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INSTITUTIONAL HARMONISATION AND DEVELOPING MARKETS IN THE CENTRAL BALKANS

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Abstract. *Serbia has conducted numerous reforms since 2001. In order to achieve macroeconomic stability and sustainable economic growth, large economic entities have undergone the process of restructuring; numerous companies have been privatized; and negotiations for European Union accession have begun. A similar situation exists in the Balkans region. A number of activities and measures have been conducted to improve business environment, attract foreign and domestic investments, enable accelerated growth and the development of the real sector, enhance the level of competitiveness and productivity, and decrease unemployment. The reform of the financial system plays a significant role in the overall reform process. Thus, it is necessary to create a new regulatory framework based on European Union directives that provides a considerable level of security and protection for all participants in the financial market. This would create a fertile ground for modern trading and the implementation of new instruments in the national and international markets. A set of laws and bylaws enacted provide modern financial market functioning, stability, and development.*

Key Words: *government, law, foreign investments, regulation, banking sector, finance system.*

INTRODUCTION

Foreign investments have become a priority for many countries in the Balkan region, particularly for Serbia, which reopened international relations in 2001. Foreign investors, including the American council business society and economic diplomacy representatives, have enhanced foreign investments[1] in the region. In June 2004, Serbia adopted the Action Plan for the Republic of Serbia, which facilitated direct investments with the Government Commission for Public Economic Development. Two years later, the Animation

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[1] The white book of the Council of Foreign Investors recognizes problems and suggests ways to improve foreign investment conditions.

and Development Strategy for Foreign Investment was adopted. This strategy involved sign posts and fixable terms to create favorable business behavior.

1. INVESTMENT BASES AND DIRECTIVES IN THE REGION

The investment climate is not the same as business environment in any one of the states in question. For the advancement of business environment, it is necessary to create for every one who has taken part in business life – domestic, foreign, bigger, smaller.

What is, in international institutions' opinion, important when it comes to business environment? East Europe has taken a significant place on the list of most efficient reformists in the world in the past few years. Out of 175 countries ranked by the World bank, according to the above stated, validating their effort in the promotion of business environment, Serbia has taken 68th place, as opposed to 27th it took in 2005. Out of all Balkan countries and former Yugoslav republics, only Slovenia went further and took 61st place. Croatia, Romania and Bulgaria have competed in the rapidity of implementing the reforms in the region with Serbia. During the last year, Serbia could have been the champion of completed reforms, and in 2006 with its customs reform, it was emphasized as one of the three bravest and most efficient reformists in the world.[2]

According to the estimate of the European Bank for Development and Reconstruction (EBOR), Serbia is actually half-way through transition, meaning crossing to efficient market economy. Serbia went further than her neighbours in targeting the goals, according to EBOR.

1.1. Investment directives in the region

The investment climate is not the same for every business in any one state. For advancement in the business environment, it is necessary to create opportunities for both domestic and foreign institutions. Eastern Europe has undergone significant reform in the past few years. Among the 175 countries ranked by World Bank for their efforts in business advancement, Serbia was placed 68th in 2006, down from 27th in 2005. In the Balkans region, however, only Slovenia ranks higher. Serbia faces increasing competition from Croatia, Romania, and Bulgaria.

In 2006, Serbia underwent extensive reformation by adopting one of the most efficient standards in the world.[3] Serbia is among a group of countries that have been advancing in the business world, especially in the employment sector.[4] Serbia was ranked at the bottom in terms of granting permission to work, an important consideration for foreign investors. According to the European Bank (EBOR), Serbia is in route to transition, meaning that it is crossing into the official market economy and becoming the most targeted area for foreign investments (Table 1).

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[2] The international Bank for Reconstruction and Development/The World Bank,Doing Business 2007:How to reform;Comparing regulation in 175 economies,2006,3.
[3] The International Bank for Reconstruction and Development, The World Bank, Doing Business 2007: How to reform; Comparing regulation in 175 economies, 2006, 3.
[4] Ibid

