Investment and Finance for the Post-Covid Recovery in Eastern Europe

The Role of Banking, Insurance and Finance

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Introduction

PAOLO GARONNA, FRANCO DELNERI, FEDERICA SEGANTI

This volume collects several contributions prepared in connection with the Trieste Eastern Europe Investment Forum that the Italian Banking Insurance and Finance Federation (FeBaf) organized in cooperation with the MIB Business School in 2019. The red thread linking together the different papers is the common perception of the need for setting in motion a Pan-European process of integration, a wholistic and multidimensional process that brings together all the components of the European “family”, and the belief that the economic and financial dimension of this process should represent a driving force and a leading component.

Why do we focus on the Pan-European perspective? And what role investment and financing can play therein? This is the basic question we intend to discuss in this Introduction.

First, the context in which the European integration processes are taking place has fundamentally changed.

2020 will go into history as the year in which Brexit materialized. The European Union is losing a big and important member. The UK is embarking on a stand-alone journey fraught with uncertain threats and likely disappointments. New partnerships will have to be created, built on the ruins of the ones that are being destroyed. The western world does not have a credible and authoritative leadership, to the extent that many people doubt that the concept itself of the West retain its a value and has a future. The multilateral order is in disarray, paralysed by its blockages and bureaucratic rituals, and challenged by muscular and volatile bilateral and unilateral dealings.

2019 marked twenty years since the end of the war in Kosovo, and with it the cessation of formal hostilities in the former Yugoslavia. Two decades onwards, the reconciliation process in the region is still in its embryonic phase. Reconciliation is considered both a decisive determinant for the democratization process and an in-

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herent precondition for Eastern European countries to join ultimately the EU at an appropriate timing. Moreover, a satisfactory degree of reconciliation is also an essential “step which would make European integration a long-term success”. Today, the political and social dynamics in the region are characterized by high youth unemployment, lack of trust in the governing élites and gloomy prospects for achieving EU membership in the near future; all factors that have seriously affected citizens’ perceptions and their level of confidence in that reconciliation can overcome the present deadlock and lack of perspective. The standstill in the enlargement progress has often given ammunition to local élites in position of power to raise nationalist rhetoric and populist appeal in public speech in order to reap short-term political gains, at the expense of the more prosaic tiring, but wider and necessary regional rapprochement and convergence process.

History teaches us that secure and stable Western Balkans and a pacified Eastern Europe mean a secure peaceful and stable Europe. By contrast, fragility in the Western Balkans, and beyond, holds risks not only for the people of the specific regions and countries concerned, but for everyone else who can legitimately call Europe home. It is therefore in everybody’s interest in the European space to work together to increase stability and enhance cooperation.

Second, the new European Parliament and Commission that were formed in 2019 have given signals of a renewed ambition and vision for moving onwards the European integration processes towards both deepening and widening the European perspective. After the deliberate commitment in the preceding term (2014-2019) to block on an a-priori basis accession of new members to the EU, a commitment that unfortunately was honoured, the new leaderships and memberships of the European institutions appear to be more reasonable and open. They seem committed to listen evaluate and consider the actual prospects for accession of specific countries in their specific progress in negotiations and compliance with requirements.

The basic assumption for relaunching with success the enlargement negotiations is that the EU countries and institutions sincerely want and accept the accession of new members and that the countries involved, foremost in the Western Balkans, sincerely want and accept to fulfil the relevant membership criteria to join in. Political will has for different reasons been lacking on both sides of the equation in the past. The initiative must come mostly from EU institutions and member states, since they are defining the policy framework, setting the dynamic mechanisms and the methodology of the process. The candidate countries should be determined on the other hand in fulfilling their obligations in relation to membership criteria that are already defined and well known. They should accept to embark on the required reforms, in their own interest, explain to their electorate the costs and gains of accession, and not attempt mimicking their fulfilment, hide their cards and exploit opacities and opportunism.

The European Union should be more committed to deepening its partnership with Eastern Europe – and the Western Balkans in particular – a region with which it shares
so much. A credible accession perspective for the region is of enormous strategic importance to the Union and to the peoples of the region themselves. This is the core message that is expected to be reaffirmed in the Commission’s contribution to the EU-Western Balkans Summit in Zagreb in May 2020, and its follow up along the course of the entire 2021-2027 planning period. The Commission continues to push for the opening of accession negotiations with North Macedonia and Albania, and for them to make steady and substantial progress. In parallel, it will seek to keep up the momentum by putting forward ways to enhance the credibility and the effectiveness of the accession process, including aspects of the enlargement methodology and a reinforced investment framework. Moreover, the European Union should establish a stronger and more convincing partnership with its Eastern and Southern neighbours, building a common area of shared prosperity, economic interaction, stability and increased cooperation. In order to maintain and further strengthen the dynamism of this important relationship, the Commission plans to put forward a new Eastern Partnership post-2020 outlining a new set of long-term policy objectives. Clearly, there is a widespread feeling that the Neighbourhood Policies of the past have on the whole failed, hostage of the anti-foreigners sentiments and fears of the populist rhetoric in many countries, the lack of vision of the moderate political leaderships and the fragmentation and inconsistency of the political initiatives towards Eastern Europe, and beyond.

On July 2019 Poland hosted the Western Balkans Summit in Poznan to build on the achievements of previous Summits – Berlin (August 2014), Vienna (August 2015), Paris (July 2016), Trieste (2017), London (2018) – and to progress further in several areas of cooperation. The summit brought together the leaders of the Western Balkans countries and like-minded European partners to discuss how to increase economic stability, strengthen regional security co-operation to help tackle common threats, encourage political co-operation, help the region resolve bilateral disputes and overcome legacy issues stemming from the conflicts of the 1990s, and finally strengthen democracy. Indeed, those are commendable and ambitious aims, but so far the Berlin process (as this initiative is called, due to the leadership role taken by the German Government) has been short of concrete deliverables and perceived as distant from the real and urgent needs of the peoples of the region. The fact is that the intergovernmental processes in favour of Eastern Europe are fragmented, thin, often overlapping and ineffective. The Vienna initiative is also full of commendable intentions, led by the Austrian Government. And the Central European Initiative based in Trieste and supported by the Italian Government strives on, constrained by lack of resources and political attention. The French Government in the past had supported the creation of the Union of the Mediterranean, whose main concrete output has been to ditch the (presumed over-reaching) “Barcelona Process of Euro-Mediterranean Partnership” of the 1990's.

Third, we need, and lack, a comprehensive unifying vision of the future of Europe. There have been, and are underway, several processes. Most of them concern the European Union, which does not cover, and probably will never cover, the “whole” of
Europe. The EU and the UK are engaged in working out the details of their “divorce” arrangements; which means that they would not be much inclined to venture into visionary ambitions of new future partnerships. The relationship with Turkey and Russia have significantly deteriorated, including their mutual relationships; which implies that their common European “identity” is now tarnished and blurred (but – in our view – not disappeared). The Mediterranean has ceased to be the “mare nostrum” of the European identity. Due to wars, migrations, instability and global confrontations over spheres of influence, and contrary to what it was and should be, the Mediterranean appears predominantly now as the frontier dividing Christianity and Islam, Europe and Africa, the developed and the developing world, inward and outward migrations, etc. If it were possible, populist leaders would erect walls in the Mediterranean, rather than bridges.

We believe that we must react to this state of affairs and re-establish a more appropriate vision for Europe. We believe this vision should be “Pan-European”, i.e. inclusive of all the countries, peoples and communities, who have a legitimate claim to the European identity, based on geography, history, civilization and a commitment to the future. In this vision, Central and Eastern Europe become central, rather than peripheral. And the people, the citizens of Europe, rather than the governments and the institutions, become the focal point of attention.

Fourth, the economic dimension and the private sector have been and will be the engine of European integration. This is in essence the Jean Monnet approach. Economic and financial cooperation are the most effective way to develop partnerships, facilitate dialogue and promote stability and peaceful coexistence. This has been a specific and highly successful feature of the European security approach. There is a social and economic dimension of security and democratization. That is why economic cooperation must precede, rather than follow, democratization conflict-resolution and institutional stabilization. In the EU approach often, we have done the opposite, on the basis of a wrong and biased interpretation of the Copenhagen criteria.

Fifth, and finally, banks, insurance companies and financial services can play an important role in the process of pan-European integration, in particular integration of Eastern and South Eastern European countries with the EU. Modern developed and sophisticated banking and insurance sectors are required for encouraging domestic production, innovation, investment and trade. Banks have channelled funds and exercised their other typical financial intermediary activities, playing a decisive role in the initial years of transition in these countries. But they have relied on relatively low expertise and made up only a tiny share of economic activity. On the other hand, insurance companies shared and reduced the investment risks faced by the private sector companies, and the state. In this way insurance has facilitated access and reduced the costs of raising the capital needed by firms, particularly small and medium-sized ones. This is especially important in emerging markets, as a shortage of capital is common there and represents one of the major disincentives to investment and
economic growth. By reducing the investment risk, insurance can also encourage companies to think more in a long-term perspective and increase their risk absorption capacity.

Prospects for the EU economic and social development have become increasingly challenging. The economic outlook has somewhat improved. The euro area grew in 2019 at the fastest pace in years. But there are downside risks, and this momentum does not promise to be long-lasting.

The EU has become at the same time more diverse and more unequal. The enlargement rounds of the past (in 2004, 2007, and 2013) have made the EU wider and richer, but also more heterogeneous and conflict-prone. The response to the crisis and the related austerity policies have increased divergence between core and periphery. The migration and the refugee crises have risked tearing Europe apart. Growth must spread to all Member States, candidate countries and other economies of the pan-European space. Labour market conditions should also improve. Economic growth accompanied by a credible enlargement perspective is an essential condition for stability and democracy in Europe, in the neighbouring countries and across the whole pan-European region.

The situation in South Eastern Europe is even more challenging. Historical political tensions seem to be warming up, particularly in Serbia and Bosnia and Herzegovina, while regional economic growth risks to slow down due to the global trade wars and the downturn of the EU economy, particularly in Germany, which is likely to have a negative impact on the whole region. We must also consider external political and economic factors, such as the Chinese Belt and Road Initiative, and the influence of other global players increasingly active in the region. As a matter of fact, China brings an important contribution to the necessary infrastructure investment in the Western Balkans for modernization and improving connectivity. But it also poses questions and possible risks related to the environment, public procurement rules and geo-political tensions linked to the conflict with the US.

Investment and financing are key to strengthen the economy in the region and facilitate economic and political cooperation. The Western Balkans lack infrastructure capacity and investment – particularly in non-traditional sectors such as water, sewerage, waste, health, social affairs and education. Overall infrastructure investment needs in the region are huge. Financial conditions in the region are underdeveloped but improving. Nevertheless, external debt levels have increased substantially since the outbreak of the global financial crisis and thus pose a serious threat to economic stability in a situation where global interest rates may be again on the rise.

Two important regional infrastructure investment initiatives are presently active in the Western Balkans: the European Western Balkans Investment Framework (WBIF) and the already mentioned Chinese Belt and Road Initiative (BRI). Both are focus on traditional infrastructure, such as energy and transport, and both come with a volume of about EUR 8 billion in loans. The European initiative has in addition pro-
vided for some EUR 800 million in grants and places emphasis on Sustainable Economy projects.

