

Credit policy and its impact in the work of Kosovo businesses

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Abstract

Credit policy in Kosovo is a result and a reflection of the general development of macroeconomic policy. In the post-war Kosovo economic trends were negative. Therefore, in order to come to recovery and promotion of economic development, Kosovo needs investments. Surely credits represent one of financial resources through which material factors are provided for opening of new jobs that will be expressed in the decreasing of unemployment and increasing of the national production. Kosovo, as a part of Euro area, can not make monetary policy, but it may make credit policy. Currently, out of the banking system of Kosovo is over 1.4 million euros of financial means, and for this sum the credit potential is reduced, as a very important factor for business and the economy of Kosovo in general. Credits in Kosovo are characterized by high interest rates and short time of their return, so the purpose of this paper is to show how much the credits have been in the function of the development of businesses in Kosovo.

Key words: *credit policy, the banking system, interest rates, economic development*

1. Introduction

Kosovo in the post war period (since 1999) was found under an international protectorate run by UNMIK as a transition phase. This phase has its own characteristics, which were expressed in the political and socio-economic developments in Kosovo. This phase was very difficult for Kosovo, as it had to overcome many political, social and economic barriers in its way to independence. So, in these circumstances the economic system was established, based on market economy. On the same basis the credit policy was established and functioned in Kosovo. Unfortunately, even

after the independence of Kosovo (17 February 2008) macroeconomic development policies and credit policies have not changed. Therefore, based on the economic results and developments, even after independence, we can say that neither adequate environment nor adequate policies that would be in function of current and prospective development of businesses and the economy in Kosovo were established. By early 2009, especially in the first years after the war (June 1999), Kosovo's economy was characterized by the phase of rebuilding the war torn country: burned residential houses and buildings, roads and bridges, clinics, schools, developing the economic and non economic private sector, the creation of the banking system with the Central Bank of Kosovo and 7 commercial banks, beginning of the privatization process in increased intensity over the past three years, investments in the energy sector, mainly from donations of international community that resulted in low levels of economic development, etc. Low level economic growth based on low gross domestic product (GDP) per capita, led to a continuous increase in unemployment. Even in 2009 there was no significant progress in economic development.

Gross domestic product per capita was amongst the lowest in the region. It should be noted that over 93% of the total unemployed are unemployed for a period longer than 12 months.

Coverage of imports of goods and services with exports in late 2009 was low (8:56%), due to the dependence of the Kosovo economy on imports, indicating a low level of general and structural development of the economy. To influence raising the level of economic development and employment, commercial banks since 2003 increased their financial support to economic activity through the extending credits for small and medium businesses and physical persons for various purposes. For long-term growth, creation of an attractive business climate remains the main challenge for economies in transition and developing countries. Creation of a suitable business climate is essential for sustainable economic development and increase local and foreign investment, and as a result growth of employment. The main goal of economy of any country is the development of the productive forces. The economic development of any country, regardless of its socio-economic system depends on many factors such as material factor, respectively investments. In 2009, Kosovo's economy recorded real growth of GDP in the rate of 3.8%, mainly as a result of increased public expenditure and fall in prices. This year was characterized by a deflation of 2.4% (previous year inflation of 9.3% was recorded).¹ The global financial crisis has not hit directly Kosovo, but its economy felt its effects indirectly.

¹ Central Bank of Kosovo (CBK), Annual Report 2009

2. Establishing of banking system in Kosovo

After 1999 the financial sector in Kosovo was newly established, since the entire former system which was based on other socio-economic system (socialist) had collapsed. Given that the new financial sector was established for a very short period, it was consolidated and it achieved considerable results, enabling a normal functioning of the Kosovo's economy.

In the view of the fact that the financial system in Kosovo is based solely on the banking system, since there is no capital market, while other financial institutions have little participation and their influence is symbolic in mediating the development of business, respectively economy of Kosovo, the banking system in Kosovo is mainly composed of foreign banks.