Table 1 Top ten banks by market share in Serbia and Croatia

	Serbia			Croatia		
Rank	Bank name	Mil $	%	Bank name	Mil $	%
1.	Raiffeisen bank	2636	14.0	Zagreb bank	1321	23.1
2.	Bank Intesa	1891	9.9	Business Zagreb bank	1022	17.9
3.	Hypo Alpe – Adria bank	1847	9.5	Erste&Steiermarkishe	6627	12.0
4.	Commercialbank	1540	8.7	Raiffeisenbank	6172	10.8
5.	HVB	1348	7.2	Society General	4837	8.9
6.	Society General	897	4.6	Hypo Alpe-Adria bank	3867	7.4
7.	Vojvodjanska banka	741	4.1	Croatian post bank	2180	3.8
8.	Alpha bank	654	3.5	OTP bank	1944	3.5
9.	Procredit bank	627	3.3	Slavonska banka	1631	2.9
10.	EFG Eurobank	601	3.1	Volksbank	1010	1.8
	Top 10	12782	67.9	Top 10	30611	92.1
	Other banks	4213	32.0	others	2999	7.8
	All banks	16995	100	All banks	33610	100

Source: www.hrcb, www.nbs.rs

Last year, Serbia ranked first in the Balkans region for economic growth. EBOR emphasizes that one of the main reasons is the low basement, meaning macroeconomic and structural problems; thus, restructuring public enterprises is a priority. Similar problems include a low transition level for infrastructure reform as well as increased competition. Over the past six years, such problems as political instability and lack of ownership rights have created a poor image of bureaucracy and corruption. Recently, Serbia enhanced its technical standards, quality control, origin regulation, consumer control, and accreditation procedures to combat this image.

2. Regulative economic and financial systems

The adoption of new bank laws has been motivated by EU directives and base regulations. Advantages of these new laws include corporative management principles; improved voting rights and bank capital; rational bank procedures; detailed bank control; client security rights, and risk management.

In 2006, 38 banks profited. Most were foreign owned banks, followed by domestic, corporate, and state owned banks, respectively. Overall, 72% were foreign banks, 20% were state banks, and 8% were domestic private banks.

In 2006, an estimated 114% of 40 countries comprised the credit ratio of the GDP, compared to 98% in 2000. Serbia had a credit ratio of 27% in 2006 and was placed 35th. This ratio was 18.7% in 2003, 22.7 in 2004, and 28% in 2005. Latvia, Bulgaria, Ukraine, Lithuania, Estonia, Romania, Geor-

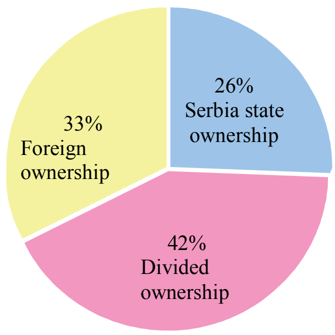

Fig. 1 Bank ownership structure since 2005

Source: ESPI Institute, www.institutespi.org gia, Russia, and Ireland have doubled this ratio since 2000. It is expected that the credit ratio in Serbia will be 31% for 2007, which remains far from that of other counties in the region.

In 2006, there were fifteen leasing enterprises, nine of which had foreign ownership, five of which had domestic ownership, and one of which had domestic bank ownership with foreign capital. The central bank grants licenses for financial leasing, employing the standards for rejection irregularity in conducting business. Written conditions for contract agreements provide transparency with obligations for financial leasing institutions.

Investment fund law is a new regulation in the region. The UCITS 1 and UCITS 2 directives (1985–2000) were developed by the EU for transition countries. Investment funds provide an efficient way to mobilize resources for corporations. Investment in the national economy influences dynamic development and the domestic capital market. Besides investment funds, voluntary retirement funds are represented by thrifty catalizators in developed financial markets.

The problem concerning the deficit is caused by transfers as well as the growing number of retirees and employees. Consolidated payment and reformation retiring administration in Serbia has been realized with the support of World Bank.[5] The basic principles of retirement funds include voluntary membership, defined investment risk, egalitarian members, work publicity, and accumulation funds. Advantages of voluntary retirement funds include safe equity, larger incomes, taxes allowances, smaller investment risk, and the development of a thrifty culture.

Currently, there are four registered funds with assets comprising 0.03% of the GDP. The EU directive offers secure manipulation of the financial market (Directive 2003/6/EC) as well as integrity and credibility for foreign financial markets through market manipulation.[6] The prospectus[7] directive (Directive 2003/71/EC) provides personal cards, which give important information to potential investors.

3. Banking comparisons in the region

The banking sector in Serbia is characterized by fragmentation. Only five banks have earned more than 5%, which comprise 50% of banking. There is no Cartesian banking problem; the largest problems are predominantly caused by the business environment. On the other hand there, there are many banks with less than 2% equity; 25 banks in the sector create the entire market share. Thus, further bank consolidation is necessary in the long term.

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[5] Voluntary retired funds and schemes are part of a third pillar retired system model.

[6] The conception of privileged information is completely harmonized with the Market Manipulations Directive, which defines privileged information and manipulations of the financial market.