In February 2020 the European Commission presented its proposal for a new enlargement methodology. “The whole process needs to be more credible, more predictable, more dynamic and more political”, stated the European Commissioner for Neighborhood and Enlargement, Olivér Várhelyi, while presenting the Commission’s proposal. The stated purpose of the proposal is to re-establish a credible perspective for the EU accession of the Western Balkans. The reform of the enlargement methodology is an ongoing effort and an important political signal. It kicked off in fact last autumn in connection with the failure of the European Council to open accession negotiations with North Macedonia and Albania, which had had a very negative impact on the public opinions of the region. The disappointment was particularly acute in North Macedonia, which concluded in 2019 an agreement on a historic name change to placate Greece. This is the time therefore to provide a realistic path towards accession for these countries, overcoming mistrust and the sense of frustration and discrimination prevailing in many candidate countries.

“EU enlargement is a WIN-WIN situation”, tweeted Ursula von der Leyen, President of the European Commission. Ultimately the inclusion of the countries of the Western Balkans in the EU, with a view to consolidate and unite the continent around a common pan-European perspective, is a strategic investment in peace, democracy, prosperity, security and stability of Europe as a whole.
Towards a Pan-European and Euro-Mediterranean Perspective: The Role of Investment and Financing

PAOLO GARONNA

“In Europa, daughter of the Phoenician King Agenore, was playing on the beach in Sidon, when Zeus disguised as a white bull came to seduce her and brought her across the sea to Crete, ... (from Greek mythology).”

“Blessed are you, Lord our God, king of the Universe, who made the Great Sea”.

“La Méditerranée est une “autre” façon d’aborder l’histoire… Avoir été, c’est une condition pour être. (F. Braudel, La Méditerranée, p. 8)

“Werde was du bist (Do become what you are)!” (F. Nietzsche, as quoted by Denis de Rougemont, Le Paysan du Danube, 1932).

I. BACKGROUND AND MOTIVATION: RELAUNCHING THE “EUROPEAN DREAM”

In global and domestic scenarios that appear increasingly threatening and unfriendly, the goal of relaunching the policy initiative for European integration has become a widely perceived necessity, almost an obsession. Time is perceived as pressing for designing new and forward-looking perspectives and moving ahead.

There are several reasons for this strongly felt new sense of urgency. First, the economic outlook. Clouds have been building up for the global economy, and Europe in particular. In spite of the longest period of post-crisis recovery, signs of weakening, deflationary bias and structural uncertainties persist feeding market volatility, secular stagnation and downside risks. Moreover, the recovery has not trickled down to the most vulnerable areas, notably to the European periphery and the Mediterranean. What will happen if and when a serious downturn settles in? Are we prepared to tackle the next crisis of instability and recession? It seems that now there is still a window of opportunity, but this window may be closing soon. As the proverb goes: better to fix the roof until the sun is shining… (see World Bank).

The second reason has to do with the socio-political context. The crisis, and the policy failures that accompanied it, left a legacy of polarised societies, youth unemployment, stagnating standards of living, feeding resentment, anxiety, fear and mistrust. In some cases, these fractures have evolved into political radicalisation, nationalism, trade confrontations, and even threats to peace and security. However, despite disappointment and frustration, the “European dream” by-and-large is still
retaining traction and inspiring hope for prosperity, better quality of life and peaceful coexistence. This is true not only within the EU, but also in the wider and diverse European space (see Eurobarometer). For how long can this glimpse of hope and positive perception last? How many more missteps, broken promises and breaches of solidarity can be endured? The time is ripe for a new sense of European concreteness, for delivering on outstanding expectations and proving relevance.

The third reason is – in our view – the most compelling. It has to do with the state of EU relationships with the wider European space. We are at the end of two cycles of failed or disappointing integration. In the “glorious” 1990’s, at the apex of post-cold-war enthusiasm, European integration accelerated towards the accomplishment of the momentous objectives of the single market, the Euro, the enlargement. Ambitious processes of further integration were set in motion, such as – among others – the Barcelona Process of Euro-Mediterranean Partnership, the Eastern Dimension, the Northern Dimension, the Transatlantic Dialogue, and the Stability pact – later the Regional Cooperation Council – for South Eastern Europe. But in the following decades, all these processes stalled or derailed. The single market and the Euro went through the gauntlet of the sovereign debt crisis, the banking crisis, the double dip (or possibly the triple dip) recession. Decisive steps were taken to salvage them (the banking and capital markets union, the EMS, the investment plan, etc.), but the rescue is still unfinished, and the repair looks still partial and vulnerable. All in all, the great promises and hopes of that “glorious” season have gone astray, while relationships between core and periphery, in the near abroad of the EU and now even across the Atlantic have deteriorated. The European response to these challenges was widely perceived as not being up to the task. There was a scaling down of ambition, demotivation and integration fatigue crept in (e.g. vis-à-vis the enlargement), bilateralism supplanted multilateralism, bureaucratic foot-dragging and delays appear wide-spread and pervasive.

Expectedly the outcomes matched the policy inputs (see MEDECC, MedReset, and Lindh Foundation). Emblematic was the shift from the Barcelona process to the New Neighbourhood Policy and the Union of the Mediterranean. From the original “grand design”, what left was a cumbersome intergovernmental machinery and a plethora of fragmented support and technical cooperation programs. Above all a sense of failure frustration and betrayal has become dominant creating resentment and mistrust. We need to invert the tide, stimulate an upturn, get out of the sentiment of decay and neglect opening a new cycle of vitality and momentum.

The fact is that in the European space, or Pan-European space, the EU has been basically inactive or passive. It has lost leadership and vision. The EU could and should have provided an anchor of stability and prosperity for her near abroad, rather than seeing the broader European context as a source of additional vulnerability and contagion. Emblematic are the migration pressures, the humanitarian emergencies, the multiple exposures to war terrorism and socio-political upheaval that Europe is not able to contain manage or redress.

There are great opportunities in this area to bank on (see Arvis et alii, Jirasave-takul, and OECD). A young and increasingly better-educated population and
labour force. Considerable resources for energy transport and trade (Tagliapietra). Natural resources, the maritime economy, mountains and forests, beautiful cities and countryside, cultural heritage and monuments, etc. The Pan-European space, including Eastern Europe and the Mediterranean, has been the cradle of European civilisation, modern trade, investment and innovation. It could gain a new centrality, at a time when other parts of the world are proving unable to provide global leadership. Can we turn the Pan-European dimension from a source of crisis and contagion for the EU into a space of sustainable development, quality of life, democratic governance and peaceful integration? This is the question we will be addressing in this paper.

2. TAKING STOCK OF GAPS AND OBSTACLES:
ENLARGEMENT AND NEIGHBOURHOOD POLICIES IN THE EYE OF THE STORM

Looking back at experience and taking stock of errors and missed opportunities, the main issues to address become apparent (see Dempsey, and Dupuis).

- First the enlargement process. Although it appears that enlargement has fully achieved its intended goals, it was then blocked, as it became the scapegoat of the so-called “integration fatigue”. It could – and should – have been carried onwards both towards the western Balkans and the southern shore of the Mediterranean, to build on the momentum of expectations and reforms of that period. But the new post-cold-war generation of European policy makers shied away from risk and responsibility. They preferred to remain confined into their cosy corners and tactical games. Enlargement became the victim of this leadership gap. Now, it has become unpopular, particularly given the fear of competing claims on shrinking European subsidies on the side of the most recent EU member countries. It will be difficult then to revive it in the near term. The President of the European Commission at the start of its term in 2014 had to “commit” not to deliver any new accession under his Presidency. And he delivered on this unflattering and myopic commitment. The June 2019 European Council agreed to delay the opening of accession negotiations with Albania and North Macedonia, with no apparent justification, and despite the significant progress made by these countries (consider that the agreement on the name change for Macedonia was a bold and painful step forward). As far as Moldova, Georgia and Ukraine, the only countries which managed to sign the Association Agreement with the EU, there was an explicit refusal to consider them candidates for the enlargement, “not even in the long term”. The attitude towards Turkey and its candidacy reflect embarrassingly prejudice and cultural constrains. It seems that some people believe they “own” the European trademark and aspire to a closed club of uncontaminated purity. Until that country itself, under a regime turned illiberal, drifted in other different directions.

- The Neighbourhood Policy (NP) has been by-and-large a failure (see Emerson 2018 for an analysis). Trade liberalisation negotiations, which were at the core of NP, have not made any significant progress. The EU did not make concessions on agriculture and services, and no framework for investment and capital mobility has
come forward. Moreover, private investment going towards neighbouring countries has been by-and-large of the type that exploit labour-intensive low-skill sectors (mostly oil and real estate) with negligible spill-over on local industry. Besides, the south-south dimension of trade has not been significantly developed. Except in the case of the Western Balkans, where however the results for comprehensible reasons have been quite limited. In the end, NP countries themselves seem to have taken a different direction, as in the case of the Agadir Process or the Greater Arab Free Trade Agreement. Separate and bilateral trade agreements were negotiated in place of the promised comprehensive global trade agreement for the whole Euro-med and NP area. The approaches of different EU member countries have diverged, reflecting narrow short-term national priorities. Not surprisingly therefore, the degree of integration of the different NP countries with the EU has remained quite uneven and tended to diverge. The single energy market, which was announced on various occasions (lastly by Juncker in 2015) has not materialised, and with it the shift towards renewables and clean energy. On the contrary, increased internal vulnerabilities in NP countries prevented innovation and pushed energy security, rather than clean energy, at the top of the policy agenda. Finally, the Arab springs, internal instability and conflicts, the bleak prospects for a settlement in the Middle East, the outbreak of war in Syria, the migration pressures, etc. have all created an unfavourable geo-political environment for European integration. The proverb says: “Who seeds wind shall harvest storm”.

3. CONCEPTUAL DRIFTS: THE EURO-MEDITERRANEAN CONCEPT “LOST IN TRANSLATION”

If one searched in current EU documents for the “Euro-Mediterranean” wording, she would be utterly disappointed. The term has virtually disappeared. The evolution of terminology is emblematic of the drastic change in the policy framework, and its inner roots in the sense vision and self-perception of a confused European leadership. In my view, it explains a lot of the failures of European external policy in the last two decades.

In the 1990’s the Barcelona process took the ambitious and charged name of “Euro-Mediterranean Partnership”. It conveyed the intention not only of a set of commercial and economic deals, but a policy process that would lead to deeper social and cultural exchanges, and ultimately to EU membership. But a few years later, the process was renamed and became “Neighbourhood Policy”. The semantic shift from partnership to neighbourhood is quite considerable. Imagine a date with your partner in which you announce that from now onwards you should not consider yourself as “partners” anymore, but simply neighbours, and would develop the relationship accordingly! I do not think your partner would take this name change lightly, even assuming away sensitivities and emotional undertones.

The second word that was dropped from the name of the Barcelona process was the “Euro-“component of the Euro-Mediterranean term. The institutional mechanism
for cooperation was in fact renamed “Union for the Mediterranean”. This small deletion represented a huge philosophical and political transformation. It made in fact explicit and clear the fact that Europe and the Mediterranean had to be considered two distinct and different concepts.

The third and final blow was given in the most recent period when the whole “Mediterranean” wording was abandoned. Countries in the southern shore of the Mediterranean were part of Africa (Northern Africa) or Asia (the Middle East). The specific term became then “MENA”, Middle east and North Africa, and assumed the connotation of a “purely geographical expression”. Please note that at the time of the Italian “Risorgimento”, the Prince von Metternich, a leading diplomat and later Austrian Chancellor, applied this wording to “Italy” itself, i.e. Italy should not be considered a people, a culture or a community, but “only a geographical expression”.

