

Effects of capital markets development on economic growth of Western Balkan countries

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Abstract

Through this research paper we have tried to elaborate the issue whether capital market development is an alternative towards economic growth and economic prosperity of developing countries in general, the Western Balkan countries in particular. The focus of the paper is to study the effects of proper functioning of capital markets and their impact on increasing the level of savings, capital investments and in locating relevant resources for long-term financing of the economy. The research paper presents positive and negative arguments, linking the establishment and development of a capital market and its impact on economic development of developing countries, particularly Western Balkan countries.

JEL classification: D53, E44, G15, O16

Keywords: Financial markets, capital markets development, economic growth, Western Balkan countries, stock exchanges

Introduction

The study presents different views of the correlation between capital markets development and economic growth and the role of institutions participating in the capital market performance. The focus of the research paper is to study the effects of proper functioning of capital markets and their impact on increasing the level of savings, capital investments and in locating relevant resources for long-term financing of the economy. The existence of a proper legal and institutional infrastructure ensures a better climate for investments and a proper assurance for investors.

We cannot speak about modern economies without mentioning the financial market as one of the most important subsystems of the economic system, and its impact on economic and social

processes. Strength and performance of a country's financial sector is an indicator of the strength and performance of the overall economy of that country. Today, many countries in the world, compare their economies based on the functioning and performance of their capital markets.

Through this research paper we have tried to elaborate the capital market as a very important segment of a financial market, capital market development and its impact on the economies of the Western Balkan countries, the challenges of developing the capital markets as the prospect of increasing the financing resources and capital investments in the Western Balkan countries. Developments in capital markets in Albania, Croatia, Macedonia, Serbia, Montenegro and Bosnia.

The future of capital markets in the Western Balkans countries addresses the challenges that these countries will experience during the process of economic integration with the developed countries.

1. Capital markets in developing countries

Today, many countries in the world, compare their economies based on the functioning and performance of their capital markets. Capital market plays an important role in economic growth and economic prosperity of a country. Most developing countries, in Eastern and Central Europe, have implemented reforms in the financial sector, in terms of restructuring and privatization of public companies and the establishment or development of capital markets.

At the core of these reforms is the importance of participating institutions towards economic development in general, and performance of capital markets in particular.

In developing countries, the greatest participants in the capital markets are individuals, or households presented as investors. Capital markets in less developed countries, are too shallow in terms of market capitalization because of the limited number of listed companies and a limited number of participants (individuals). This limitation comes as a result of lack of capacity or awareness or conscience on capital markets.

However, during the last two decades, capital markets in developing countries have experienced a rapid development. Aggregate value of the capitalization of developing countries, classified according to the IFC (International Finance Corporation), has increased by 488 billion dollars, as it was in 1988, to 2.2 billion dollars in 2006.¹

Bank-based system as the source of funding, still dominates in some developing countries. Theoretically, financial markets affects in reduction of depen-

¹ Stefan Hellmer, "Establishment of Capital Markets in Least Developed Countries", July 2008. p. 54

dency from bank-based system. Most of the developing countries, until very recently, haven't had a developed capital market. Even those countries that have established a market-based system, have experienced stagnation in terms of their performance for several years as compared to developed markets in the world.

Capital markets in developing countries do not have only the meaning of mobilizing domestic resources for financing, but also providing or attracting foreign direct investments. Capital markets will impact on improving the mobilization of domestic resources to finance and promote the efficient use of capital.

For a country, in order to establish and develop a genuine capital market, firstly it must strengthen its financial institutions like banks, mutual funds, pension funds, credit unions, savings associations. These are the most important institutions which can mobilize financial resources in the form of savings by individuals, and puts them into capital markets. Capital market development, equity market respectively, has been the main goal of the program of internal financial liberalization, implemented by many countries of Central and Eastern Europe.² However, unfortunately in some countries, this program of financial liberalization reforms has not been completed, which results in the non establishment or further development of capital markets. Today, the governments of these countries are committed to establish and further develop their capital markets as a direct form of mobilizing capital for the corporate sector.