[7] The securities act is organized by regular form, precise defined issuer subject responsibility, as well as the other persons involved in prospectus work.
Directive 2004/39/EC, organizing financial market and Security Exchange Commission.
Directive 2004/109/EC, transparency matter and protect investors.

Table 2 Bank shares for total banking assets in Serbia

Asset volume	December 31, 2005		December 31, 2006	
	Bank number	Asset participation	Bank number	Asset participation
Over 5%	5	50.3	5	49.3
2% till 5%	5	18.2	8	26.4
Under 2%	30	31.5	25	24.3

Source: www.nbs.rs, Bank balance sheets, author prepared

Unlike Croatia, there is no bank cartelization in Serbia. The top 10 banks comprise 92.2% of the market in Croatia but only 68 % in Serbia. The top 5 banks in Croatia comprise 72.7% of the market, compared to 50% in Serbia. It is important to note that the banking sector in Serbia, despite enormous growth in the last few years, comprises only one third of the balance sum in Croatian banks. The banks that have dominated market share can expect profitability due to good network positions and connections with clients.

4. Resemblances and differences in the region - banking sector

As for the banking sector in Serbia, it is characterized by fragmentation. Only five banks have earned more than 5%, which comprise 50% of banking. There is no Cartesian banking problem; the largest problems are predominantly caused by the business environment.

On the other hand, there are a lot of banks whose equity is under 2% so that 25 banks in the whole banking sector have participated in creating market share only with a quarter. This means that further banks consolidation is necessary, because in the long run, all mentioned banks would not survive independence.

Comparing banking in Serbia and Croatia, one can affirm the hypothesis that there is no Cartesian bank problem in Serbia: **Top 10 in Croatia make up as much as 92.2% of the market, and at the same time 68% in Serbia.** There are numerous differences in top 5 banks: in Croatia they make up as much as 72.7%, at the same time in Serbia about 50% of the market. It is important to consider the size of banking sector Serbia, which is, in spite of the enormous growth in the last years, only one third of total assets of the Croatia banks, under the total assets of the first 2 banks from Croatia. For the banks that dominate market share, it can be expected that their priority would be profitability, and not further growth in market share in business policy and development.

Most of them are very well positioned, have developed networks, connecting good clients and good management. New products are being introduced to the market; investment banking is being developed, investment funds widened, as well as private pension funds that are in some cases connected to the insurance. The dominant bank capital owners in Serbia (estimate December 2006) are: the state, banks and investors from Austria, Greek banks, other owners and other foreign owners. The best relationship between investing capital on one hand and collected deposits and placed assets (which is the most important purpose and goal for the arrival of the capital into the market as a precondition of the profit size) on the other hand, has been in the Austrian banks. Italian capital (Intesa bank) prefers the relationship similar to the German one, but with a small market share.

The most unfavorable are the banks with domestic capital, with their market position permanently getting worse.

The market is introducing new products and widening investment funds, especially private retail funds that are connected with insurance in some cases. In 2006, the dominant bank capital owners in Serbia were states, banks, and investors from Austria and Greece. Austrian banks have invested capital from one side and placed assets on the other side, which is the most important precondition for high profits. Italy also has a favorable market relationship but a small market share. The most unfavorable banks operate with domestic capital.

Table 3 Share in balance bank categories by ownership origin (in millions of dollars)

Origin stockholders	Capital participation		Asset participation		Placement participle		Deposits participation	
Austria	685	23%	6573	35%	3201	34%	4613	37%
Greece	637	21%	3225	17%	1362	15%	2007	16%
Italy	204	8%	2084	10%	1059	10%	1512	11%
France	174	7%	1032	6%	604	6%	890	6%
Slovenia	95	3%	549	3%	250	3%	338	3%
Hungary	74	3%	243	2%	152	2%	156	1%
Cyprus	57	2%	318	2%	151	2%	191	2%
Germany	64	2%	628	3%	301	4%	425	3%
Sweden	15		43	0%	20		23	
Other for.inv.	102	4%	302	2%	207	2%	203	2%
Serbia state	252	10%	1242	6%	645	7%	722	6%
Serbia enterp.	380	14%	1501	9%	957	10%	910	8%
Physical person	35	1%	159	1%	91	1%	106	1%
Total	2774	100%	17899	100%	9000	100%	12096	100%

Source: Bank balance sheets, author prepared

5. Financial system attractiveness

The regulatory framework for the financial market must continue development in order to achieve macroeconomic stability. Since 2006, Serbia has successfully reached an agreement with MMF and achieved a credit rating of B+, indicating stable to positive outlook. In the same period, World Bank, OECD, EBRD, and other referent institutions announced Serbia as the leader in Central and Southeast Europe.[8]

