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The primary focus is on its financial stability

Abstract

Refers to the process of simplifying complex ideas or concepts by focusing on the most important aspects and ignoring unnecessary details. The financial system encompasses financial markets, intermediaries, and other institutions responsible for executing the financial choices made by people, businesses, and governments. The composition of the financial sector includes various markets, such as the stock market, bond market, and derivatives market. It also includes financial intermediaries such as banks and insurance companies, which are considered enterprises that primarily provide financial products and services. From this perspective, the financial system may be understood as a constantly evolving entity, driven by interconnected transactions that occur across many temporal, geographical, and spatial dimensions. The multitude of financial links and transactions render these cycles a very intricate environment, devoid of a clear starting or ending point, yet nonetheless readily conceivable. The Kosovo financial system is a recently established entity.

Keywords: Financial system, banking institutions, accounting data, managerial practices, strategic planning, marketing strategies, etc.



Introduction

An efficient system is one that achieves a high level of function fulfillment while utilizing the most suitable instruments. These two directions are precisely recommended by the field of finance to assess the progress of financial institutions within a financial system. The relationship between the functions and form of financial institutions is characterized by the stability of the functions across time, while the structure of these organizations evolves to accommodate the functions. Consequently, the inquiry emerges: what specific roles does a financial system serve?

A financial system facilitates the temporary transfer of economic resources between various companies and nations by providing essential tools. This transfer is conducted from entities with surplus resources to entities in need of resources. The range of instruments utilized or provided by a financial system differs based on the system's level of advancement, the complexity of the system, and the economy it operates within.

The tools and procedures offered by it facilitate risk management, as each individual financial transaction involves the transfer of risk from one party to another. Financial intermediaries, particularly insurance companies, are commonly involved in transferring risks by offering specialized 'risk protection' to clients in return for premiums.

Enables the transfer of products and services by offering the essential methods of payment and compensation, regardless of location and time, among diverse economic entities with little resource and time consumption for the transaction.

It facilitates the consolidation of resources into a shared investment fund, enabling individuals to participate in shares of any amount. Additionally, it enables the collective ownership of enterprises based on the total invested capital without disrupting the physical structure of the unit.

The financial system's role, relevance, and dynamism rely on its intimate connection with the information system, which accurately represents every aspect and action within it. Individuals, businesses, and governments are financially engaged in a constantly changing information environment. They receive and provide data as they interact and develop relationships inside a financial system. The financial system inherently produces the essential price information required to facilitate the crucial decision-making process.

The aim of the paper

The theory of finance and the role of the financial system assume an essential concept: Depending on the level, role, and influence of the financial system on the economy, three stages of economic development are identified.

The initial stage is characterized by the empirical economy. Another crucial aspect of the empirical phase is the sluggish pace at which capital is circulated. An economy is deemed to be in the stage of growth described as a cash economy, when the financial and banking systems are primarily influenced by cash transactions and exchanges, eliminating the necessity for financial intermediaries.

The second phase corresponds to the credit-based economic system. Currently, banking plays a significant role in the movement of resources and income. The financial system becomes more dynamic with the use of banking intermediation. Consequently, the surplus entities transfer their resources and

finances to the deficit entities that require them. By adopting this approach, capital is exchanged more rapidly compared to the empirical phase, enabling economic expansion and the simultaneous growth of national wealth.

The third phase pertains to the realm of financial markets. The current stage exhibits a significant degree of development and refinement in financial intermediation institutions. Financial rights mediation institutions emerge and operate alongside liquidity mediation institutions. Within the realm of financial markets, the economy functions via intangible currency, specifically electronic money, which allows for the seamless transfer and investment of assets and capital regardless of location, time, or physical limitations.

Presently, the Kosovo economy exhibits a notable advancement in the banking system and its overall importance. However, a sizable amount of cash is still moving around in it. Kosovo has recently transitioned into the second stage, which involves credit.

The evolution of the financial system during the transitional period

- The establishment and ongoing growth of the financial system and market have played a crucial role in promoting and advancing the market economy during the transition period of the Kosovo economy. Naturally, it is important to view all this progress not as a goal in itself but rather as a means to drive the growth of our economy.