Also these countries have had, and still have considerable support from the International Finance Corporation (IFC), in terms of continuing the implementation of these financial reforms.

Further development of capital markets in developing countries is expected to improve the mobilization of local resources and to promote a more efficient use of capital. Also the governments of these countries will play an important role in promoting foreign direct investments and in the integration of their markets to global markets.

Reforms in the financial system continues to be part of the development agenda. Recent movements in the global economy have contributed to the urgent growth in financial sector reforms in developing countries.

1.1. Correlation between capital markets development and economic growth in developing countries

For years, different researchers have done many studies to support with evidences or arguments, if the establishment of capital market and its development will have or not a significant positive effect on economic growth in deve-

² Mohtadi, H., & Agarwal, S. (n.d). *Stock Market Development and Economic Growth: Evidence from Developing Countries*. p.38

loping countries. Different research papers made, provided different results or arguments.

Some studies conducted on this topic have found that if a developing country establish a capital market, it will contribute to positive economic growth of that country. In these circumstances, companies will raise capital needed and individuals or households will require investments that offer the best return rate on the capital market. Capital markets, as a result of their liquidity, helps reducing the investment risk as a result of the ease of trading capital, and which make the securities more marketable by reducing the liquidity risk.

However, other studies has resulted in contrary arguments or evidences, concluding that the establishment and development of capital markets in developing countries have not contributed positively to economic growth of those countries, but have had more negative than positive effects, because these countries tend to have high rates of volatility on the price of securities.³

These countries would do better if they use their human, institutional and material resources in order to improve more their banking system rather than promoting capital markets.⁴

The main argument of this hypothesis is that capital markets in developing countries, are generally less regulated and poorly organized in comparison to the capital markets of developed countries. This hypothesis emphasizes that there is an evidence or argument in terms of the importance and influence of the capital market development into long-term economic growth, and almost no such argument in terms of developing countries.

Some developing countries are characterized by smaller financial system compared to the size of their economy, with a narrower range of financial institutions, mainly dominated by commercial banks. In these countries, the Central Bank is a "branch" of government, as a result of lack of independence of the Central Bank, which is influenced by the political process and its role in economic development is limited.

Capital markets with the proper functioning financial institutions and well organized regulatory system, accelerates economic development. Stock market liquidity is an important indicator of a real GDP growth.⁵

Capital markets influences economic growth through a number of channels such as liquidity, risk diversification, providing information for companies, corporate governance and the mobilization of savings.

³ Stefan Hellmer: "Establishment of Capital Markets in Least Developed Countries", p. 80.

⁴ Ibid p. 82

⁵ Stefan Hellmer, "Establishment of Capital Markets in Least Developed Countries", July 2008. p. 78

Countries with developed capital markets have shown greater GDP growth compared with countries without capital markets. Risk index and the level of income of a country are the best indicators of functioning capital market. The higher the risk index and the low level of income, the more dysfunctional will be the capital market and vice versa.

Correlation between capital market development and economic growth varies based on level of income and capitalization rate of a country. Countries with more developed capital markets benefits more from foreign direct investments.

2. Capital markets in the western balkan countries

The financial sector in the Western Balkan countries has improved markedly in recent years. These achievements are the result of continuing the implementation of comprehensive reforms by governments and supported by international financial institutions like World Bank and International Monetary Fund.

Chaotic situation created by the banking sector crisis, hyperinflation and pyramid savings schemes are almost forgotten. Regulatory frameworks are upgraded and financial supervision is strengthen and improved. The privatization process has helped to reduce public companies, and encouraged foreign banks to enter the market.