The fundamental drifts that affected the name of the “Euro-Mediterranean partnership” in a matter of only two decades represent a serious political and cultural alteration of the concept itself of European integration, and of the identity of Europe. Europe was then deprived of one of its historical and essential components. Wounded and mutilated by stealth, without an open transparent and informed discussion, Europe has shrunk and lost breath. What is striking, and most surprising, is that this deplorable change came about with no significant opposition, or even with the support of the Euro-Mediterranean governments of the EU. When history and geography are ignored or manipulated, it is inevitable that policies become seriously affected. Most acutely in the Euro-Mediterranean periphery.

I am convinced that this cultural and political shift, born out of poor vision, or worst ignorance and prejudice, is at the root of the incomprehension and mistrust that underlie North-South and East-West relations, contributing to the polarisations and divides that foment nationalism and the identity crisis in Europe, and even in individual countries, like Italy and Spain.

4. AN INSTITUTIONAL AND CONCEPTUAL DIGRESSION: WHAT IS EUROPE?

If Europe is, and should be, more than a “geographical expression”, the next question is: what is Europe? or better what is it that we want to build as Europe?

From the institutional point of view, Europe in the post-war period has evolved into an original institutional construction that does not lend itself to pigeonhole. It does not correspond in fact to a single institutional model, nor does it conform to rigid blueprints.

Let us proceed then ad excludendum, and review the various options on what Europe is, or is not, or should not aim to be.

1. Europe is not like any intergovernmental organisation. Many would agree that the “Community method”, or supranational approach, has been a source of strength of the EU, particularly in areas like trade, competition policy, and more recently in economic and monetary affairs (the Euro).

2. Is then Europe a State?, or better a State in the making? In general, the idea that Europe will gradually become a single centralised sovereign State, wiping out
the original “member States” and their prerogatives is not widely supported. Europeans are attached to their individual Nation-States and democratic traditions (e.g. national Parliaments), and do object to their gradual hollowing out, or phasing out (subsidiarity).

3. More traction gets the idea of Europe as a *Federation (or Confederation) of States*, or Federal – Confederal State, modelled for instance on the USA, or Switzerland. It is undeniable that we have seen, and will probably see, a progressive and substantial transfer of powers from the national level to the European one. This is necessary in many instances if we want Europe to make progress and work effectively. Think of Monetary Union, Schengen, and the ambitious projects for a digital Union, or a capital markets Union, or an energy Union. But it is difficult to believe that even in the most radical Federal formulations and ambitions, Europe would go as far as what we have now in the US or Switzerland, reducing the role of national governments to that of regional or provincial entities (like Cantons). The fact is that contemporary Federal or Confederal States are philosophically and historically based on the notion of the “Nation-State”, and Europe does not seem to conceive herself as one.

4. Is Europe a “*Nation-State*”? Is Europe a “*Nation*”? Like the US, or Switzerland? I strongly doubt it. Not so much because Europe does not seem to have the basic ingredients of common identity (language, culture, history, etc.), which normally go into the notion of a “Nation”. The difficulty here is not with the concept of Europe, I believe, but with that of “nation”. What is a “nation”? We must recognise that in theory it is impossible to define uncontroversially what are the essential traits that unambiguously define what a nation is, and what it is not. That is why all nation-building processes, or national liberations, or secessions, become inherently conflictual and are generally solved on the basis of power relations, or even open conflicts. The nation-state concept is a relatively recent one in European history, and has been, and still is, the root of many confrontations, tensions, and even wars. Nation-states were generally formed in the 19th and 20th century through bloody “national” or “liberation” wars. The European Union instead was born in the middle of the bloodiest European civil war (see the Ventotene Manifesto of 1943), exactly in reaction to those wars, and as an antithesis to the belligerent nationalism of those “nation states” that were at the origin of the European “civil wars”. Contemporary Europe came about against the disruptive and conflict-prone essence of nationalist “nation-states”, and not simply as a new “nation” that supersedes all the others. That is why Europe has always rejected the idea that it should integrate with violence and top down impositions. Persuasion, collaboration, bottom-up pressures, voluntary arrangements, are the essence of the European process. It is a truly post-Westfalian institution. It aims at safeguarding national and cultural differences and specificities. From this point of view, I find the old formula “the United States of Europe” highly misleading. The expression dates back to the 17th century and has been raked up at various occasions after that. To-day I believe that it evokes wrong analogies and arbitrary historical linkages. Above all, it does not help in clarifying what is, and should
be, the desired relationship between the European level and that of the national institutions (often referred to in terms of “subsidiarity”).

5. THE ROOTS OF OUR COMMON IDENTITY: EUROPE AS “IMPERIUM”

This relationship, between national states and EU institutions, is central to the definition of the European identity, as it has been built up through the legacy of her rich past and as it projects herself into the future. There is an uninterrupted thread that links the European idea from the classical world into the present (“28 centuries of Europe” reads the famous book by Denis de Rougemont). The transition from the classics through the Middle Ages to the Modern Era was marked by growing fragmentation, divisions and schisms. After, and in reaction to, the religion wars, the crusades, the conquests and re-conquests, modern Europe took shape based on a set of common trends:

a) the aspiration to emancipate political institutions from a centralised religious authority (*cuius regio eius religio*);

b) the formation of a plurality and variety of independent institutions with distributed, competitive and shared sovereign prerogatives;

c) the search for, and drive towards harmonisation and assimilation of jurisdictions, economic activities and cultural traits;

d) pressures from below to obtain more rights and freedoms, participation in public life, and constitutional constraints on the exercise of power.

After the French revolution, with the consolidation of the new Nation-State model, national liberation movements, and “absolute national sovereignty”, fragmentation and conflicts in Europe became highly destructive, leading to bloody confrontations, totalitarianism, intolerance, and threatening the unity and continuity of the European framework. The European pathos survived in the built-up of national Empires, whereby nation States reached out beyond their borders, and undertook to dominate the world. But this tendency made European rivalries global and even more destructive. Until the humanitarian tragedies and the millions of victims of the 20th century’s world wars and totalitarian regimes brought this process to the extreme consequences and laid out the seeds of a new beginning.

The new Europe saw the light in reaction to the excesses of nationalism, with the aim to stop the “useless carnage” (Pope Benedict XV) of the European civil wars. European integration after that has aimed at managing and transferring rivalries from the military to the economic sphere. It translated them in terms of free market competition, the promotion of cooperation, and developed joint institutions and common spaces of interchanges and linkages. The institutional concept that probably best approximates the reality of present Europe is that of “Imperium”, i.e. a community of States countries and governance institutions sharing values aspirations and sovereign prerogatives and safeguarding their different cultures traditions and lifestyles. This model is very old, probably the oldest form of constitutional set up, but in Europe from the Roman Empire onwards, through the Sacred Roman Empire, the British Em-
pire, the French Dutch Portuguese Empires, the Russian and the Soviet, etc., it has retained its attraction purposes and inspiration.

“Imperium” means:

i) a multitude of peoples, cultures, languages, traditions, practises, open to interchange and cross-fertilisation, but determinate to resist assimilation and disappearance;

ii) a common identity, drawn from the linkages of the past and the common vision of a more prosperous influential and peaceful future. It is also based on common roots and values (the Christian roots, human rights, the European quality of life, etc.);

iii) a common jurisdiction based on the rule of law and the common law (inherited from the Roman Law);

iv) free cross border markets for trade investment and finance, and free movement of people capital goods and services;

v) common guarantees of defence and protection;

vi) social and citizenship rights (inspired by the Roman concept of citizenship);

vii) aspiration to universal dissemination of values and civilization (global leadership).

In conclusion, it is not easy, nor probably desirable, to define narrowly what institutional model the European integration process should follow. Europe is, and will be, an evolving institutional set up adapted to respond to the needs, circumstances and aspirations of its citizens. This model might not be fitted neatly into the conventional categories inherited from the past. It will instead follow an original path and design. But it is reassuring to note that there are patterns and precedents in European history, culture and tradition that provide inspiration and guidance, and enable us to develop and choose the institutional options that best correspond to our idea of the future. In particular, I believe, this set-up should enable Europe to respond positively to the legitimate ambitions and demands of its citizens that wish it to extend its influence and values, contribute to global governance and leadership, and work closely in a multipolar world with the other big players (such as China, India, the US, etc.) on the basis of a peer relationship to create a world order of peace prosperity and social justice. Europe as a strong global player.

6. THE EUROPEAN UNION IN THE BROADER EUROPEAN SPACE

We can now return to the question of the relationship between the EU and the Euro-Mediterranean, Eastern Europe, etc., i.e. between the EU and the wider European space. If we look back at the last three decades of European history, it must be acknowledged that the position, role and status of the EU in this space has significantly weakened. Moreover, the overall situation of the broader European space has also seriously deteriorated. Evidently the two processes are not unrelated. On the contrary they have reinforced each other (Bildt, Falkner, Franke, Lehne, Leonard, among others).
Whereas the end of the cold war, which was basically a intra-European ideological war with global spill overs, could have heralded a new era of European re-unification, pacification and renaissance (as it happened in Germany), the post-cold war period was marked by geo-political strife, new tensions and conflicts. The paradox is that whereas at the global level in that period we had a drastic decline of conflicts, with a beneficial impact on the cessation of the ideological confrontations that the cold war had exported globally (e.g. in Asia and Africa), in Europe itself the fall of the Berlin wall rekindled repressed nationalistic tensions and frozen conflicts, leading often to war and humanitarian tragedies, as in former Yugoslavia, the former Soviet Union, Ukraine, etc. Unlike the post-World War II, the winners of the cold war, the US, Eastern Europe and their satellites were not able to manage the transition to a more stable, peaceful and prosperous European order. This occurred despite considerable efforts and initiatives; think of Camp David, the Stability Pact in the Balkans, the EU enlargement, the Barcelona process, WTO, the UN peacebuilding and Millennium Development Goals, etc.

The end-result of those unfinished or failed endeavours has been that Europe became, once again, a framework of instability, unresolved tensions and confrontations, and – as it had happened in the past – the exchequer of broader global rivalries and power relations in a disorderly, more complex and multipolar world. What fundamentally changed more recently is the global context, in relation to the progressive decline of American leadership. Europe before had been able to count on external support, particularly the big brother’s help coming from the US to overcome the secular intestine clashes that so much trouble had caused to global equilibria. But now the US does not seem to have the resources, the strength and the vision to comply with all this daunting problematique.

7. WHAT IS THE EU PLAN FOR EUROPE?

The EU in turn has been, and still is, basically inward-looking, focussed on the construction of internal markets and institutions that preside over its successful operation. It has appeared weak and unable to play a significant role in the area, which she interacts most intensely with, for reasons of proximity, history, identity and socio-economic linkages. There is a striking paradox: the EU has policies and action-plans for a wide range of themes problems and policy fields; but oddly enough, the EU does not have a “European” policy, i.e. a policy for Europe. It has often been implicitly assumed that the EU, and only the EU, is Europe, implying therefore that the European countries or societies outside the EU either are or should be on the road to EU accession. After denying others the European label, the EU has also denied access or even the right to be candidate for access to countries and peoples that feel, and are, European. This has created frustration and a sense of discrimination in those that are not in the position, or are not willing, to seek accession to the EU.

The case of the US in this context is strikingly different. The US has always had an explicit and recognisable policy for the “Americas” (please note that the plural for Europe does not exist!). Please note also that the US has not been very success-
ful in its policies towards the “Americas”; it has not been able to stimulate in the other American countries a sentiment of attraction to join the “United States”, as it is the case for the EU. I believe that the EU should take advantage of this widespread sentiment, until it lasts. Moreover, it should feel the duty, and the right, to formulate a clear and possibly ambitious vision for the whole of Europe, for her future, for her identity and development.

