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The Role of Banks in the Kosovo Economy

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Abstract

Banks play an important role in a country's financial system and economy. As a key component of the financial system, banks transfer funds from savers to borrowers in an efficient manner, thus mediating the financial system. They offer specialized financial services that reduce the cost of obtaining both savings and loan information. With these crucial financial services, banks help to make the economy efficient. If banks did not exist, the economic growth of any country would not be as it is now. This paper aims to present the role of banks in the Kosovo economy and it is fair to say that the Kosovo economy has been greatly assisted by banking activity as businesses grow and consumption increases. From all that has been said so far, it can be concluded that imagining a bankless economy is very difficult and scary because it is precisely what all economic agents rely on.

Keywords: banks; economic growth; interest rates; financial system.

1. Introduction

Economic growth is considered one of the essential objectives by countries around the world for more than half a century. However, investment and production, the two main development requirements, occur through the transformation of the economy's excess financial resources from financial institutions. In particular, developing countries face many economic problems such as unemployment, poverty, low living standards and inflation. Thus, these countries are always striving to increase their national income and thus create more jobs with steady economic growth. In fact, the development of the financial and banking sector leads to the growth of economic growth in any economy through the financing of economic development.

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This argument has been confirmed by much empirical research around the world. Most scholars argue that fi1nancial intermediation, especially banking, helped to boost the productivity of the economy and the bank is an essential instrument for innovation and development in any developing and underdeveloped country [1]. The growth rate of the real economy depends heavily on the banking system as it has the ability to facilitate investment by channeling funds from savers to borrowers in an efficient manner. Its role in providing entrepreneurs required loans to finance the adoption of new production techniques. Therefore, facilitate financial intermediation activities and contribute to economic expansion in much of the economic sector such as; Sector of agriculture, industry and trade. The banking industry contributes to the formation of start-up capital for investment projects and the ability to foster real growth by finding and using a new combination of factor use [2]. However, the causal relationship between bank lending and economic growth has been widely debated and discussed in the financial literature. Considerable work has been done by [3]. They argue that financial institutions stimulate economic growth and that underdeveloped financial systems delay growth. Reference [4] stated the main effect of the supply of the financial system on economic growth, where the financial system contributed by providing more funds in terms of credit. Similarly, Reference [5,6] asserted that economic growth is the result of financial development. This implies that financial development has a significant positive impact on economic growth. Therefore, this paper empirically analyzes the relationship between banking sector development and Kosovo's economic growth.