Despite these positive developments, capital markets in the Western Balkan countries are characterized as small, fragmented, in the early stage of their development. In many countries of the region, banks constitutes the largest part of the financial sector, while capital markets constitutes a marginal role. Market capitalization value of the nine Stock Exchanges of the Western Balkan countries reaches the value at 54 billion euro. This shows that the capital markets of these countries are far from comparing with the european countries capital markets and beyond.

Capital markets for Western Balkan countries do not have only the meaning of mobilizing domestic resources for financing, but also providing or attracting foreign direct investments. Capital markets will impact on improving the mobilization of domestic resources to finance and promote the efficient use of capital.⁶

Research has found that the establishment and development of capital markets in the Western Balkan countries do not have any major impact on economic growth of those countries. Capital markets in the Western Balkan countries in general are less regulated and poorly organized in comparison to the capital markets of developed countries. These countries are mainly characterized by

⁶ Bekaert, G., Harvey, C. R., & Lundblad, C. 2006, 'Emerging Equity Markets and Economic Development', *Journal of Development Economics*, vol. 66 (2 Dec), pp. 465-504.

smaller financial system compared to the size of their economy, represented with a narrower range of financial institutions, mainly dominated by commercial banks.

Economic and political decisions involved in the legal framework for the establishment or continuous development of capital markets were rushed to several Western Balkan countries. For this reason, stock exchanges have not succeeded in promoting or encouraging the participation of a greater number of internal or external investors, excluding public companies.

Capital markets of the Western Balkan countries are characterized as non liquid markets, isolated from other markets, have a small volume of transactions, limited capital mobility due to high costs of travel and communication. Greatest market participants are governments, public companies, pension funds, banks, insurance companies, investment funds etc..

The bond market is in a slightly more developed than the stock market, because of the greater potential to mobilize a large amount of capital. Bonds are generally more attractive and favorable to investors than stocks.

Establishment of an well-integrated and organized information service, which will provide accurate and timely information for investors, would be necessary for capital market development.

The limited presence of institutional investors effects a restricted demand for capital. Consequently, the lack of an active role in public distribution of securities by other financial institutions such as banks, pension funds, insurance companies are restraining the supply of capital.

The low level of savings in some Western Balkan countries has led to falling demand and supply for capital into capital markets.

2.1. Challenges of developing capital markets in the Western Balkan countries

In many aspects, ensuring the financing resources through capital markets fulfill the needs of the economies of the Western Balkan countries to support their future economic development.

Greater reliance on capital markets by companies in these countries can enhance the level of competition by improving and strengthen the forms of ensuring the necessary financing funds needed for economic growth and development, and improving corporate governance. Finally, the increased demand for financial information relating to developments in capital markets will lead to the establishment of an information infrastructure in the region.

Capital markets contribute to economic growth through mobilization of savings of an economy and distribution of them into the most productive investments in the corporate sector.

The financial crisis has highlighted the needs for economies of Western Balkan countries to develop local funding resources and to diversify their financial system dominated by banks.⁷

Modernization of the trading system to improve liquidity, encouraging foreign investors are among the measures that are also needed.

Economic policies directly effects the confidence and activities in the market, therefore it requires a close public-private partnership between government and private sector, to ensure that policies are formulated with the guide from the two sectors, in order to ensure economic welfare and prosperity.

2.1.1. Capital market in Albania

In the early 90's, Albania implemented important and substantial reforms, the effect of which gave a positive result. expressed in high economic growth, low inflation rates, improved current account from balance of payments, and significant improvement in the fiscal deficit.

However, due to the centralized economy, Albania inherit a completely underdeveloped financial system, with a little experience in the banking system and a nearly unknown non-banking system.

Recently, the Albania's financial system has evolved to a significant degree, except the financial shock in the market caused by the collapse of pyramid scheme in the mid 90's.

The main pillar of its financial system is the banking sector, composed of several local and foreign banks operating in the country.

Good macroeconomic performance has been achieved based on macroeconomic stabilization program (reduction of fiscal deficit, increase of money supply and control of inflation rate), price liberalization, privatization of the economy, etc.