Serbia offers many advantages to foreign investors[9] such as strategic positioning, the lowest tax rate on profit enterprises in Europe, and a simple procedure for export trading and production. The EU has recommended the development of company law and an action plan[10] based on expansion transparency. There are two important areas for corporate

[8] Report World Bank, Business effects in 2007.
[9] Agency for direct investment and export promotion.
[10] Valuation system used by Freedom House, valuation 1 is absence of corruption; valuation 7 is max corruption;

governance: financial services regulation[11] and voluntary regulation. Corporate governance[12] refers to transparency of public information; equal treatment of auctioneers; a limited role of interest groups in corporate management; and a responsible management board.

The regulatory framework for financial market function was the condition sine qua non, but not sufficient. It was necessary first to realize and maintain the level that would enable satisfactory macro-stability and development, which had been accomplished to a large extent.

Starting in 2006, when an agreement with IMF was reached, and a change in Serbian credit outlook occurred from B+ stable outlook (November 2004) to BB- positive outlook (S&P credit ratio). During the same period in many reports of: World Bank, OECD, EBRD and others referent institutions Serbia was announced leader compared with countries in Central and Southeast Europe, thanks to fast conducting reforms.[13]

The advantages Serbia offered to foreign investors, by the order SIEPA[14] organizing are:

- Strategic position in Europe, Asia and Middle East,
- Customs-free and free trade zone in southeast Europe – 60 mil consumers
- The only country outside CIC – Community of independent countries that has a free trade agreement with Russian Federation
- Serbia is not a member of the EU, which gives more flexibility and advantages for the investors
- Lowest tax rate on enterprises profit in Europe (10%)
- Educated and cheap labor force
- The highest percentage of English-speaking people in southeast and central Europe
- Stable economy
- Simple terms for foreign investment
- Simple procedures for export, production and enterprise foundation
- Getting into Partnership for peace in December 2006.

The banking sector in the region has grown very fast during the last few years. Simultaneously market positions of banks have changed. The enormous interest of foreign banks has led to stronger competition. As part of the end game in the takeover of the complete banking sector reaches the finish line, competition becomes ruthless.Foreign banks, already positioned in the domestic market, have brought noticeable change to the business culture and mentality.

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[11] Transparency Directive (December 2004), Prospectus directive 9 November 2003), Insider deals directive (October 2002), national codexes corporate managing, corporate management in OECD.

[12] Modernizing Company Law and Enhancing Corporate Governance in the European Union. A Plan to Move Forward

[13] Report World Bank – Business effects in 2007 – valuabled from 92 up to 68th position in total ranked 175 countries. It has mean positiv signal for foreign investments:

- Direct foreign investment netto was $4.400 mil.
- Direct foreign investment netto was $1.550 mil in 2005

Was $966 mil in 2004.

[14] Agencie for direct investment and export promotion.

CONCLUSION

The banking sector in the Balkans region has changed rapidly over the past few years. Simultaneously, the market positions of banks have changed. The enormous interest in foreign banks has led to strong competition. Foreign banks that are already positioned in the domestic market have brought noticeable change to the business culture and mentality of Serbia. A number of activities aim to improve the business environment, attract foreign and domestic investments, enhance the level of competitiveness, and decrease unemployment.

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INSTITUCIONALNA HARMONIZACIJA TRŽIŠTA U RAZVOJU NA CENTRALNOM BALKANU

Nada Vignjević-Đorđević

Srbija je sprovela brojne reforme počev od 2001. godine u nameri da poveća makroekonomsku stabilnost i stabilizuje ekonomski rast, što je uticalo na početak procesa pridruživanja Evropskoj uniji. Brojne mere i ektivnosti koje su sprovedene i koje se sprovode imaju za cilj da postignu atraktivnost i povećaju ulaganje kako stranih tako i domaćih investitora, što bi uticalo na razvoj realnog sektora, povećanje konkurentnosti i produktivnosti kao i na smanjenje nezaposlenosti. Reforme u finansijskom sektoru igraju veoma važnu ulogu u celokupnom procesu. Stoga je neophodno kreirati novi regulatorni okvir, set zakonskih i podzakonskih akata, koji treba da se bazira na evropskim direktivama koje obezbeđuju poverenje i sigurnost za sve učesnike na finansijskom tržištu.

Ključne reči: *vlada, zakoni, strane investicije, regulativa, bankarski sektor, finansijski sistem*