During the period from 1991 to 2005, the market and financial system experienced significant development. One notable aspect until early 1996 was the establishment of the Kosovo banking system with two levels. This involved the enactment of specific legislation and the increased autonomy of the Bank of Kosovo from the executive branch. Currently, the Savings Bank, the National Commercial Bank (BKT), and the Agrarian Bank are the remaining second-level banks in our country. However, the Agrarian Bank, in particular, has experienced a substantial decline in its significance throughout this period. As a result, the Agricultural Bank was dissolved and subsequently liquidated. Efforts were made to establish an office at the Bank of Kosovo to monitor the progress of the Prishtina Stock Exchange's establishment and the issuance of securities, including privatization bonds, during this time. This succinctly summarizes the initial stages of the creation and early development of the financial (banking) market during this period.

- Kosovo, at the onset of its shift from central planning to a market economy, held the unfortunate distinction of being the most destitute, geographically secluded, and technologically underdeveloped nation in Europe. The country's isolation resulted in the eradication of nearly all types of private ownership and effectively severed its connections with external influences and information. During the initial phase of the transition, the country was deeply entrenched in abject poverty, and the majority of its inhabitants lacked any understanding of market institutions and their operations.
- Despite Kosovo's rapid and relatively successful transition to a market economy, the changes implemented in the banking sector were severely restricted. The Kosovo financial system was still in its early developmental stages. Multiple private banks existed. An informal loan industry emerged and grew as a result of banks being unable to meet the private sector's credit needs. This market relied on family connections and remittances. Initially, informal lending companies were regarded favorably and were recognized as making significant contributions to the local economy. Furthermore, there were companies that not only received deposits but also engaged in investment activities on behalf of their clients, rather than providing loans. These companies eventually transformed into pyramid schemes, which had a significant impact on the economy, finance, and society, resulting in severe consequences.

- Given the circumstances, where the limited progress made in developing the financial system had been completely undone, it became imperative to essentially begin the work anew. This entailed rebuilding the financial system (including traditional banking, not modern banking) and establishing and operating the necessary market institutions, both in terms of legal framework and practical implementation. This became particularly evident after 1998, when a thorough and ambitious program of economic reforms was initiated, which definitely encompassed the financial sector and gave it significant importance. The objective of these changes was to provide the fundamental framework for the establishment of the financial market by providing the requisite institutions for the effective operation of this system and its entities in Kosovo.

There were several directives that governed the reform in this sector:

Firstly, it is important to prioritize the development of modern and progressive financial legislation, as well as the establishment of private banking and non-banking institutions. This should be done in collaboration with international institutions such as the IMF and World Bank, which specialize in providing guidance and support in this area.

Secondly, the implementation of a comprehensive and determined program for the privatization of two second-tier banks, namely the Savings Bank and the National Commercial Bank, both of which are fully owned by the state.

The third point emphasizes the governments' recognition, from 2000 to 2008, of the importance of prioritizing the development of the banking industry and non-banking financial markets as key drivers of rapid market economy growth. This recognition served as a catalyst for the establishment and functioning of banks. This became even more significant given the circumstances in a country like Kosovo, where private financial resources were inadequate for the essential and requisite development of the private market economy.

The majority of banks have implemented ATMs to facilitate electronic transfers and other transactions. In 2004, there were 93 ATMs and 155 POS. The constraint on ATMs stems from the fact that individual banks employ their own network of equipment and card acceptance. The government aims to overcome this challenge by establishing a national card to streamline financial transactions.

Nevertheless, electronic currency itself is not an impeccable answer. Similar to any medication, there are accompanying adverse reactions:

Table 1: Pros and cons of electronic currency

The main actors	Positive effects	Negative effects
Regulators	More controllable at the time of making the transaction	It leaves no trace, tax evasion Regulatory framework in motion
issuers	New and profitable markets	forgery
Clients	More practical to use	Failure to protect the client's anonymity
Traders	Access to global markets, Efficiency in actions	forgery

The rise in the number of electronic money users in Kosovo has corresponded with the increase in bank transactions.

From the previous description of the Kosovo economy and its progress, it is evident that despite being labeled as "fragile," it is important to assess its advancements towards stability and create an environment conducive to attracting both foreign and domestic investments. Additionally, it is crucial to foster the growth of a robust and influential financial system to further promote the economic development of the country. Nevertheless, the substantial prevalence of the informal economy continues to be a worrisome factor hindering further economic advancement. In order to understand how the economy's influence is manifested inside the financial system, it is necessary to thoroughly evaluate the system and all its constituent parts.

Conclusions regarding comparative analysis

The degree of advancement of a financial system and its constituent institutions varies among countries due to disparities in economic, technological, historical, political, and cultural development. Nevertheless, the shared characteristic across them is that every country's financial system has a specific set of functions to accomplish, which it performs through its financial institutions.