Other major powers have developed major regional and global initiatives in the European space, including the Euro-Mediterranean. Consider the American presence in Europe, the Belt and Road initiative of China, the EurAsian Union promoted by Russia, Obama’s TTIP, i.e. the Transatlantic Trade and Investment Partnership, etc. The EU has either supported or contrasted several of these initiatives, but it has failed to take autonomous initiatives of corresponding ambition. The EU has no plan or dream for its own space or backyard, i.e. for Europe.

Under these circumstances, it should not be surprising that the situation in the European space has seriously deteriorated. The migration challenge, social and political instability, illiberal regimes and intolerance, terrorism, polarizations, etc. Add Syria, Libya, Ukraine, the Middle East, etc. Also, the relationship between the EU and Russia, and Turkey, has deteriorated, or it did not improve. Add Brexit, and the challenge it implies for the future of the EU Capital Markets.

To conclude, the European space has become more unstable, fragmented, conflict-prone and problematic. It is increasingly perceived by European citizens as a threat, a challenge to the “European dream”. This outcome appears closely related to the fundamental neglect by the EU to deal with the wider European problems. It has also fed a sentiment of alienation and rejection.

Can we keep the problems of the larger European space out of the EU? The intractability of the migration pressures is to a large extent a nemesis of such an illusion. Should we not rather take responsibility, in our own interest, of this wider area? Should we not develop a project of inclusion of this area in a common European framework? Should we not engage with the peoples, the resources and the institutions that have a legitimate claim on the European identity? And could take a suitable place in the European community?

What do we gain by closing our eyes to the reality of Europe? What do we gain by limiting the outreach of our values, influence and power? Do we really want a smaller, more Nordic, more protestant, more “barbaric” (in the classical sense of the word) Europe? What do we gain by not growing in terms of population, resources, opportunities? It is alien to the European ethos the idea of an “Empire” that does not want to grow, become larger and stronger.

The sad think is that such questions were not even asked, nor seriously considered. Choices in relation to the European space were made almost by stealth and by default. Without the benefit of an open informed and transparent discussion. They were not driven by rational motivations, but rather by instinct (“fatigue”), sentiment, or better resentment, in so far that the enlargement became the scapegoat of the difficulties of integration. They were made by closemindedness and prejudice, by fear and lack of leadership.
The time is ripe then for a fundamental change of tack. There are several reasons for that. First, the threats coming from the East and the Mediterranean are becoming unbearable. Think of the migration crisis, which can only be solved with the collaboration, and the development, of the countries in the Southern shore of the Mediterranean and South East Europe. Think of the Syrian crisis, and the growing meddling of the superpowers with the areas of tension in the European space, driven by their greed for influence and their rivalries. Think of the precarious social and political equilibria in many countries of the region, from Turkey to Egypt, and the European interest to pro-actively promote stabilisation and growth.

The second reason is more important. It has now become apparent that the Mediterranean is rich of resources and opportunities. Energy and trade, the green economy and the blue economy, its strategic position in the global transport and trade routes and logistics, a young population, tourism and the extraordinary cultural heritage, etc. it has high potential (EMNES, European Parliament, ISPI, Farnesina). It could become the California or Florida of the European space. This explains the growing global interest to invest in the Mediterranean, from the Chinese Road and Belt initiative (see Fardella) to the Russian presence in the Middle East. The pharaonic project to double the Suez Canal could become a game changer in global freight and harbours economics (Accademia delle Scienze). The EU cannot miss this opportunity.

The third reason is Brexit. Whatever happens to the UK relationship with the EU, in the future the British and the continental European common interests for this strategic area of the globe will have to lead to joining forces and collaborating to promote peace stability and prosperity. In this effort, all other European countries will have to be involved in a cooperative approach, including not only Switzerland and Norway, but also Russia, Turkey, Egypt, Israel, etc. The EU, being the major player, will have to play a leadership role in promoting cooperation and inclusion, rather than antagonism conflict and hegemonic contests.

We need to open a new cycle of Pan-European and Euro-Mediterranean integration and cooperation. After the glorious 1990’s, the Barcelona process, the Stability Pact, etc., and the unfulfilled promises of that season; after the retrenchment of the following decade, the stop to the enlargement, the shift towards the Union for the Mediterranean, the Regional Cooperation Council, the Neighbourhood Policy; we need to open a new season of more ambitious and pro-active policies for the whole European space. We should learn from the failures and mistakes of the past and correct them.

Please note that the “European policies” of the EU should appear clearly distinct and different from broader foreign and cooperation policies, from the policies for Africa, the neighbours, etc. It is not simply a question of semantics. It is a question of identity, humility, respect and consideration that are due to all those Europeans that do not aspire to join the EU and/or would not be able to join, at the least for the foreseeable future.
9. A NEW APPROACH TO EU ENLARGEMENT AND PAN-EUROPEAN INTEGRATION

This change would have two major implications: for the enlargement and the Pan-European dimension.

First, we need to review in depth and adjust the approach to the enlargement. The Council decision in June 2019 to postpone the formal opening of negotiations with Albania and North Macedonia, despite the significant progress made particularly in the change of name of Macedonia, has been embarrassing and has given a very negative signal on how serious, trustworthy and honest are the enlargement policies of the EU. In the same direction go the refusal to consider the enlargement perspective “even in the long-term” for Moldova, Georgia and Ukraine, and the fact that there are no Association Agreement for the Mediterranean countries. The process should be made more transparent and eliminate all possible suspicions of discrimination, prejudice and political exchange. It should be made clear that for all countries in the broader European space, provided conditions are met, the door is open for accession and membership; for all countries, including Israel, Morocco, Tunisia, etc. It should also be clarified that the conditions for membership apply to all in the same way, without any discrimination, and that they are not subject to partisan political trafficking or interference. The same conditions should apply for countries applying from the outside, but also for countries already in (there should be no double standards in evaluating the illiberal policy measures of countries in and out of the EU).

I believe that blocking the enlargement for political reasons has been a terrible mistake that should be corrected. This means working with accession countries to help them accelerate the transition process and satisfy the conditions for entry. It does not mean to dilute the criteria for accession nor politicise the verification of the compliance of such rigorous criteria. The EU should give the impression that it is ready to do what it can to open its doors to candidate countries that qualify. This is not the impression that the EU has given and gives now, particularly in the South.

But EU accession should not be the only way to be “in Europe” and to have a European identity or membership. There should be other ways of being recognised Europeans, member of the European community and enjoying some of the prerogatives and the symbolism of such an identity. Without entering the EU, European integration has gradually developed with variable geometry and through concentric circles. Schengen, the Euro, the Banking Union, have all different memberships. There should be an outer circle of European cooperation, endowed of full legitimacy and recognised status of Europeanship (see Garonna and He). This outer circle should in principle be more “economically oriented”, rather than politically oriented, more gradual and pragmatic, more flexible and adaptable, less binding. A Pan-European community of countries and peoples should be established, where on demand access should be granted almost automatically, a European Forum for exchanging views, with no implication for formal EU accession.

It should be noted that the concept of Pan-European dialogue and integration is not new. There are already several Pan-European organizations, such as the Orga-
nization for Security and Cooperation in Europe (OSCE), the Council of Europe, the Economic Commission for Europe of the United Nations (UNECE). Membership in these organizations include not only the countries of the EU, but also Russia and Eastern Europe, all the countries of the former Soviet Union, South Eastern Europe, Turkey, several Mediterranean countries, like Israel, etc. These organisations operate at the Pan-European level and focus on issues that benefit from the Pan-European dimension, like security, economic cooperation, trade, transport and environment.

Another thing to note is that in several such Pan-European organizations, the US is a member (e.g. in UNECE and OSCE). This should not be considered surprising. These organizations in fact reflect the post-World-War-II global and European order. In that context we know that the US plaid a fundamental role in promoting and supporting European integration not only thanks to economic incentives (like the Marshall Plan), but also, and more importantly, with their political drive and leadership.

Finally, Brexit – if and when materialises – would provide an opportunity for re-launching economic and financial integration at a wider European level. For instance, a Pan-European Capital Markets Union would evidently see London and the UK play a leading role, even with London outside the EU. This idea, which in British circles has been muted, should not be seen with a backward-looking orientation aimed at safeguarding the links and opportunities of the past that Brexit undermines. Rather, it should have a future orientation, taking advantage of the global role of the City and the special relationships of the UK financial market with transatlantic partners, Asia and the Commonwealth. Whereas Brexit therefore would deprive Europe of a fundamental partner and player, it could at the same time give the EU a Pan-European partner capable of playing a legitimate and recognized leadership role in a wider Europe context.

The vision of a Pan-European integration process covering the whole of Eastern Europe and the Mediterranean could appear to many as far-fetched or unrealistic, particularly in light of the present state of intergovernmental relations and big political divisions in Europe. But we should always remember that in international relations, and particularly in European relations, we need to draw a sharp distinction between Governments and people, a distinction that in the European liberal democratic tradition has ancient and deep roots. European relations affect and engage the world of business, civil society, the public opinion, the youth. Not only Governments. This distinction becomes particularly relevant, when we deal with illiberal democracies or autocratic regimes. The Pan-European dimension is above all the dimension of people, business, society, communities, local authorities, etc., and – as we shall see – it is particularly relevant for the world of finance.

10. THE ROLE OF CAPITAL MARKETS, BANKING AND INSURANCE IN THE PAN-EUROPEAN COOPERATION SPACE

The European construction has already advanced following a concentric circles’ configuration. At the core, we find the Economic and Monetary Union and the Euro. The European Union with its single market is a wider space of parliamentary democra-
cy and economic freedom. Then, there is Schengen. The overlap and partial interplay with the OECD, NATO and the Pan-European organizations I mentioned above provide in my view useful synergies and cross-fertilisation. Variable geometry can give to this set of multiple relationships a fair amount of flexibility and room for political expediency.

The establishment of an outer circle of Pan-European cooperation and economic integration represent a major and significant innovation and should give the EU a visible and effective driving role in the wider European space. The other fundamental innovation is the multilateral approach in European cooperation, overcoming the narrowness, the over-technicality and the petty bargaining mode of one-to-one bilateral relationships that characterize the Association Agreements, the Enlargement and the Neighbourhood Policy. The EU has been, and is, a strong supporter of multilateralism and should therefore find a way to go beyond the excessive bilateralism of its European policies. The adoption of EU standards would be a natural consequence of the stronger position of the EU in relation to the other Pan-European players, but the EU should be careful to provide mechanisms of consultation, on a multilateral basis, to involve her partners as much as possible in the harmonization and adoption of such standards.

The Pan-European Economic Area could envisage several important policy domains for the exchange of best practise, peer pressure, standardisation, common policies, etc. These domains are in line with the resources and the growth potential of the Pan-European region. We should mention in that context energy, transport and logistics, the maritime economy, shipping, the green economy, tourism, culture and heritage, education and training, trade, technology and the digital economy, SMEs and start-ups, etc. (see Braendle, and Biondi).

But there is one sector that in my view is most promising and cuts across all the others: that of investment and financing (Garonna, Delneri, Seganti). Investment and financing embrace the whole value chain of the activities relevant for growth and sustainability, from energy to social infrastructure. It is an application of the Jean Monnet approach: first economic and financial cooperation, then more ambitious integration harmonisation and political dialogue. Developing an integrated financial sector with modern banks, insurance companies, efficient capital markets, etc. is a pre-condition for sustaining growth and promoting innovation and employment. Financial services have an inherent tendency to cross-border and benefit from large and deep markets with critical mass.