2. Literature Review

Existing literature has supported the link between banking sector development and economic growth. The leading supply hypothesis was logically argued by [7,8] that confirms the accelerating effect of development of banking services and financial activities on economic growth. In 1993, Reference [5] conducted a study and found that financial markets, especially banks, play an important role in boosting the real economy by providing the funds required to lend to entrepreneurs to finance investments that stimulate the movement of activities. economic. However, using the data of the sixteen developing countries in 1996 [9] found the causal relationship between financial development and economic growth, but did not argue for any meaningful relationship. Using data from developing and industrial countries, Reference [10] found bilateral causality between financial development and economic growth and they suggested that over a long period of time financial depth would make a significant contribution through causal relationships in countries. in progress. In 2006 a strong leadership supply relationship between the banking sector and economic growth in developing and developing countries was tested by [11] using Granger causality and Odedokun model to infer results. Furthermore, Reference [12] examined the relationship between financial development and economic growth in ten developing countries and found no causal link between financial deepening and output growth in the short run, while they found one-sided, although no bilateral causality between financial developments to produce in the long run In some developing countries, Reference [13] examined the relationship between economic growth and financial development in Nepal using data from 1975 to 2012. He found evidence which confirms that financial development causes economic growth. In fact, financial growth is the cause of economic growth in the short run, while economic growth holds financial growth in the long run. Reference [14] investigate the negative relationship between economic growth with bank lending and interest margin in central and southern eastern Europe. They used bank loans, interest rates, and quasi-money ratios as independent variables while gross domestic product as a change in pro- curement. However, Reference [15] reviewed the long-run relationship between financial development indicators and economic growth in Nigeria. The findings revealed that in the long run, liquid liabilities of commercial banks and the opening of trade exert significant positive impact on economic growth, on the contrary, private sector credit, interest rate spreads and government spending exert significant negative impact. Recently, Reference [16] explored the impact of banking sector development on economic growth in MENA countries. They found that the negative impact of financial development on the economic growth of MENA countries over the short and long term. Similarly, Reference [17] explored the dynamic interactions between Islamic banking and Malaysian economic growth using the interplay test and the Vector Error Correction Model (VECM) to see if the financial system impacts growth and growth transforms functioning. of the financial system in the long run. They found evidence of the bilateral relationship between Islamic bank and fixed investment and there is evidence to support the finance hypothesis driven by GDP growth and Islamic Bank. Reference [18] examine the short-term and long-term relationships between the development of Islamic banks and economic growth in the case of Indonesia. They found a significant two-way relationship in the short and long term between Islamic financial development and economic growth. Furthermore, Reference [19] examine the impact of the financial system on economic growth for the 28 EU countries and 34 OCEDs. Their empirical result shows a significant positive relationship between the banking system and economic growth. However, some banking variables have a negative effect on economic growth. Furthermore, Reference [20] investigate the role of financial development in the economic growth of Central, Eastern and South Eastern European (CESEE) countries between 1995–2015. They found benefits of the CESEE economy from the presence of foreign-owned banks, and those banks foster economic growth.

3. Banking system in Kosovo

Banking involves primarily the acceptance of deposits of individuals, firms, and others. Second, banking involves lending to firms and individuals who need them. The bank requires interest on this service, which is higher than the interest it gives on deposits. Banks, like all other businesses, have a profit maximization which they provide as a difference between income and expenses. The banking system operates at two levels: the first level is identified with the central bank; and the second level is identified with banks and other financial institutions. The Central Bank of the Republic of Kosovo is an independent institution, which is accountable only to the Assembly of Kosovo for its activities and operations, while exercising its powers in accordance with the Constitution of the state where its activities are regulated by law. Pursuant to Article 4.2 of the Law on the Central Bank, the Central Bank of Kosovo, as an independent public body, enjoys independent autonomy in the performance of operational and administrative activities, and at the same time functions and operates outside the framework of Kosovo's governmental structures. By this we mean that the Central Bank of the Republic of Kosovo is independent of government bodies as it is in different countries. In this regard, in addition, the Central Bank of Kosovo, as a financial institution, shall establish internal rules and procedures governing the employment of personnel including staff, advisers, experts and procurement, based on the general rules governing public service. The responsibilities of the Central Bank are closely linked to cash operations and management, dealing with the euro currency that is in use in the euro area countries and beyond. In this regard, based on its competences, which are harmonized with the law of the Central Bank, the whole banking system is enabled. In addition to operations, activities, products and services that are harmonized with the law on the bank, the Central Bank is also responsible for licensing commercial banks and other financial institutions.