These reforms posed to coordinate the process of establishment of important financial institutions, regulatory authorities, operating agencies, etc., in order to do an easy transformation from centrally planned economy to a market economy.

Albania had no previous experience in capital market, up in the last decade. The beginning of the privatization process brought the need for capital market, legal framework and establishment of institutions. Currently, in Albania operates only a single stock exchange for trading of securities, Tirana Stock Exchange (TSE).

TSE is organized as a market driven by the order, and trading sessions are performed through an open system with manual call. Currently, TSE do not

⁷ Bajraktari, Rexhina & Brahja, Ermira: *"Capital Markets in Central and Eastern Europe"*, 2004. p. 128.

have an electronic trading system. TSE has six members (three banks and three private companies).⁸

Although the capital market is underdeveloped, in Albania there are some capital market participants who create supply and demands for securities. Leading securities bidder is the Government which emits securities of public debt.

So far there are emitted bonds or debt securities at the local level (municipal bonds). Public companies are also important bidders and they only emits ownership securities (shares). These shares issued by public companies are emitted only for strategic investors, while private companies trade their shares in the informal market.

The demand for securities, mainly comes from financial institutions such as banks, insurance companies, pension funds, brokerage houses, then the international financial institutions like EBRD, IFC, EIB, American Express Fund, etc. Another important market participant is the public, particularly individuals who invest their savings in Treasury bonds.

The main reasons for the malfunctioning of the capital market in Albania are:

1. Imprudence and fear of businesses to list on the stock exchange.

Generally this comes from lack of financial transparency and the tendency of local businesses to evade taxes.

2. Inadequate policies and advice implemented by donors.

All advice and technical assistance from donors, since 1997 have been focused more on developing the banking sector, and less on non-banking financial sector.

3. Lack of political will to develop and trade

Besides the lack of funding from donors, the government could have done more for capital market development in Albania. This can be accomplished through:

- Listing on the stock exchange of public companies. TSE has never been involved in the privatization process, as other East European countries did. Government has never issued a public offer to public companies through the TSE.

- The granting of rights, the TSE to organize the primary market for emission of public debt instruments.

- Providing support and encouragement of companies to list on the stock exchange.

⁸ Bank of Albania, annual report 2008. p. 30.

FIELD	CHALLENGES
Capital market infrastructure	<ul style="list-style-type: none"> • Deficient legislation • Lack of donor funding and orientation towards development of the sector • Market regulators are inexperienced and not well coordinated with bank regulators • Companies are unwilling to disclose the requirements for listing on the stock exchange
Volume of activity	<ul style="list-style-type: none"> • Small market • Listing and trading are in small amounts • Investments in government securities to finance budget deficits are increasing as companies are faced with insufficient funding to finance.
Lack of investors	<ul style="list-style-type: none"> • Still higher degree of political, commercial and market risk to foreign investors (but not for local investors) • Insufficient level of development of contractual savings system to produce demands from institutional investors
Other	<ul style="list-style-type: none"> • Lack of political will to support further development of non-banking financial sector

Non-banking financial sector in Albania is much less developed than the banking sector, characterized by a limited number of financial intermediaries and small capacity of financial services. There are many challenges that the sector is facing in its path of development in the near future.

Unlike the experiences of countries in Central and Eastern Europe and the countries of the region, the privatization process in Albania has not gone through the capital markets, thus avoiding the possibility of creating an initial offer of securities in the market. Tirana Stock Exchange, as the only stock exchange licensed by the Securities Commission of Albania was discarded without proper support from state authorities, operating only in legal terms but not to the operational.

The high level of informal economy is affecting local businesses for not using the stock exchange as an alternative source of financing.

2.1.2. Capital market in Croatia

The process of globalization in Croatia is backed by the full acceptance and strengthen of international accounting standards, but the development of capital market is going with very slow steps.