As shown in the aforementioned analyses, this research aimed to examine the financial systems of nations that bear resemblance to Kosovo in terms of their size, level of development, geographical location, historical crises, and transitions, among other factors.

The reports and studies on the financial systems of these countries consistently reference and support the principles of contemporary financial theories, which assert that economic development and the financial system are intricately interconnected. Furthermore, these theories emphasize a reciprocal relationship between the two, wherein they mutually promote each other's growth. What is particularly notable in these analyses is that the banking system is consistently the most advanced component of the financial system in all countries. Even in nations that have seen a full decade of transition, such as the Czech Republic, Hungary, and Poland, it was the banking system that underwent development and became more intricate and stable as an integral part of the financial system, hence fostering the growth of the credit economy. Economic development and fostering an environment conducive to attracting international investments in the financial industry.

Justification

The previous decades have witnessed a significant feature of the global economy, namely the trend of globalization and the integration of financial markets. Financial deregulation and technological innovation have been the main drivers of this movement. In Kosovo, the financial sector comprises 10 authorized commercial banks, 2 authorized pension funds, 15 authorized insurance companies (including 3 offering life insurance), 11 microfinance institutions (MFIs), 18 insurance brokers, and 56 financial institutions for business and investment (IFJB). Among the IFJBs, 8 are engaged in money transfers and payment activities, 4 are involved in credit activities, 3 are engaged in leasing activities, and one is involved in factoring. Additionally, there are 42 exchange offices, out of which two IFJBs are involved in credit activities along with other activities. In December 2017, foreign-owned banks controlled a significant majority of Kosovo's banking sector, overseeing 88.1% of the total assets. The remaining portion of the assets (11.9% as of December 2017) is under the management of local ownership. In Kosovo, the banking sector is highly concentrated, with the three largest banks managing 61.1% of total banking assets. Additionally, foreign-owned banks control 88.1% of the assets, indicating a significant level of concentration.

1. a) The EU has been actively working towards establishing a unified set of regulations for financial markets throughout its member states. This initiative is known as the Action Plan for Financial Services.
2. b) The aggregate value of assets held by the financial industry (excluding CBK) in Kosovo reached 5.91 billion euros in 2017, marking a 9.7% rise compared to 2016. The banking sector's assets amount to 3.87 billion euros, with an annual growth rate of 6.4%. This represents around 65.5% of the overall assets in the financial sector. The trust now manages pension funds totaling 1.653 billion euros, reflecting a growth rate of 16%. These funds make up 27.9% of the total financial assets. The assets under management by MFIs amount to 192.4 million euros, reflecting a growth of 28.6% and constituting 2.5% of the total assets in the financial sector. In comparison, insurance companies hold assets worth 177.1 million euros, with 155.7 million euros allocated to non-life insurance and 21.6 million euros allocated to life insurance, making up 3% of the financial sector's assets.

Over the past few years, the banking system has undergone infrastructure growth adjustments, resulting in a decline in the number of branches and agencies (sub-branches) of commercial banks from 265 in 2015 to 238 by December 2017. Foreign capital, specifically from Austria, Germany, France, Turkey, Slovenia, and Serbia, owns eight banks, while two banks are held by local entities.

Conclusions

1. The financial system, consisting of markets and financial intermediaries, is a constantly evolving entity that operates through the interchange of flows in many locations and times.
2. The primary functions of a financial system are resource allocation and risk management.
3. The economy and its financial system are intricately interconnected, with the level of development and the role of the financial system playing a crucial part in determining the stage of economic growth in a country. The three prominent phases are: 1. The second stage of the empirical phase. The text refers to the third phase of the credit economy. The financial markets are in a transitional stage.
4. An advanced financial system necessitates a robust economy, integrated markets, sufficient infrastructure, a civic and work culture, and, of course, a robust legal framework.
5. For almost 15 years, the financial system of Albania, along with other areas of the country's growth, has been undergoing a period of upheaval. The establishment of a dual-tier banking system denotes the early stages of financial system development. The primary phenomenon that significantly impacted the system was that of pyramid schemes, which had long-lasting adverse effects on the Kosovo financial landscape.
6. Despite being characterized as a "fragile" and unconsolidated economy, the Kosovo economy is noteworthy for its significant rates of development. In 2004, it had the greatest growth rate of 6.2% among other countries in Southeast Europe. Nevertheless, the primary issue plaguing the Kosovo economy is the significant amount of physical currency in circulation, indicating a lack of participation in the country's financial flows and system.
7. The Kosovo economy's savings are currently not fully integrated and utilized within our financial system. The system exhibits a tenuous linkage between personal and business finances. Individuals and corporations establish informal financial connections with other participants in the financial system without fully engaging in them and keep a substantial portion of their

finances outside the system. It is worth noting that over half of the population in the country lacks access to banking services. The majority of business funding comes from internal sources, accounting for around 75–80%. On the other hand, the contribution of financial intermediaries to addressing these demands is very small, at approximately 10–15%.