At first, foreign banks were the first to conquer the financial market of Kosovo; later several local banks were founded. First foreign bank that operated in Kosovo is the Micro Enterprise Bank, which began its work in 2000 and at first (until 2001) it was the sole operating bank. This bank in 2003 was transferred to Pro Credit Bank and the same is a mixed capital of some international financial institutions. After this bank, other banks that operate in Kosovo nowadays were established. Thus, in 2001 six (6) new banks - New Bank of Kosovo, Kosovo American Bank, Bank for Business, Commercial Bank, Credit Bank, Kasabank and Pristina Creditor Bank were licensed and began their work in Kosovo. Increase of number of banks operating in Kosovo was a positive development for Kosovo financial market, as it increased the competition in the banking business. During the years 2000- 2006 7 banks operated in Kosovo, and two of them (ProCredit Bank and Raiffeisen Bank) are foreign banks, while the five others are local banks. Two mentioned foreign banks were dominant and controlled more than 70.0% of the financial market in Kosovo. In March of 2006 Credit Bank of Pristina bankrupted, but this case did not endanger the banking system, as its participation in the financial market was only 4.0%.

The period from 2006 to date is considered as a phase of consolidation of the banking system, which is characterized by the increasing number of commercial banks operating in Kosovo. During this period two commercial banks were established in Kosovo - the Albanian Commercial Bank and Commercial Bank of Serbia (founded by the end of 2007). Meanwhile, in January 2008 Turkish Economic Bank and NLB (which was founded by joining of two banks: Kasabanka from Slovenia and New Bank of Kosovo) were established. Having in mind what we mentioned earlier, we may conclude that within the banking system in Kosovo now operate a total of eight (8) commercial banks, of which six (6) are foreign owned and only two (2) are in Local ownership. In this context we can say that the banking system in Kosovo is mainly composed of foreign banks, i.e. the financial sector is dominated by foreign capital. Thus, the total participation of these banks in assets of banking sector in Kosovo in 2008

makes about 90.0%. Kosovo's banking sector remains dominated by banks in foreign ownership, who manage 91.5% of total assets in 2009. Characteristic of the Kosovo's banking market continues to be high degree of concentration, where 81% of total assets are managed by three major banks.

From this it is not hard to conclude that the market of capital in Kosovo is currently dominated and controlled by foreign capital. Finally we can say that the banking system in Kosovo is efficient, stable and liquid and all internal and external financial transactions are processed by the same. The banking system in Kosovo was formed in the new basis, in accordance with European standards and made a clear progress, both in capital and in services. Now, the banking system in Kosovo is a modern one, with satisfactory performance in its scope of work.

3. Credit Policy

The period after 1999 represents the transition phase for Kosovo. This transition process in Kosovo had its own specifics and we have to mention on this occasion the destruction of Kosovo's economy by the invader during the war, lack of statehood, respectively lack of independence for Kosovo, and the time when Kosovo was ruled by United Nations administration called UNMIK. Not denying the economic achievements, we can say that Pillar IV and the government of Kosovo to independence and after it did not consistently apply policies of macro economic development. In other words the policy holders lacked the macro economic development concept and strategy. Unfortunately, they implemented an ad-hoc and a partial economic development policy in the post war period Kosovo. Based on this we can say that the policy holders of macro economic development policies (Pillar IV and the Government of Kosovo), failed to create for themselves sufficient economic and political space for preparing a comprehensive strategy and applying consequently economic policies which would ensure a proper and an efficient development in Kosovo. This policy led to a very serious economic situation of Kosovo, which now lies in a very low stage of development, and its population is facing a very difficult social situation. As a part of Euro area Kosovo is not in a position to make monetary policies, but it can make independently its credit policy. The inappropriate developments that took place in the monetary field could have been stopped and thus the means of the Kosovo institutions and its residents should have been returned to the market of capital, i.e. to the banking system of Kosovo. Here we face the paradox of Kosovo in monetary - credit policy. Unfortunately out of the financial market, respectively out of the banking system in Kosovo there are large amounts in monetary value, and this sum reduces the credit potential of Kosovo, as a very important factor for the development of businesses and the economy of Kosovo in general. The fate and destiny of over 400 million euros