Pan-European financial integration would have a policy agenda that is very relevant for the EU financial communities and the other European communities. At the top of the agenda, we should place: fighting fragmentation and ringfencing; investing in Trans-European infrastructure, e.g. trade facilitation, energy, transport, the environment, etc.; support for cross-border value chains, increase in firm size, minimum efficient dimensions for productivity and efficiency, wider opportunities for retail savers and investors, SMEs and households, etc.; consistent harmonized or even single rulebooks of micro- and macro-prudential regulation, and supervisory convergence. Please note that a Pan-European development bank or regional promo-
tional bank already exists. It is the EBRD based in London. This institution, which initially was focusing on transition economies, has cleverly extended its range of action well beyond Eastern Europe and the formerly command economies of the ex-Soviet bloc. It now deals also with the Euro Mediterranean. It could be revamped to become a Pan-European Development Bank.

II. Conclusions: Launching the Value Chain of Investment and Financing in the Pan-European Economic Space

The relationship between the EU and the wider European space goes to the heart of the identity and the future of Europe. It should be put on the table and addressed adequately in a transparent informed and forward-looking way. It has so far instead been by-and-large neglected, by-passed or concealed behind the smokescreen of other, different, and more distant, questions like the relationship with Africa, the circle of neighbourly friendships, the turbulence of the MENA region, etc. As such they have appeared less priority and more in the remit of member states than the Community level, leaving fundamental, almost existential, questions at the mercy of disinformation, after-thoughts and often prejudice. What relationship does the EU want to establish with “Europe”? What is the future of Europe, the EU, and their relationship?

I recognise that satisfactory answers to these questions would not come over night and might diverge. I know that my approach reflects the vision of a person that lives and works in Rome, and inevitably carries with it a “Roman”, Italian and Mediterranean bias. I accept that people living in other parts of Europe might bring to the discussion other biases. Taking that into account, the discussions should rely on solid arguments, based on a robust and bold understanding of the strategic long-term interests of Europe and the EU. On that basis, I am deeply convinced that the Pan-European space, including eastern Europe and the Mediterranean, is an integral part of Europe and cannot be left out of the European institutional framework. There can be no Europe without the Mediterranean and Eastern Europe. This is based not only on history, culture and identity reasons, but above all, on the strategic perception of the common interests threats and opportunities that we would have if we want to build a future of shared prosperity, security and socio-political stability in Europe.

If this is true for the whole of Europe, for Italy is almost an axiom. Italy is the only big country of the EU (with Malta, Greece and Cyprus) that has all her shores on the Mediterranean. It also links the West and the East of the continent. Its geo-strategic position, among many other things, means that it cannot have prosperity and stability unless there is prosperity and stability in the Mediterranean and Eastern Europe. The migration question is clear evidence of this inextricable linkage. But this applies also to all other EU countries, starting from France, Spain and the other countries facing the Mediterranean, and – since no wall can prevent Mediterranean waters flowing into the Atlantic, the North and the Black Sea, and vice versa – all other EU countries.

This means that the enlargement policies should be reviewed in depth, both because of their success (it has been extraordinary in Eastern and Southern Europe),
and of their failures (it has created bitter resentment in other candidate and would-be candidate countries). It means also that it is urgent to launch an initiative for Pan-European dialogue and cooperation, targeted to Eastern Europe and the Mediterranean. Another circle of European institutional integration should be built and pragmatically operationalised. This would have great potential benefits since both Eastern Europe and the Mediterranean after the “revolutions” of 1989 (Dahrendorf) have shown a wealth of new opportunities, resources and a new centrality. It would also avoid the scourge of these European regions drifting away towards illiberalism nationalism and antagonism; which would have, and to some extent is already having a negative impact on the EU.

I believe that while there are many areas for such dialogue and cooperation, a very promising candidate for progress and success is the financial sector. By which I mean the whole value chain of investment and financing, including energy, trade, the environment, the blue and the green economy, trans-European infrastructure, SMEs, etc. Advancing on this path would create the conditions for modernisation, more trust, growth and jobs, and would make dialogue on more political or policy-charged issues, such as peace and security or migration, easier and more pragmatic. This is the essence of the Jean Monnet method that we have been applying in the post-war EU. Brexit in this context would not be an obstacle, since in this outer space post-Brexit Britain could play an important role, particularly considering the importance of London for the cross-border operation of capital markets.

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The views expressed in this paper are those of the Author, and do not necessarily represent views of the corresponding organisations.
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The Financial Service Sector in South-Eastern Europe Economies

SAFET KOZAREVIĆ, SELENA BEGOVIĆ

In Part I of the survey we will shortly present the basic performances of the main segments of the financial service sector in the countries of South-Eastern Europe, i.e. Slovenia, Croatia, Bosnia and Herzegovina, Serbia, Montenegro, Kosovo, Albania, North Macedonia, Greece, Romania, Bulgaria, Turkey, plus Ukraine. After a short macroeconomic introduction, financing potential of banks, insurers and other relevant financial institutions will be presented as well as their contribution to financing small and medium business. The data for this publication were collected from the official reports and via the survey of banking and insurance associations, central banks, national statistics offices and financial supervisory authorities in the SEE countries (South Eastern Europe). Database for the previous years, back in 2002, provide the trends, in other words, long-term dynamics of the economy of the SEE region and its particular countries.

Part II of the survey is the individual Country Report.  

POSITIVE TRENDS IN THE ECONOMIC OUTLOOK OF SOUTH-EASTERN EUROPE IN 2017

At the beginning we are going to briefly overview the basic macroeconomic parameters of the SEE in order to create the context for the research issue, i.e. the financial structures of the SEE region countries. Although the subsequent comparative analysis provides an overview of the basic macroeconomic indicators for the SEE countries over the period 2002-2017, we will put the emphasis on significant changes in the macroeconomic environment in 2017. In that regard, the total GDP for the SEE coun-

2. The author of PART I is Safet Kozarević, PhD, Professor at Faculty of Economics, University of Tuzla, except for the analysis related to the banking market (Banks as the main players in the financial service sector) written by Selena Begović, PhD, Assistant Professor at School of Economics and Business, University of Sarajevo.
tries was EUR 1.438,7 billion in 2017 and continued to increase. It needs to be emphasized that Turkey’s share in the SEE GDP in 2017 was slightly more than a half (precisely, 52,4% or, in absolute term, EUR 754,0 billion). When we compare the SEE GDP of EUR 1.438,7 billion, to the EU GDP in 2017 of EUR 15.382,6 billion, we can conclude that the SEE countries generate only 9,4% of the EU GDP. The data regarding the total GDP of the particular SEE countries from 2002 to 2017 are presented in Figure 1.

What is most important, all SEE countries registered economic growth in 2017 (see Figure 2). The highest rate of real GDP growth was recorded in Turkey (7,4%), followed by Romania (6,9%), Slovenia (5,0%), and Montenegro (4,4), while other countries had the rate of real GDP growth less than 4%. More specifically, Bosnia and Herzegovina (BiH) had the same rate of growth as in the previous year (3,1%), while in the case of Croatia, Kosovo, North Macedonia and Serbia the rate of growth was lower than in the previous year (by 0,6; 0,4; 1,3 and 0,9%, respectively). By comparison, an average real GDP growth in the EU in 2017 was 2,4%.

The EU member states of this region, Greece (since 1981), Slovenia (2004-), Romania (2007-), Bulgaria (2007-), and Croatia (2013-), are trying to be more competitive members, while other countries are at different stages in the EU integration process. To be more precise, Turkey, Serbia, Montenegro, Albania, and North Macedonia have the candidate status (Turkey as of 1999), while BiH and Kosovo are the potential candidate countries. Ukraine has still not applied for the EU membership. As we can assume, the progress in the EU integration process depends much more on political than economic issues. Nevertheless, there are still many economic reforms that need to be implemented, such as pension reform, reduction of grey (informal) economy, rule of law, elimination of corrupt practices, consolidation and reduction of the number and costs of parafiscal charges and burdens, etc.
Thanks to the trend of economic growth, foreign direct investments (FDI) inflows to most of the SEE countries boosted in 2017, especially for those countries making efforts to join the EU (for example, the Western Balkans achieved an increase of 18,0%). Most of the FDI is a result of interregional cooperation, while other investors come from the EU, China, the Middle East, and the Russian Federation. From the interregional perspective, the largest investor in the region is Turkey. The investors are mainly interested in energetic and financial sectors, but there is also an increasing interest in the manufacturing industry, such as automobile plants and organic food production as well as tourism, infrastructure investments, etc.

As a result of these mostly underdeveloped economies, which are substantially behind EU member states, probably the biggest economic problem for most of the SEE countries is a high unemployment rate (Figure 3), in particular of the youth. For example, while the general unemployment rate in some SEE countries was above 20% in 2017, the youth employment rate was above 50%. For the purpose of comparison, in Germany, as one of the leading EU economies, the general unemployment rate in the same year was only 3,7% and for the youth around 7,0%. Therefore, the migration trend of the young, unemployed, and well-educated population to the EU is becoming more evident and, consequently, a major threat for the SEE countries in the future, as the EU labour market opens. Moreover, working-age population is decreasing as the result of unfavourable demographics and in some SEE countries there is almost only one employee per each retired person. This creates additional difficulties to their social pension and health insurance systems.

Regarding the (general) unemployment rate in the SEE countries in 2017, the lowest unemployment rate was noticed in Romania (4,9%), less than in 2016 (5,9%). In order to make comparison to the EU countries, in the same year an average un-
employment rate in the EU was 7.6%. Kosovo had the highest unemployment rate (30.5%), even higher than in 2016 (27.5%). Besides Kosovo, three countries had the unemployment rate above 20% (North Macedonia 22.4%, Greece 21.5% and BiH 20.5%), which means that around a fifth of their labour force was out of a job in 2017. On the contrary, because of intensified migrations and grey economy, we should have doubt in official statistics about unemployment in some countries.

Furthermore, Figure 4 illustrates the trends of the population changes, where we can notice stagnation or even a decline of the population in almost all the countries, except Turkey. Turkey had the continuity of the slight population growth over the period, exceeding 80 million in 2017 (precisely 80.8 million). The total population of the SEE region was 184.8 million and it was 36.1% of the EU population (512.2 million).5 Greece, Slovenia, Bulgaria and Romania are included in both groups. Hence, Turkey’s contribution to the SEE population was 43.7% in 2017. Also, owing to the increase of the Turkish population, the total population of the SEE region increased by 7.6% since 2002 or by 4.4% in the last ten years (the data for Ukraine dating back to 2010). Compared to the previous year, the total population in the SEE region grew by only 0.3% slowly decreasing in most of the countries.

Average GDP per capita for the region was EUR 7,785 in 2017 and it increased by 0,6% compared to 2016. However, it was still far below the EU average of EUR 30,000, almost four times smaller. Besides, while GDP per capita in the SEE region increased by only 0,6%, the EU GDP increased by 2,7% in 2017 compared to the previous year.

More analytically, Slovenia was the SEE country with the highest GDP per capita in 2017, of EUR 20,951. Ukraine was the poorest among the observed countries, with GDP per capita EUR 2,097 (the second lowest in Europe in 2017, after Moldova). Further, Croatia, Greece and Slovenia were the countries with GDP per capita above EUR 10,000, while Albania, BiH, Kosovo, North Macedonia and Ukraine had the amounts below EUR 5,000. Bulgaria, Montenegro, Romania, Serbia and Turkey were in the middle, with GDP per capita between EUR 5,000 and 10,000 (see Figure 5).