8. The banking system is a robust component of our financial system; nevertheless, it alone is insufficient to initiate the entire system into action.
9. The Kosovo banking system holds a significant position as the driving force behind the entire financial system, accounting for 90% of the total financial assets. The expansion of the banking network, the introduction of new banking services, and the increase in deposit volumes have greatly contributed to the economic development of our country. There are currently 17 banks operating in the country, with a total of 190 branches within the country, 101 agencies, and 3 branches located outside.
10. The fiscal system in Albania primarily relies on VAT and customs revenues. The two most significant sources of income in the state budget are the value-added tax and the personal income tax. However, our fiscal system faces challenges due to a substantial amount of tax evasion, which accounts for 11% of GDP. This evasion is mainly attributed to small businesses operating in the informal sector. These businesses, although minimally connected to the banking system, conduct their economic activities independently, without any oversight or reporting to the government.

Recommendation

1. The financial sector should enhance its framework, including banking oversight, and assume a more significant role in the advancement of the nation's economy.
2. Governments can prevent the occurrence of pyramid schemes in the future by implementing a well-functioning and official financial system. Additionally, they should establish a control framework that encompasses both formal and informal markets, with clear lines of responsibility for oversight and action. While preventing pyramid schemes may not be the primary motivation for establishing good governance, the existence of such schemes serves as a powerful reminder of the significant societal consequences of inadequate governance.
3. The current financial system in Kosovo relies mostly on the banking system. However, there is a need for the establishment of financial markets. This entails enhancing the institutional framework by curbing the presence of the underground economy and promoting electronic transactions over cash.
4. It is crucial to enhance the social security sector as it will serve as a reliable source of long-term investment capital. Unlike banks, which primarily provide short-term loans, insurance companies are the primary investment entities in most countries' financial markets, offering long-term capital. We have great expectations and a positive outlook on the growth of this sector.
5. Our nation currently lacks a fully developed economy and sufficient capital resources to establish and sustain a national stock exchange. A viable solution would be to establish a regional or Balkan stock exchange, where Balkan countries can join and participate in a unified stock exchange that includes countries of comparable size and development to Kosovo.
6. Enhanced assistance to facilitate the growth of institutions nationwide, particularly in the banking sector, with a specific focus on the establishment and advancement of novel banking

products. This includes ensuring their widespread availability across the country. Additionally, there should be consideration for endorsing the establishment of a private bank dedicated to bolstering agricultural production and agribusiness, or a private investment bank.

7. It is crucial to continue developing and expanding the non-banking market. Specifically, we should focus on ensuring the effective operation of existing non-banking institutions, such as property and life insurance companies, newly established pension companies, and enhancing the authority of supervisory institutions, not just through consolidation. In addition, effective enforcement of the current legislation in the private insurance and pension market is crucial to facilitate the continued liberalization of this market. Specifically, this pertains to the property and wealth insurance sector, where enhanced regulatory oversight is necessary to ensure fair competition and promote the growth and development of this market through legal enhancements.
8. The establishment of private pension businesses signifies the initiation of non-bank financial intermediaries, particularly those operating inside the indirect circuit. If the non-bank lending intermediaries we mentioned earlier, such as leasing companies, factoring companies, consumer credit companies, or participating intermediaries of the financial holding type, merchant bank venture capital, begin their operations, we can conclude that we are establishing a market for non-banking financial intermediaries in the indirect circuit.
9. However, the non-banking financial market would be significantly reduced if both non-banking financial intermediaries from the indirect circuit and non-banking financial intermediaries from the direct circuit, such as securities brokers, savings management companies, investment funds, insurance companies, and mutual fund investment companies, were not operational.

Enhancing the infrastructure is a crucial factor in enhancing the appeal of alternative payment methods. The authorities primarily focus on enhancing the security of information sharing and promoting enterprises to share this information.

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