of the Fund (Kosovo Property Agency or former Kosovo Trust Agency) - means which are gained from the sale of socially owned enterprises (SOEs), is not known. This fact, in addition to having a negative impact in the foreign investors, also brings more confusion since the capital of Kosovo lies in the external financial market, which would be understood as if this county has no needs for investments. We also may raise the question, why over 200 million euros from the Pension Saving Trust, financial means of residents of Kosovo, are not in the banking system? Central Bank and the Government of Kosovo are to be held responsible for this, since they failed to take measures in the frame of their competencies in order to bring back these means to the Kosovo banking system and thereby enhance the capital market which would affect extending credits under favorable terms.

In the post-war period the economic trends in Kosovo were not satisfactory, so, in order to come to promoting economic recovery and development, Kosovo's economy needed investment. The low level of gross domestic product (GDP) per capita is an indicator of low economic development of Kosovo after the 1999 war until the end of 2009, even compared with countries in the region; Kosovo is the most undeveloped country. The level of GDP per capita at the end of the third quarter of 2009 was conducted with an amount of 1731 EUR, or 1:59% lower than in the previous year. The realization of gross domestic product in Kosovo at this level is a result of several factors, in particular: lack of local production, lack of foreign investment, failure to complete privatization of SOEs, failure to activate many of privatized enterprises and the decline of the donations from the international community. Three factors that affected most formation of gross domestic product are: imports, foreign assistance and sent funds: Kosovo's economy recorded real growth of GDP of 3.8%, mainly as a result of increased public expenses and falling of prices.²

Table 1. Gross domestic product in Kosovo

Discription / Period	2002	2003	2004	2005	2006	2007	2008	2009
GDP (In Million euro)	2.447	2.420	2.282	2.238	2.270	2.378	3.804	3.792
GDP (Per Capita)	1288	1252	1161	1120	1117	1150	1759	1731
Workers Dispatch/ shipments (In Mil Euro)	341	341	215	281	318	398	536	506
Assistance from abroad (In Mil Euro)	887	688	565	491	465	352	357	291
Population (In 000)	1.900	1.932	1.965	1.999	2.015	2.063	2.096	2.129

Source: CBK "Monthly Statistical Bulletin" December 2009

² Ministry of Economy and Finance (MEF), the Kosovo Budget 2010, Prishtina

The year 2009 was characterized by a deflation of 2.4% (in the previous year the inflation of 9.3% was recorded). The year 2009 marked reduce of 5.6% of the money that Kosovars living and working abroad send to their families in Kosovo. The year 2009 also marked reduce in direct foreign investment of over 20% and reduce of exports and imports by 18% to 1.5%. It should be noted that, neither fiscal policy nor foreign trade policy and monetary policy were in full function of economic development. On contrary, in many cases the instruments of these subsystems made a negative impact in the economic situation, respectively in the local businesses. For example, in order of providing more means for the Kosovo consolidated budget, the tax policy had simply a fiscal character. Furthermore, in order to ensure greater budgetary funds, revenues are collected at the border through customs and VAT (Value Added Tax).

Credit is a tool for creating and maintaining good relations of the deposits, which are the fundamental source of funds for bank crediting. Thus the state enforces certain macroeconomic policy through the credit system, in terms of both sector and territorial aspects.

