiative for the implementation of the second pillar of the Basel regulatory framework: ICAAP / SREP Introduction and practical examples” was held in the framework of the CBK project for the implementation of the Basel framework for banking supervision. These standards aims to create unified international standards for banking supervision and were prepared by the Basel Committee on Banking Supervision within the Bank for International Settlements. This initiative is a fundamental step forward in the enhancement of the regulatory perspective, as well as in the alignment of the banking sector supervision standards with the EU standards. Also the commercial banks should reflect upon their own operating standards and to align their practices towards best practices available in

the EU countries.

Conclusions

All the countries in the region are in the process of European integration although with different stage. The fulfilment of the EU membership requirements is the main driver of the reforms. The economies are highly dependent on EU through financial and economic linkages. Financial integration provides benefits but expose the Balkan countries to the risks. This has been evident through transmission of the crisis from EU. Financial integration, through enabling source of financing, was viewed as one of the main factors of economic growth of the region in pre-crisis period. However, high dependence of foreign funding in unprepared Balkan countries in context of EU crisis and reduction in foreign lending were observed as important causes of decline in the economic activity in the region.

Since the countries are going to integrate their financial institutions and markets into European financial system, on the way on harmonizing national legislations with European one and preparing the financial systems for the integration, there is a need for the cooperation among financial intermediaries and markets of Balkans. The cooperation could take various forms from political, financial sector's regulatory and supervisory level to the level of financial institutions, stock exchanges and educational institutions.

However, cooperation should not only be viewed as an element in meeting the prerequisites of the region's integration in EU but also as a factor of legal and economic/financial improvements that are important prerequisites of political and social stability in the region.

The EU and Western Balkans can be considered partners and, as such, they have a legitimate interest in the policies and actions of the other.

It is essential that Kosovo and other countries of the region to intensify reforms to build a financial sustainability, to the challenges necessary to meet the criteria for EU membership and to improve competitiveness.

References

- EBRD (2012). "Integration across borders", Transition Report 2012.
- ECB (2014). Financial Stability Review, May 2014.
- BCBS (2003). "High-level principles for the cross-border implementation of the new accord", Bank for International Settlements, Basel.
- European Commission, 'Proposal for a Council Regulation Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions', COM (2012) 511 final, para 1.2. (Commission Proposal).
- Fullani, A. (2013), "Overview of Albania's recent economic and financial market developments", speech at the technical meeting to promote regional cooperation in the framework of Vienna Initiative II, 3 October, Tirana.
- Darvas, Z. and Wolff, G. (2013). "Should non-euro area countries join the single supervisory mechanism?", Bruegel Policy Contribution 2013/06.
- Minchev, O. (2011). 'Conclusions', in *The Western Balkans: Between the Economic Crisis and the European Perspective* (Sofia: IRIS, 2010).