With two stock exchanges for trading securities, well equipped and in readiness for serious transactions, Croatia is still waiting for real investors and to stimulate trading climate.

Financing the development of companies through public offer is totally unknown to companies in Croatia. State has not stimulated the development of capital market due to the sale by public tender of all companies that had shares in the portfolio of public funds.

Croatia belongs to the group of countries in Central and Eastern Europe, that during the transition process, has made market regulation through the democratization of policy and access to a free market economy. Croatia, like other countries in transition, has been in a situation which had necessarily developed financial market, especially the capital market with necessary financial and non-financial institutions. Besides the huge success of macroeconomic stabilization program, Croatia's capital market has developed relatively slowly, due to the time of wars and regional security risk.

Bond market in Croatia is an excellent example of the correlation between fiscal policy and the market itself. As a country in transition, Croatia is facing the implementation of a series of necessary reforms in its economic and financial system. The level of capital market development is the result of an open economy, but also partly as a result of current needs related to the efficiency of this financial market segment.

2.1.3. Capital market in Macedonia

Creating a vital financial system in Macedonia, has been an essential aspect of economic transition process in a market economy. Building such a system has shown great difficulties and challenges. Macroeconomic stability of Macedonia is a result of maintaining low inflation rate and stable exchange rate of the denar, which have impacted positively on the capital market operations.

In recent years, in Macedonia are introduced and implemented a number of initiatives that have affected all aspects of development of banking and financial market. Through the implementation of programs for monitoring the financial system stability will be achieved improvement of economic conditions as a prerequisite for effective reform in the capital market.

Programs for managing monetary policy, legal frameworks, the application of positive experiences and practices of developed countries, has helped Macedonia a lot in the promoting and implementation of specific policies directed for reforming the financial system.

Among the most important financial institutions in Macedonia are banks, insurance companies, leasing companies, brokerage houses. On the other side, the Macedonian Stock Exchange, as part of the capital market, has remained as essential part of the process of transition to a market economy. All these entities operate in particular regulated and controlled segments.

**The structure of Macedonia's Financial System
(in % of total assets and GDP)**

Sub-systems:	% of total assets	% of GDP
Banking sector	91.67%	65.9%
Insurance sector	4.48%	3.3%
Financial Leasing	2.02%	1.6%
Capital Market	1.83%	1.3%

Source: Ministry of Finance, Republic of Macedonia, Annual report 2008

Macedonia's financial system has the same characteristics with continental (Europe), where the banking sector is dominant. Other financial market segments are in the process development. In recent years, the capital market and insurance segment has undergone a rapid development. Failure of Macedonian financial system to respond to the request for funding from the local private sector, remains a serious problem for economic growth. With underdeveloped capital market, the collection of savings to finance the development of private sector companies is done banking sector.

Among the main problems which effects the slowly development of capital market in Macedonia are:⁹

- higher costs of financing for firms (interest payments) -which is reducing their profitability;
- Wider benefits from the investment of money in bank deposits rather than in securities (deposit interest rates is higher than the rate of return from investments in securities);
- low rate of savings (lack of capital needed for investment in capital market)

Investors should have complete, precise and in time information for firms that wish to invest. This allows them some time to respond to developments in the company and to prevent losses.

⁹ Broadman, H., Anderson, J.; Claessens, C.; Ryterman, R.; Slavova, S.; Vagliasindi, M.; & Vincelette, G. (2006), "Building Market Institutions in South Eastern Europe: *Comparative Prospects for Investment and Private Sector Development*", The World Bank, Washington, D.C. p. 145.

The confidence of investors in the stock exchange is based on legislation which protects their property rights and the possible manipulation of securities prices.

For Macedonia is very important to continue to work on further liberalization of market segments by removing all barriers and by simplifying administrative procedures for the entry of major financial institutions in the Macedonian market, improvements in the field of law, improving competition.