In the sector aspect the state supports industrial branches through the credit system with better conditions (lower rate of interest, longer time for return). In the territorial aspect, the state aiming acceleration of rural development and less developed regions finances their economic branches through more convenient conditions of credit system. The characteristics of loans in Kosovo are high interest rates and short time of their return. On the other side, the interest rate for deposits is very low. Thus, average interest rate on loans in 2004 was 14.8%, which in 2006 had a small decrease, 14.6%. Meanwhile, the average interest rate of deposits for the abovementioned years was 2.8%, 3.1% respectively. From these data it is not hard to conclude that the difference between positive rate (credit) and negative (deposits) was too large, and as a result commercial banks gained high income, and even extra profit, while interest rates in Kosovo remained pretty much similar to the ones from the previous year. The global financial crisis has not affected their growth, but on the other hand economic growth of 6% and the adoption of certain laws has not affected in reducing the mentioned rates. Government institutions refer to the quantitative measuring, but lack the quality aspect, as a result foreign investors (but also local ones) still see high risks in the banking system, for example that return in investment to be 15%, while in 2009 it was 13%. Despite the fact that the number of bad credits is increasing (from 3.3% in 2008 to 4.3% in 2009) credit interest rates remain high (10-24% average). High interest rates on deposits in Kosovo in 2009 could be considered as a "phenomenon", since the deposit rates in Europe have been

about 1% lower, as a result of the injection of liquidity in the financial sector by the Central Banks of European countries ³.

Therefore the reduction of deposit rates in 2010 in Kosovo is a normal adaptation to the market. High interest rates on deposits listed in Kosovo in 2009, reflect a situation in which banks have been in panic as a result of the global financial crisis. Being intimidated by any potential lack of liquidity, they compete to attract as many deposits and as a result we have had higher interest rates on deposits. Lack of "Lender of Last Resort" function by the CBK, to inject liquidity into the banking sector if needed, has also contributed to this phenomenon. At the same time, the inability of the CBK to inject liquidity into the banking sector has made banks to reduce granting of credits and preserve liquidity, and this has affected the real sector of the economy. Position of loans (net) by 70%, continues to dominate the structure of profitable means, while other positions take part with 24% form the requirements of banks' placements, marketable assets with 2.69% and 4.4% marketable securities. Last year cash profit structure was composed as follows: 77.31% credits (net), 19.86% requirements to banks' placements, 1.57% marketable assets and 1.26% of marketable securities. The difference between interest rates on deposits and credits at the end of 2009 was 10.1 pp, which represents an increase of only 0.7 pp compared to 2008, when this difference was smaller. This increase was the result of a slight increase in interest rates on credits (0.3pp) and decreasing interest rates on deposits (0.4 pp).

4. Structure of credits according to schedule and sectors

a) Structure of credits by maturity

Most of the credits consist of those with maturity of more than two years, which make 70 percent of total of credits. The difference in time frame of structure of credits is in favor of the medium/long term credits (70 percent). From the aspect of maturity, the banking system is characterized by a move towards medium-term credit, and in particular towards the long-term credits as a consequence of increased demand for these types of credit, in the frame of the diversity of products that banks are offering nowadays. Participation of credits with longer term maturity has followed a consistent trend of growth, reflecting increasing confidence of the banking system towards the business environment in Kosovo. The rest of credits consist of credits with maturities between one and two years, representing 11.2 percent of credits in total. Meanwhile, credits with maturity up to one year represent 18.8 percent of total credits in banking system. The most significant decrease in credits sector has been observed in