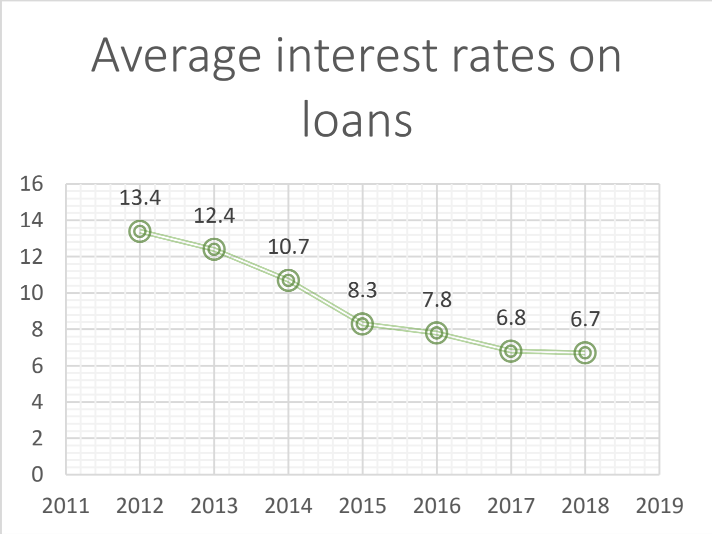

Figure 1: Average interest rates on loans, 2012-2018

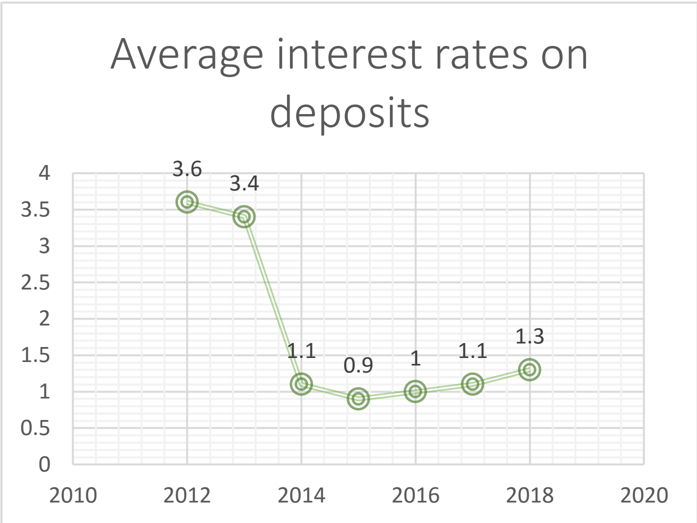

Figure 2: Average interest rates on deposits, 2012-2018

There are currently 10 licensed banks operating in the territory of Kosovo. 8 of them are foreign-owned banks and 2 are domestic-owned. Their products and services include bank accounts, loans, domestic and international payments, bank cards, bank guarantees, letter of credit, e-banking. Access to these banks' services is currently enabled through 217 branches and sub-branches, 482 ATMs and 13,319 POS and 273,752 e-banking accounts. The number of bank employees is around 3,300. Their activity is dominated by loans, whose maturity can be up to 15 years, depending on the type of loan. Out of total loans it is EUR 2,755.5 million, loans to enterprises are 63.6% while loans to households / households are 36.00%. Most of these loans are absorbed by trade sector enterprises (48.9 percent of enterprise loans), while the industry sector (including mining, manufacturing, energy and construction) has 24.7% of total enterprise loans. The agricultural sector currently accounts for 3.9% of total enterprise loans. The structure of the banking sector liabilities is dominated by deposits, which represent

81.9% of total liabilities. Banking sector deposits marked an annual growth of 8.7, reaching a value of 3 billion euros. The banking sector deposits in Kosovo consist of household deposits with a share of about 70.5% of total deposits, while deposits of private enterprises account for 23.3%. According to the reports of the Central Bank of Republic of Kosovo, interest rates on loans and deposits are shown on Figure 1 and Figure 2.

4. Conclusions

Based on all that has been discussed so far in relation to the banking system in Kosovo, we can conclude that this system has much room for further development and that the current level of development does not exceed the level of development. of other transition states. On the other hand, although the banking system in Kosovo is relatively new with only 20 years of activity, we can say that there has been a moderate developmental growth that has impacted on Kosovo's economic growth through the conduct of banking and other financial institutions.

5. Recommendations

What needs to be done is:

- Increasing competition by allowing to operate more banks in Kosovo so that interest rates can be lowered, thereby increasing consumption and improving the standard of living of citizens.
- Incorporate new lending policies, apply lower interest rates and extend loan repayment periods for some prospective sectors, in order to support them more.
- Implementation of projects aimed at the joint organization of banking institutions, ie the creation of an information center for citizens and businesses that require loans or deposits (savings) in financial institutions in order to have sufficient information on the conditions and their criteria.

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