Strengthening of economic growth will enable financial institutions to improve their performance and enhance their activities. So, right now the convergence through the EU financial sector is low, but is expected to grow in the near future.

2.1.4. Capital market in Serbia

Capital market in Serbia has started functioning at 90's to, affecting general trend of liberalization during the early phase of transition toward market economy.

Initial positive developments are accompanied by social and political disorder and economic collapse caused by hyperinflation, wars, isolation from Eastern Europe and other countries of the world.

The process of privatization of socially owned companies and emitting of state bonds to savings holders in foreign currencies, has started in the early 90's. As a result of the privatization process and the allocation of government bonds, many individuals have become current and potential participants of the capital market.

However, the fact is that along with increased public interest in securities trading, stock market still remains unknown to a large population and a serious effort is made to educate the public on these issues.

In the past decade, the concept of planned economy has been abandoned, the capital market was not really established. As part of the small changes undertaken in that period, no significant change is made in terms of free functioning of capital market.

Recently, there have been four fundamental changes that have created the institutional framework of the capital market. These are:¹⁰

- The law on capital market and securities;
- Regulations in terms of savings in foreign currencies;
- Changes in tax system;
- Accounting and audit law.

Currently in Serbia operates only one stock exchange for the trading of securities, the Belgrade Stock Exchange. Further development of Belgrade Stock

¹⁰ Belgrade Stock Exchange, annual report 2008. p. 18.

Exchange is closely related to the development of the country's entire financial system. The main purpose of the Belgrade stock exchange is to cover the need for the developing and financing of local enterprises, banks and other market participants.

As another important factor in further development of capital market in Serbia, is the process of privatization.

2.1.5. Capital market in Montenegro

In the last five years, Montenegro has made significant progress in establishing and developing the capital market. However, it is still far from the level of development and comparison with the capital markets of developed countries.

As in many transition countries, also in Montenegro, the main participants in the capital market have different objectives or goals from those of developed countries, and their behaviors are different.

Capital market in Montenegro is in the initial stage of development. In recent years, Macedonia completed the institutional framework for efficient market functioning. In 2000, it implemented the law on securities, which also represents the primary legislation governing the securities market in Montenegro.

Securities Law regulates the conditions for the emitting, public offering and trading of securities, the rights and obligations of market participants and the organization, purpose and work of the Securities Commission.

Securities Commission is the regulator of the market in the Republic of Montenegro. The Commission has the right of licensing and supervision of participants in the securities market, approval and supervision of public offerings of securities, authorization and regulation of collective investment scheme, regulating the forms of trading and circulation of securities.

Currently, in Montenegro are operating two stock exchanges for trading securities, Montenegro Stock Exchange and NEX - New Securities Exchange.

Capital market in Montenegro has experienced a tremendous growth over the period 2005-2007. In fact, all markets have experienced a growth, but Montenegro was the market with the highest rate of growth (595.63%).¹¹

Many indicators show that the capital market in Montenegro has a good prospect in the coming years. These indicators are based on:

- Creation of open investment funds and analysis of opportunities for transformation of existing closed investment funds in open investment funds.
- Development of pension funds
- Establishment of channels for private savings in the capital market.

¹¹ Montenegro Stock Exchange, annual report 2008. p. 20.

2.1.6. Capital market in Bosnia

Bosnia's capital market is still considered as the underdeveloped market. Currently, there are active two stock exchanges: Sarajevo Stock Exchange and Banja Luka Stock Exchange. Both exchanges have similar stories of their establishment and their aim is the establishment of a stable and functioning capital market. Sarajevo Stock Exchange was established in 2001, as a central market for trading the securities. Initially established as a joint stock company of eight members, mainly brokerage houses. In recent years the performance of the Sarajevo Stock Exchange is growing. Since 2002, when work began on trading securities, the capitalization rate on the Sarajevo Stock Exchange has grown to about twenty times, and at the end of 2007 it was 651 million euros.¹²

In recent years, has been an increase on the average daily trading volume of securities, and at the end of 2005 the amount reached 1.5 million.