In 2017 the inflation rate was between 1,1 and 3,0%, excluding Turkey and Ukraine with the inflation rates as high as 11,9% and 14,4%, respectively. As Figure 6 shows, the lowest inflation rate, of 1,1%, was recorded in Greece, as the Economic and Monetary Union (EMU) member since 2001, and Croatia, that has led flexible but managed monetary arrangement. Hence, unlike 2016, the case of deflation was not registered in 2017. For the purpose of comparison to the EU countries, an average inflation rate in the EU was 1,7% in the same year.
Figure 5. GDP per capita of the SEE countries over the period 2002-2017 (EUR)

Figure 6. Average annual inflation rate of the SEE countries over the period 2002-2017 (%)
CHAPTER I
INVESTING IN “WIDER EUROPE”:
POLICY AGENDAS AND BUSINESS STRATEGIES
IN THE NEW GEO-POLITICAL SCENARIO
Central and Eastern Europe and the EU: Stronger Together.
The Contribution of Assicurazioni Generali

GABRIELE GALATERI DI GENOLA*

CEE’S SCENARIO FOR INSURANCE AND ASSET MANAGEMENT PROVIDERS

Despite the global slowdown in the economic activity, Central-Eastern Europe remains one of the most promising and rapidly growing regions of the world and deserves therefore a special attention from European institutions and businesses.

Regarding the macroeconomic scenario, the industrial output and the domestic consumption are supporting the economic growth of the region, which significantly exceeds that of Western Europe. It is estimated that the GDP growth in Central-Eastern European countries will range from 2.2% of the Czech Republic to 4.5% in Hungary this year. Combined with fiscal stability and low inflation, this environment sustains employment, wage growth, household savings, investments and improved public finances. The positive momentum is confirmed by evidence showing that businesses find it increasingly hard to fill job vacancies. With this scenario, Central-Eastern Europe can be regarded as the region with the highest growth potential in Europe.

For insurance and asset management players, like Generali, the CEE (Central and Eastern Europe) represents an area of opportunity in terms of revenues and margins.

In addition to the encouraging economic fundamentals, it must be noted that the insurance penetration in these countries is still low, compared with Western Europe. As the economy expands, it is expected demand for property and casualty insurance to grow. It is also important to recognize a generalized increase in savings due to demographics, the wage dynamics and the relatively low level of private debt.

The insurance and asset management industry welcome also the efforts made by many local authorities in the CEE to incentivize fair competition and investments from abroad, although within a regulatory framework that, unfortunately, is still fragmented.

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Generali in CEE and Russia

Generali started operations in CEE since its very beginning. In 1832, it opened a shop in Prague and Pest, and soon after in Croatia, Slovakia, Slovenia, Romania and Poland. Trieste, where the Generali Headquarters were – and still are – based, was at that time an integral part of the Austro-Hungarian Empire, its largest port and one of its biggest cosmopolitan cities. It kept that status until it joined Italy in 1918. In the Iron Curtain times, Generali shifted its strategic focus elsewhere, due to the uncertainty over the possible developments. But already 30 years ago it became one of the first major Western European players to enter CEE in the wake of Perestroika and the revolutions of 1989, becoming again active in Hungary, in Ceckia and Romania in ‘93, in Slovakia in ‘96, in Slovenia in ‘97, in Poland in ‘99. In 2008, Generali established a partnership with the Czech conglomerate PPF Group, until 2015 when it decided to buy out the minorities and gain complete control over the operations. This partnership marked a period of expansion in Central-Eastern Europe, as revenues more than tripled and the number of clients more than doubled.

Today, Generali operates in 13 countries in the region, with an extremely solid foothold. The company is the second largest regional insurer by premiums with 15 million customers and a top-3 ranking in 6 countries. It is also the second largest asset manager in the area with the highest level of profitability among its competitors.

In 2018, the Italian insurance company announced the acquisition of the Adriatic company in Slovenia, reaching the second position in the country’s ranking. Moreover, it took over Concordia in Poland, a key player in agricultural insurance in the largest CEE market.

Both acquisitions contributed to rebalance the Group’s portfolio towards solutions highly profitable and very synergic with its existing model. In the asset management area, the company announced the acquisition – still under regulatory approval – of the largest non-captive asset manager in Poland, Union Investment, and it signed a long-term agreement with UniCredit to distribute insurance solutions through their vast local network of bank branches.

In October 2018, Generali opened an office in Moscow. Russia is not a completely new market for Generali since its presence in the Russian market dates to many decades ago when the company acted as reinsurers for risks in the space exploration. Generali also have a participation in Ingosstrakh, the fourth-largest insurer in Russia, to which provides with guidance and expertise to improve profitability, capital solidity as well as innovation.

Generali’s strategy in CEE as part of Generali 2021

In London, a new 3-year strategic plan has been presented. The so-called “Generali 2021” plan has the ambition to make Generali a life-time partner to its customers and the leader in the European insurance market for individuals, families, professionals and small-medium enterprises. The plan is focused on profitable growth and digital transformation pursued by strengthening leadership position in continental
Europe and capturing opportunities in high-growth segments and markets, including Central-Eastern Europe.

Generali’s expansion in CEE will be largely driven by innovation, mainly in the form of digitalization and connectivity. Such elements allow to let predictive power of insurers to explode.

The reason why this strategy is so relevant is that it carries the promise to improve the quality of life of clients. Generali 2021 aims to enhance the individual, to value his or her needs and to contribute to improving his or her life quality. For decades, insurance companies have been more interested in the technicalities of their products than in their customers. Today, the paradigm has changed. Digital innovation enables solutions that are completely tailored to the customers’ needs. Generali will no longer limit itself to the optimization of forecasting and to the anticipation of tariff dynamics, but it will define modular, flexible, simple and connected solutions aimed at improving life. The aim is to transform insurance into a personalized service, able to provide individuals and businesses with all the peace of mind that is necessary to capture their full potential, guide them towards healthier and safer lifestyles and prevent accidents. For example, in the Motor segment, the company is now able to analyse data collected through telematics not only to offer discounts to the safest drivers but, on top, to help them on how to drive in a safer and more cost-effective way.

In the CEE, the role played by digital transformation will be as crucial as in any other geography. Perhaps, even more so. The rapid development of these economies, coupled with unemployment rates close to zero, and rising wages, puts a pressure on businesses to evolve their models and to value and reward qualified labour. Generali is a pioneer in terms of digital transformation in the insurance industry in Central-Eastern Europe and, in turn, a provider of innovative stamina to the whole society and economy.

There are many examples. In the Czech Republic, the company have launched a new generation of apps that simplify claims management thanks to innovative features such as geo-localization and remote inspection and calculation of claims. In addition, it has introduced robots to automatize repetitive back-office tasks that do not add value and making the customer journey fully digital and paperless. In Serbia, Generali was the first company in the market to create an ecosystem based on a fully digital customer experience which enables, among other functions, remote claims. In that country, Generali has been a leader in smart agriculture insurance by using drone technology and satellite data, in cooperation with the State and leading agricultural institutions. Another example is Slovakia, which has been selected as the pilot country in this region for telematics, offered in combination with a comprehensive Motor insurance coverage.

Going forward, the commitment to innovation will remain central. In next years, Generali will continue to digitalize the relationship between agents and clients to improve customer satisfaction and efficiency. This process will lead to an increase in the amount of digital policies as a portion of the total number of policies sold. Between 2019 and 2021, Generali will invest 160 million Euros in internal strategic ini-
tiatives in this region. The implementation of robotics and machine learning across CEE will improve claims processes.

The company’s commitment is to improve the quality of life not only of its customers, but also of its employees. The case of Serbia can serve as an example: 20 projects are being carried out to ensure a greater balance between professional and personal lives of employees. Generali Serbia became the first financial institution in the country, and the second company overall, to be awarded the prestigious “Family-friendly Enterprise Certificate”.

Furthermore Generali aims to improve the quality of life of communities, too. This is consistent with its approach to sustainability through The Human Safety Net, Generali’s global community support program, aimed at fighting extreme inequalities and liberate the full potential of disadvantaged people, families and communities. This initiative is gaining traction in CEE. For instance, Bulgaria and Croatia are about to join this year, while Poland and the Czech Republic joined in 2018. Serbia also joined in 2018 by teaming up with the Novak Djokovic Foundation.

EU AND CEE – STRONGER TOGETHER

As previously illustrated, Generali cannot claim to be among the continental leaders and cannot reach its ambitious targets without the success of its operations in Central-Eastern Europe.

From an economic point of view, Central-Eastern Europe is strongly integrated with the Western nations. According to the latest Eurostat data, among the 5 most integrated European countries in terms of intra-EU trade, 4 are located in Central-Eastern Europe. The CEE economies are highly dependent on Western demand, especially of industrial goods that are vital to manufacturing in countries such as Germany and Italy. On the other hand, Western economies rely on CEE for both manufacturing and consumption and, broadly speaking, as an engine of growth.

However, from a political point of view, the debate across Europe, and more specifically Central-Eastern Europe, concerning EU and Eurozone enlargement is still ongoing. This mirrors the uneven political framework and the emergence of protectionism and nationalism in some countries.

The recent European elections have confirmed that the vast majority of the EU citizens believe in the vision of a stronger, better and more united Europe. A more integrated Union and common strategies in important fields including immigration, defence, digitalization, fiscal systems, industrialization and energy, among others, would truly benefit citizens and businesses. The outcome of the European elections should serve as a stimulus for a reform of EU’s institutions towards this vision.

At the same time, this vision requires the engagement of all citizens in a joint and energizing project. Europe has the opportunity to gain global leadership in a geopolitical scenario that lacks one. Europe is already leading the world in terms of social model, as its progress is founded on values such as inclusion, justice, economic democracy, universal healthcare and environmental protection. Europe’s identity is based on this social model... and its global leadership should be based on this identity.
A more united EU, paving the way for a stronger global role, could impact Central-Eastern countries by pushing, on one hand, the Union and the Eurozone to enlarge further and, on the other, CEE economies to implement reforms that are key to join.

A wider Europe can only happen if these improvements are made. A wider Europe is, simply, a stronger and better Europe.
Reinforcing the Capital Markets Union with Domestic Financial Markets in CEE

MARIO NAVA *

In Central and Eastern Europe there has been a positive trend in the last 5 years as macroeconomic data show that there has been an increase in terms of GDP and employment, along with the recovery of investments. In fact, all European economies have grown in the past decade, thereby recovering from the previous economic and financial crises in 2007-2008 and recuperating the previous levels of private and public investments prior to the crisis. The priorities in the area remain the same, while the challenge of sustainability and “green growth” will be fundamental in the next few years, particularly in order to raise investment levels even further. In order to facilitate the conversion of the economy, the European Union has invested a lot of political capital since the Paris Agreement, and in this field the necessity for more cooperation and coordination of all Member States and the European Parliament is vital for the achievement of the goals set. Additionally, sustainability has huge potential to be fostered as it becomes an element of good investment to both domestic and foreign investors.

In terms of capital markets union (CMU), the trend was also positive since it was pointed out that 11 out of the 13 number of reforms were successfully completed during the Juncker Commission. In the last European Financial Integration Report, in the section dedicated to South-Eastern Europe, the issue was addressed whether there were contradictions or not in the development of a national market alongside greater financial integration at European level through a reinforced “CMU 2.0”. Interestingly enough, evidence brought forward by the report suggested that development of a national market and financial integration reinforce each other. As a matter of fact, further efforts need to be made at national level in order to strengthen capital markets through more streamlined and proportional legislation, encourage the development of mature equity markets – which would benefit also SMEs – and encourage the opening up of national equity and debt markets to foreign investors. The positive consequences of these developments would specifically benefit the area of Central and Eastern Europe, where SMEs would particularly profit from further investments in “green finance” and where investments in new and sustainable infrastructure projects are undeniably needed in the years to come.