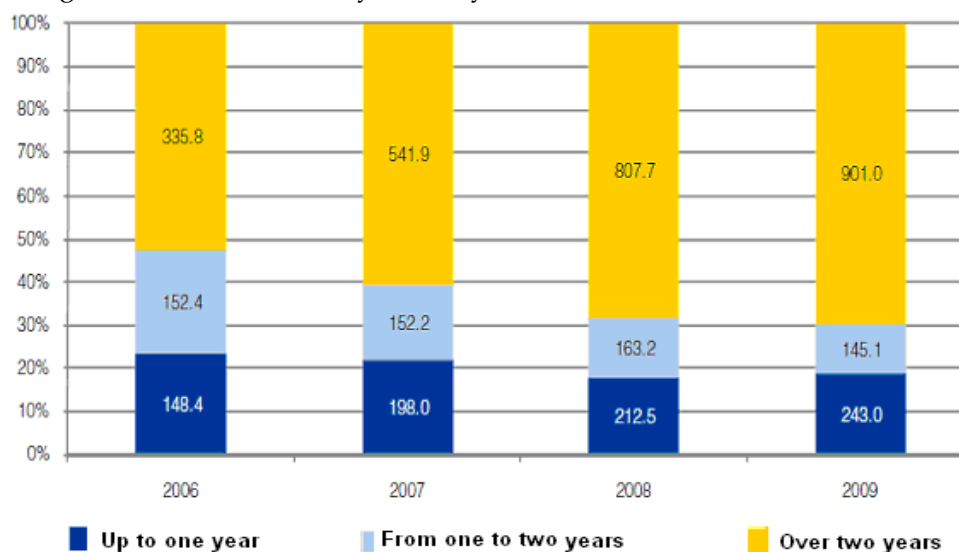
³ Central Bank of Kosovo, "Monthly Statistical Bulletin, December/2009

credits with maturities of one to two years, which represent the only category of credits, the value of which decreased for 11.1 per cent. As a general conclusion we can say that despite lack of stability that has affected credits, a trend can be noticed - in 2009, banks have intensified their work in the process of providing credits for a term longer than one year. This comes as a result of clients' preference and also reflection of a more secure environment in which banks operate. It is expected that this trend could continue in the future, because the conditions in which the banking system is operating, are becoming more favorable.⁴

b) The structure of credits by sectors

In the last three months of 2009 growth rates of increase of crediting of businesses slowed significantly. This performance reflects the slowdown of credit growth for liquidity and obvious contracting of credits for investment. Three month difference in net investment credits show a moderate decline, showing both the lack of support from the banking system for long-term projects, as well as lower demand of businesses for this type of credit.

Fig1. Structure of credits by maturity



Source: CBK (2010)

⁴ Central Bank of Kosovo (CBK), Annual Report 2009

Many businesses affected by the uncertain macroeconomic situation and the implications of the global financial crisis in the ALBANIAN(?!!)/Kosovo economy, become more reluctant in undertaking investment activities. During 2009, the survey of crediting activity of banks, noted that banks have impeded credit conditions for businesses. This behavior is influenced by future economic uncertainties, the worsening terms of specific sectors of the economy and rising level of nonperforming credits.

- **Sector of industry:** credit lending slowdown seems to have not affected the industrial sector credits, which reached a value of 236.7 million euros in 2009, representing an annual growth of 47.8 percent, which means that there is an increase in participation for credit industry (7.5pp).

- **Agricultural sector:** the sector with the lowest participation continues to be the agricultural sector, with only 4.0 percent of total credits to enterprises.

- **Trade sector:** the slowdown in crediting was noticed most obviously in the retail/trade sector, where annual growth of these credits was 5.7 percent, rising significantly lower than the prior year of 21.3 percent.

- **Credits for firms:** in their survey in crediting activity for 2009, experts said banks are tightening standards for credits given on a scale to enterprises compared with the previous observation where their participation in total of credits fell to 73.3 percent (to 76.3 percent in 2008). Factors identified by the banks, with significant impact in this tightening are the current situation and the expected macroeconomic situation as well as the sector specific problems in which firms operate. Condition of non-performing credits is a factor whose importance to the tightening of credit standards adoption has increased this year. Banks expect a relief in the degree of tightening of standards in 2009.

- **Crediting for family economies:** the share of credits to family economies rose to 26.7 percent of total credits (23.7 per cent in 2008). It is worth noting that the problems related to the execution of guarantees or credit given hostages affect, among others, the crediting policies of the banking system. Homes, real estate, other forms of collateral are put on mortgage but in most cases these forms of guarantees offered by the credit seekers are not executed by the execution organs i.e. the same are prolonged, a phenomenon that has forced banks to be more cautious in lending credits.