Despite these promising figures, stock exchanges in Bosnia continues to be small in terms of number of transactions and amounts compared with other stock exchanges in the region and beyond.

One of the main reasons why Bosnia's stock exchanges are experiencing a slower rate of development is poor legislation.

Another weakness is the lack of transparency regarding company information. For all other stock exchanges in the region and beyond, transparent information about companies are elementary and basic conditions for the functioning of a capital market.

Another problem is the political situation in the country, since the process of further developing of the capital market in Bosnia is closely linked with the process of political stability. Capital market in Bosnia can get itself in complete form only when the country achieved sufficient political stability, and this will also affect the promotion of foreign investors in the accumulation of capital from abroad, cooperation with countries and other regional stock exchanges etc.

3. Conclusion

Capital market, being a very important component of the financial market, plays a key role in mobilizing the funding resources of a country and stimulating foreign direct investments. For developed economies but also for some emerging economies, financial market, capital market in particular, is considered as a promoter of economic growth and development of these countries.

In theoretical terms, many studies have argued that there is a positive correlation between the establishment and development of capital markets and

¹² Sarajevo Stock Exchange, annual report 2008, p. 25

economic growth, but in practical terms, specific empirical studies have given different results.

Several studies conducted have found that if a developing country establish a capital market, it will contribute to positive economic growth of that country. In these circumstances, companies will raise necessary capital and savers (individuals) will require investments that offer the best rate of return on the capital market. Capital markets as a result of their liquidity, help reduce investment risk as a result of the ease of trading with capital, and which make the securities more marketable by reducing the liquidity risk.

However, other studies has resulted in contrary arguments or evidences, concluding that the establishment and development of capital markets in developing countries have not contributed positively to economic growth of those countries, but have had more negative than positive effects, because these countries tend to have high rates of volatility on the price of securities.

Also there were many positive signs when examining the esablishment of capital markets and their impact on economic development of Western Balkan countries. Capital markets in the Western Balkan countries are characterized as small, fragmented, in the early stage of their development. Are less regulated and poorly organized in comparison to the capital markets of developed countries. These countries are mainly characterized by smaller financial system compared to the size of their economy, and represented a narrower range of financial institutions, mainly dominated by commercial banks.

Almost in all Western Balkan countries, banks covers most of the financial sector, while capital markets constitute a marginal role. This shows that the capital markets of these countries are far from comparing with the capital markets of other European countries.

Capital markets for Western Balkan countries do not have only the meaning of mobilizing domestic resources for financing, but also providing or attracting foreign direct investments. Capital markets will impact on improving the mobilization of domestic funding resources to finance and promote the efficient use of capital.

Economic and political decisions involved in the legal framework for the establishment and further development of capital markets were rushed to several Western Balkan countries. For this reason, stock exchanges have not succeeded in promoting or encouraging the participation of a greater number of internal or external investors, excluding public companies.

Among the main problems facing the capital markets of the Western Balkan countries are:

- relatively small capitalization of securities market;
- limited perspective to joint capital investments and private investments;
- small volume of transactions, which affects the increase of transaction costs;
- low number of participants in the market (the main participants are the government and some large public companies, less private companies);
- information regarding investments and borrowings are not readily available as in developed markets but are relatively expensive;
- basic information about investment opportunities and rates of return are imperfect;
- Diversification of investment portfolio is relatively expensive;
- Increased presence of the informal economy.

The limited presence of institutional investors effects a restricted demand for capital and consequently, the lack of an active role in public distribution of securities. The low level of savings in some Western Balkan countries has led to falling demand and supply for capital in capital markets. The future of capital markets in the Western Balkan countries addresses the challenges that these countries will experience during the process of economic integration with the developed countries.

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