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The Benefits of Capital Markets
in the High-Potential European Economy

RICK WATSON*

Much has changed since the Commission first unveiled its initial Capital Markets Union (CMU) plan in 2015, but the fundamental basis for CMU – that in order for businesses to grow and create jobs they need to be able to easily access capital and attract investment, from across Europe – remains just as true today as it did in 2015.

AFME fully supported and still supports the measures set out in the original CMU 2015 Action Plan. It is in fact more vital now than it has ever been for the EU to enhance and integrate its capital markets capacity and infrastructure.

AFME has strongly supported investments in infrastructure finance, as a core component of both the existing and future CMU. During the existing CMU, AFME and ICMA launched a Guide to Infrastructure Financing in support of the launch by European policymakers of the Investment Plan for Europe and the European Fund for Strategic Investments (EFSI). Since then, the EFSI has mobilised €375 billion of investment towards both SMEs and infrastructures. A local example is the Venice airport which received a €150 million loan from the European Investment Bank (EIB) guaranteed by the EFSI. In Italy alone, 156 transactions and €9.7 billion of additional investments were approved for EFSI support, which is expected to unlock €63.3bn in financing. Such concrete actions are essential to demonstrate that CMU is having a tangible impact to the European economy.

To help monitor actual impact of CMU both in aggregate as well as at the individual EU member state level, late last year AFME published a report6 “Capital Markets Union – Measuring Progress and Planning for Success” to measure the progress of CMU through seven Key Performance Indicators. We believe it is important to keep track of the progress on the CMU, which is such a vital project and key to stimulate Europe’s capital markets and its economy more widely. The report shows that European companies continue to over-rely on bank lending compared to market-based instruments (bonds and equity). Only 14% of new external funding by EU non-financial corporates in 2017 was through bonds or public equity, with the remainder funded through bank lending. AFME’s report does show that European capital mar-

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In addition, the report shows that in 2017, five of the countries with the highest values for the loan transfer index, are countries that have had significant issues with NPLs in recent years, Spain, Italy, Ireland, Greece, and Portugal. This is encouraging as it shows that efforts are being made to deal with non-performing loans on bank balance sheets in these countries with a significant contribution of loan sale disposals (the most prominent instrument used by banks for distressed asset sales). On the other hand, the report highlights that Italy, alongside Germany and France, rank surprisingly low in the EU’s capital markets integration’s scale as a good proportion of their capital markets activity is carried out domestically or globally rather than intra-EU.

While there have been some legislative steps completed towards achieving CMU objectives, such as the introduction of a new framework for simple, transparent and sustainable securitisation, reforms of the prospectus regulation, and the promotion of SME growth markets expected to facilitate SME listings on public markets, there is still much more to be done. It is clear that for CMU to be a success, 2019 cannot be viewed as the end of the story.

It is important to maintain momentum for CMU to continue to develop EU capital markets as part of an open, integrated and resilient financial system that supports financial stability and economic growth. The future relationship with the UK on financial services will clearly be an important element of this debate.

There are a number of outstanding areas that CMU could target, which could significantly boost the effectiveness of Europe’s capital markets.

For example, as part of the aims of the CMU and in view of the increasing retirement savings gap, member states need to encourage households to invest more savings in capital markets instruments, particularly equity/risk capital which supports new business formation and expansion (in the form of equity, for instance, through private pension funds). Currently, EU households have high levels of savings, but they prefer to accumulate these in conservative cash products such as bank deposits. As a result, the stock of EU household savings held in capital markets instruments is only 1.18 times GDP, compared with 2.9 times annual GDP in the United States.

Another example would be further work on improving the functioning of the EU’s insolvency frameworks. Europe’s conflicting insolvency rules create uncertainty among investors, discourage cross-border investment and delay the restructuring of companies facing financial difficulty.

Addressing the general gap for all forms of risk finance for SMEs and Growth companies should also remain a priority within the next CMU project. There is still a lack of availability of risk capital in Europe which threatens Europe’s competitiveness and
future prosperity. AFME focused on this shortfall through the policymaker-focused publication *Shortage of Risk Capital for Europe’s Small & Medium Sized Businesses* in Europe in 2017. AFME worked with 12 major European trade associations and institutions outlining the existing sources of risk capital for growing businesses, why shortages occur, and highlighting recommendations for European and national policymakers to improve its supply. This report followed the publication of *Raising Finance for Europe’s Small & Medium Sized Businesses*, distributed to CEOs of AFME member SME clients. This publication provided practical information on how SMEs can find the right type of finance to finance their projects and, which has been published in 6 languages.

Start-up businesses or existing businesses with significant expansion plans usually have uncertain or negative actual and/or projected cash flows. Although there are banks which provide loans to such businesses, risk capital in the form of equity or venture debt provided by family and friends, business angels, peer-to-peer marketplaces, venture capital and private equity funds, venture debt providers are often more appropriate for businesses at this stage. Many European SMEs are profitable businesses with recurrent stable cash-flows, making bank loans an appropriate source of financing. But high-growth or innovative SME businesses have different needs. They have higher growth but less stable cash flows. This higher degree of risk makes equity and quasi-equity funding more appropriate for this type of businesses.

Today, Europe lags behind in providing risk capital to start-ups and growing companies. In the *AFME-BCG Bridging the Growth Gap* publication, BCG compared small business finance in Europe and the US. The report found that although European SMEs have more financing available than their US counterparts, they have available significantly less equity alternatives. There is €2 trillion of funding available for SMEs in Europe compared to €1.2 trillion in the US. But of those €2 trillion available in Europe for SMEs, 77% was in the form of loan or debt compared to only 40% in the US.

And significantly, our final point is that *CEE countries could also be bigger beneficiaries of the Capital Markets Union*. As highlighted in the AFME/New Financial publication – *The Benefits of Capital Markets in High Potential Economies*, deeper capital markets in EU’s 11 countries could unlock €200 billion in long-term capital as well as more than €40 billion a year in additional funding for companies. Companies

in the Visegrad/EU11 are even more heavily reliant on bank lending than in the rest of the EU (85% vs. 75%) whilst the pool of capital in the EU11, particularly pensions and insurance assets, are only a third as large relative to GDP as the rest of the EU, with households making more use of cash deposits for their savings. Therefore, the potential growth opportunities for EU11 capital markets is huge: if each country had markets as deep as the “best in class”, i.e. the most developed country in the EU11 in each of the 23 analysed, it would mean an extra €225bn in pension and insurance assets to put to work in the EU11 with annual flows of financing for companies in the EU11 of around €45bn.

Finally, the decision of the UK to leave the EU has fundamentally modified the context of the initial CMU launched in 2015. As we enter the next phase of the CMU, AFME would urge policymakers to take stock of this new context, the work done so far, and the scope for further progress, to develop policy measures that balance market resiliency, market integrity and appropriate supervision. In the future, CMU needs to develop and maintain a level playing field to keep Europe’s capital markets sufficiently open and competitive to grow their capacity, boost investment, reduce reliance on banks, and create jobs.
Integrating the Western Balkans in the European Framework: Political Commitments and Structural Problems

FERDINANDO NELLI FEROCI

In this paragraph, the focus will be shifted to a specific region of Eastern Europe, the Western Balkans, for its geopolitical implications. From both an economic and political perspective, the signals sent from the Western Balkans to the rest of the European continent are mixed. Overall, the economy of the region has been recovering since the financial crisis of 2007, and to a certain degree it is relatively improving. Nevertheless, there still are structural problems to be addressed, such as a high unemployment rate, an insufficient level of economic integration, an inadequate level of physical connectivity, and a wide mismatch in skills requirements between the ones required by employers and those of potential employees.

From a political point of view, the region since the end of the 1990s has showed improvements in terms of stability and progress in the process of reform. One particular event needs to be mentioned among the positive developments in the region: the agreement between Athens and Skopje on the controversial issue of the name of the Macedonian State, now being officially named as the Republic of Northern Macedonia. On the other hand, relations between Kosovo and Serbia are still far from being normalised, which is a fundamental condition for the further integration of the two countries of the region into the European Union (EU).

THE EUROPEAN UNION

The EU is both the major investor and economic partner of the Western Balkans and remains formally committed to the objective of a full integration of the countries of the region in the EU. This objective was solemnly announced by the European Council in 2003 at Thessaloniki. But so far, the enlargement process has not yet been completed. And a serious reflection is needed to understand the reasons why this process has not been completed yet, as well as to define a more credible strategy to integrate this region in the EU.

The causes of the enlargement fatigue are both endogenous and exogenous. In the EU, the economic and financial crisis has weakened the European economies, has had an impact on per capita GDP, has challenged the governance of the Euro, has increased disaffection in public opinions towards the EU and its institutions, and

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has fuelled mistrust among member State. Today, the consequences of this crisis are still felt.

Secondly, migratory flows have also challenged the EU and its member States. Even though the most critical phase of migratory flows is now behind our shoulders, and migrations have become a structural phenomenon with which Europe should learn to leave, the prevailing impression is that the EU has not been capable of developing a consistent and effective common migratory policy. And that on the contrary migrations have created conflicts and tensions among the members of the Union, triggering different reactions in national politics and media.

The European Union has given the impression, in most cases wrong, of not being able to mitigate the consequences of the economic and financial crisis, and to a certain extent of migrations. National Governments and EU institutions have been mainly focused on these two domestic challenges, which have witnessed the weaknesses of the EU governance. In these circumstances it should not come as a surprise that appetite for further enlargements has in turn become very modest. But the objective of enlargement to the countries of the Western Balkans maintains its strategic validity if the EU will want to maintain the region stable, prosperous and anchored to the rest of Europe. The countries of the Western Balkans should in turn continue pursuing the structural reforms needed to attract more European investments and finally become more integrated into the EU.

In the meanwhile, two positive developments stand out from this rather negative picture. First of all, in 2014 Chancellor Angela Merkel launched the idea of the Berlin process. Since the official process of accession to the EU was visibly slowing, the more committed EU countries to the stability of the region resorted to this practical experiment of cooperation that envisaged concrete projects in the fields of connectivity, infrastructure, energy and human mobility. These projects which are being by some Member States and by the EU are intended to fill the gap left by the lack of concrete progress in the process of enlargement.

And in 2018 the EU Commission has presented a new strategy for the Western Balkans that draws also on the first results of the Berlin process, which can be considered as positive in general terms. The objective is to steadily complete the projects in the above-mentioned sectors to facilitate the fulfilment of the conditions for the completion of the process of enlargement and accession of the countries of the region to the EU.

At the moment, the EU is engaged in accession negotiations with Montenegro and Serbia, two of the countries of the region. Negotiations with Montenegro are smoothly following the scheduled timeline, as 32 negotiating chapters were opened and 16 of them were already provisionally closed. Negotiations with Serbia are also going rather smoothly, even if they started later compared with the former, as 16 negotiating chapters were opened and 2 were closed. And the Commission released a positive report on the accession of the Republic of North Macedonia, and Albania, which are now ready to obtain the green light for the opening of accession negotiations.

On the contrary, the situation in Bosnia-Herzegovina is still too unstable and accession negotiations are not at hand. The same is true, in the case of Kosovo, espe-
cially in the light of recent tension with Serbia (following the imposition of tariffs on imports from Serbia). Both countries still need to adopt policies and measure aimed at the full normalisation of their bilateral relations.