5. The effects of creditor policy in Kosovo businesses

Trends in changing the structure of credit in favor of manufacturer and service sectors have not been favorable. Distribution of credits by sector is mainly conditioned by the existing conditions of unfavorable credit lending. These conditions are particularly unaffordable for serious investment in the sector of SMEs (Small and Medium Enterprises) of the country, which require longer term for the return of the credit and lower interest. Lack of grace period

(free time between the moment when credit is taken and when it starts to turn) represents a special difficulty since this engulfed businesses with high costs of production. The distribution of credits by sector is mostly conditioned by unfavorable state of the existing credit lending. These conditions are particularly unaffordable for serious investment in the sector of manufacturing of SMEs in the country, which require longer periods to return the credit and lower interest. Volume of credit can not be considered adequate in comparison with the needs of businesses, demand for credits and experiences from other countries, especially with the needs of society for creating new jobs.

Consequently, the increased volume of credit supply and credit must be one of the main concerns of economic policy makers in Kosovo. As a result trends for changing the structure of credit in favor of manufacturer and service sectors have not been favorable.

In aspect of sectors, it seems that larger manufacturing enterprises face most serious problems, although declaratively the banks in their credit policies have given priority to this sector. However, the volume of credits, the term of returns and their interest rates make these credits unacceptable for the production sector. Over the last years credits from friendly countries and donations are significantly reduced, while there is an increased participation of own revenues and bank credits. Orientation towards the further development activities through new investments is still quite well expressed.

About 92% of surveyed enterprises have stated that they were planning new investment activities. It also should be noted that about 86% of enterprises intending to invest will need credits. However, predictions regarding the investments have been made "more realistic" in terms of investment volume expected to be realized.

Yet, businesses identify in the sources of investment main obstacles in realization of their plans, and while the other two (lack of business plans and economic and political uncertainty)⁵are seen as slighter obstacles.

In this regard, while in 2001 the economic and political uncertainty was considered the primary limiting factor, lack of financial resources is considered currently as the primary limiting factor. At this stage of development of banks, the improvement of conditions for business financing is conditioned by the influence of these factors:

- a) deposits and their structure,
- b) promotion of long-term savings,
- c) activation of specific credit lines.

Financial market development and introduction of new institutions in the financial system, especially insurance companies, guarantee funds, pension

⁵ Riinvest Institute, Research Report

funds and other financial income would significantly improve the financial environment, affecting the growth of financial and credit offer. According to the answers of entrepreneurs surveyed, more than half of them (55%) consider that the overall crediting conditions unfavourable. Compared to the previous year, the critical stance toward lending conditions is reduced, but still large majority of entrepreneurs consider credit conditions as not suitable for serious investment. Three factors that affect credit conditions have mostly influenced creation of these perceptions:

- Lack of grace period,
- Higher interest rates and
- Short deadlines for the return of the credit

With this analysis we come to the conclusion that credits are not favourable to businesses in Kosovo, in fact they are unfavourable.

Conclusion

Therefore, based on the results and the economic situation of the post war period, and even after independence, we can say that the Kosovo government did not create the proper space, i.e. failed to create a system and consistent economic policy and monetary – credit policy, which would be in function of current and prospective development to businesses and to the economy in Kosovo in general. We can conclude that credit policies were unfavourable for business and the economy of Kosovo, because interest on credits which are granted to citizens and businesses, is still considered high. They are higher than in countries of the region and Europe, but we believe that the entry of new banks in the market and increasing competition in the banking sector, particularly after the creation of circumstances after the independence of Kosovo and its international recognition, plus accession of the CBK in the international financial institutions as the World Bank and International Monetary Fund, will drop interest rates further. Serious problem in Kosovo remains a high level of unemployment, estimated about 45%, of course here we should have in mind the fact that a large percentage of the population of working age are not even included at all in the labour market. This problem becomes more complex with the age structure of the population, since a number of new job seekers is added to Kosovo each year. Government, in collaboration with key local and international actors, should develop a medium and a long term development strategy for Kosovo, where the key role would be given to the creation of better conditions for sustainable financing and development of businesses.

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