In conclusion, many government officials and policymakers across Europe, agree on the necessity to fully support the commitment made by the countries of the Western Balkans to become part of the EU. Among these commitments a special attention should be given to reforms aimed at strengthening the respect of the rule of law and the independence of the judiciary; but also, at concrete steps to be undertaken fight against criminal organisations and corruption. In the next European Council in December 2019, member States should follow the Commission recommendations and decide to open accession negotiations with North Macedonia and Albania, as a strong signal that the process of enlargement maintains its credibility and that the EU sticks to its promises.
Western Balkans countries are already economically integrated with the European Union, although the process of transition to become a competitive player in the global economy is far from complete.

After the financial crisis of 2008, the biggest one since the Great Depression of the 1930s, we can say that the investment mood and climate have never been fully restored. Although, the availability of various funds is still adequate, we experience a cautious, selective and responsible investment approach in the management of the resources.

There are so many definitions and visions of Europe and the European Union (EU) and how it could improve its efficiency, function and approach to its citizens. Western and Eastern Europe are getting closer to each other, although the process is still slow. Thirty years have passed since the fall of the Berlin wall.

Today there still are significant differences in labour costs, tax rates and consequently direct impacts across the social systems. If the key principles of the EU, better known as the four freedoms – free movement of goods, people, services and capital over borders – will remain, we shall experience further equalization of living standards and an overall improvement for the whole European continent. Despite the previously mentioned slow but stable convergence, the process will be very challenging in the future due to pressure on high tax rates in the West and to a push up on labour costs in Central Europe. This will continue to support the already existing EU scepticism and bring additional social, economic and political tensions.

The biggest competition inside of the EU will happen between investment flows from West to East and labour flow from East to West. In this strained environment within the EU, scepticism grows towards the enlargement and it is getting harder for the Western Balkans to integrate into the modern economic standards and finally become part of the European family.

Without foreign direct investments, the economy of the Western Balkans region would be even more vulnerable, than it is today. Investments in these countries appear to be mostly sporadic and they are not based on strategic planning and deci-

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sion-making processes. Without strategic external investments and system improvements, the brain drain and social tensions will continue to grow, risking the prospects of the young generations. Importance of the investments can be found in the World Bank’s latest report on the Western Balkans which highlights that investments supported the economic growth in Southeast Europe countries.\textsuperscript{12} Economic growth in the Western Balkans picked up in 2018 and the outlook for 2019-20 is stable, but limited private sector dynamism is reflected also in low, and slow-growing foreign investment inflows.

According to World Bank data, foreign direct investment in Southeast Europe countries seem to have dropped considerably in 2012 and 2015, and still a positive trend has taken place ever since. Investments in the region were increased with 157 million$ in 2017 compared with the previous year.\textsuperscript{13}

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\begin{tabular}{|l|c|c|c|c|}
\hline
\hline
Albania & 3.8 & 4.2 & 3.8 & 3.6 \\
Bosnia and Herzegovina & 3.2 & 3.0 & 3.4 & 3.9 \\
Kosovo & 4.2 & 4.2 & 4.4 & 4.5 \\
North Macedonia & 0.2 & 2.7 & 2.9 & 3.2 \\
Montenegro & 4.7 & 4.4 & 2.9 & 2.4 \\
Serbia & 2.0 & 4.2 & 3.5 & 4.0 \\
Western Balkans & 2.6 & 3.8 & 3.5 & 3.8 \\
EU28 & 2.6 & 2.1 & 1.8 & 1.7 \\
Central and Eastern Europe & 4.9 & 4.3 & 3.6 & 3.2 \\
\hline
\end{tabular}
\textsuperscript{*e-expectation, ^f-forecast}
\end{table}

Source: For the Western Balkans: World Bank estimates based on data from national authorities. For EU28 and Central and Eastern Europe: European Comission Winter Economic Outlook.

Notes: Growth in the Western Balkans is a weighted average by population. EU28 comprises the 28 EU member countries. Central and Eastern Europe comprises Bulgaria, Croatia, Czech Republic, Hungary, Poland and Romania.

In addition, despite a challenging economic environment, GDP growth in the Western Balkans is gradually stabilizing, driven by investment and private consumption. GDP growth in the region is expected to rise from 3.1% in 2016 to around 3.6% in 2019. 

A challenge for the future, but also a possibility, is the fourth industrial revolution and turmoil in the world economy and trade. The whole European continent is at risk, especially when it comes to task of adapting to the new circumstances and conditions at the world market. The most vulnerable countries in this process are the Western Balkans countries.

The killing competition for direct investments could be managed by some sort of cooperation and specialization amongst the recipient countries, so that each country has its priority development areas. This would require strategic, structured and disciplined approach, changes in educational systems, and building professional investment promotion.

The challenges we face today are too big for one country to address it alone. In this, the regional cooperation, knowledge sharing from Central Europe to Western Balkan is more essential than ever in order to exchange best practices and create responses to the emerging challenges and opportunities.

Source: The European Investment Bank in the Western Balkans 5/2018 (https://www.eib.org/attachments/country/the_eib_in_the_western_balkans_en.pdf)
CHAPTER II
FOSTERING INVESTMENTS IN PORTS,
LOGISTICS AND THE MARITIME ECONOMY
FOR EUROPEAN ECONOMIC AND SOCIAL DEVELOPMENT
Neutrality of the Mediterranean and the Pivotal Role of Italy: the Adriatic Corridor

MASSIMO DEANDREIS*

The centrality of the Mediterranean Sea is re-emerging thanks to three main factors:
- The New Suez Canal, such as the reduction in transit times, the absence of limits in ship size and finally the presence of adequate logistic facilities.
- The growing role of China, that seeks to revive the ancient Silk roads in order to create new corridors of economic activity transiting on land and sea.
- Evolutions in the shipping industry, as the growing ship size and mergers between carriers that determine economies of scale and the need for routes with many stops in order to load and download containers.

THE GLOBAL MARITIME TRADE SCENARIO

Over 80% of global trade by volume and more than 70% by value are carried on board ships and handled by seaports worldwide. Between 2017 and 2018 there has been an increase of 4% in world seaborne trade leading the global volumes gathered momentum and reached 10.7 billion tons. Moreover, the overall volume is projected to grow by 3.8 annually until 2023. In particular, this growth would entail an increase by 6% in containerized trade volume, a 4.9% increase in five major bulks, an increase by 1.7% in crude oil along with an increase in refined petroleum products and gas by 2.6%.

THE NEW SUEZ CANAL

Transit goods through the Suez Canal account for 8-10% of global seaborne trade and 2018 was the year of records. For the first time in history, the threshold of 18 thousand ships was exceeded (+ 3.6%). They transported over 983 million tons of cargo.

Along with this impressive result, Southbound cargo (524.6 million tons, +9.8%) and Northbound cargo (458.8 million tons, +6.6%) registered a remarkable growth.

* Managing Director, S.R.M. Economic Research Center, Intesa Sanpaolo Group
### Statistics 2018/2019. Port of Trieste

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Figure 1. Ship Sizes are growing

Source: SRM on Alphaliner
MEDITERRANEAN PORTS ARE INCREASING THEIR COMPETITIVENESS

The gap between the ports of the Northern Range and the North of the Mediterranean has greatly reduced between 2004 and 2018.

The ports of the North of Mediterranean are growing also thanks to the development of the attractiveness of the area for the deep sea and short sea shipping.

Figure 2. Liner Shipping Connectivity Index (LSCI) 2008-2018

In particular, the Italian port and logistic system is gaining competitiveness as it climbed the top spot in 2018 starting from 110th place in 2007 in the ‘Trading across borders’ category of the Doing Business. In addition, the system saw an overall improvement of the Logistics Performance Index.

In 2018, all Italian ports managed a volume of freight traffic of 491 million tonnes. In this context, the strategic sector of Ro-Ro realized the best performance of growth (+3%) reaching a volume of 109 mln tonnes.

In addition, Italy can be considered as a logistic and energetic bridge between Europe, Mediterranean and Asia. There are 14 Port Network Authorities, 2 Port Authorities and at least 5 strategic ports. Finally, there are strategic gas pipelines from North Africa and Middle East. Last but not least, Italy is one of the leaders in the trade with the Med and the BRI Countries.
THE PORT OF TRIESTE

The port of Trieste features key competitive factors as its strategic geographic position, being linked to Central and Eastern Europe by intermodal and railway connections. Thanks to its naturally deep sea floor (18 m), it can host ocean liners from the Far East. Finally, the Free Port of Trieste has got an extra-territorial status with a legal and fiscal regime.

The simultaneous presence of all these advantages led on 24th March 2018 Italy and China to sign a Memorandum of Understanding (MoU) about the railway infrastructures located in the region port of the Eastern Adriatic Sea.

The Trieste Free Port features a series of further advantages. First of all, there is no time limit on the storage of goods. Secondly, no customs duties must be paid as long as the transported goods remain in the Free Zones. Furthermore, manipulation of goods along with their transformation is permitted and a custom deferred payment scheme is applied, whereby duties and taxes on goods imported can be paid up to six months after the date of customs clearance. Finally, no customs formalities have to be completed as long as the goods stay in the free zone.
Figure 4. Italian ports performance: Type of goods handled by the Port Networks in 2018 (mln tonnes)

Source: SRM
Figure 5. Goods handled by Trieste 2013-2018

Source: SRM on PNA MAO

Figure 6. Goods handled by cargo type in Trieste

Source: SRM on PNA MAO
WHAT DO WE NEED TO FOSTER ECONOMIC DEVELOPMENT IN THE MEDITERRANEAN?

First of all, we should look at ports and logistics in a Euro-Mediterranean perspective not only in their national context, but as a supranational and macro-geographical area. Furthermore, an economic development could be achieved by improving intermodal connections with inland areas that are key factors for Italian gateway ports. Moreover, we should have to invest in modernizing port infrastructures at national and European level. Finally, we are moving towards a new concept of ports, namely “Portuality 5.0”. This new framework presents 5 key aspects about the new role of port:

1. Internationalisation
   In “Portuality 5.0” there is a dedicated department for the international development of the port, along with a regular monitoring mechanism of routes and international trade.

2. Intermodality
   The presence of a dedicated department for the development of intermodal traffic is vital for the definition of a 5.0 port, as it improves the local transport networks and it allows the monitoring of local and global transport phenomena.

3. Training & academy
   The infrastructure of the ports has consolidated a long-term dialogue with universities and think-tanks, in order to ameliorate the logistic side. In addition, it allows the collection of publications and databases and the availability of study rooms.

4. Innovation & start-up
   The Port is based on “XL model” and it needs the support from port managers with specialised expertise and the incentives for regular updates on technological developments.

5. Free zone and territorial marketing
   The port location needs to be transformed into a key pillar for attracting both foreign and Italian investments for the territorial development, along with the creation of a promotional plan for free zones with financial and bureaucratic incentives.

Moving into this Port 5.0 approach is the way to let the Port a new development hub for all the territory and for the overall economy.
The Port of Trieste in the New European and Global Context. Investments in Ports, Logistics and the Maritime Economy for European Economic and Social Development

FABRIZIO ZERBINI

The port of Trieste will enable to save time and be environment-friendly, as shipping a container from Suez to South Germany via Trieste rather than via North-European ports, allows emission reduction of 135 kg/Teu of CO2.

* Chairman Trieste Marine Terminal (TMT)
Moreover, recently there has been an increase in the growing trend of TMT volumes in TEU, which more than tripled from 2005 to 2019 and with steady increase in the vessels operated in the same period. The first figure amounted to 625,000 while the second to 593 in 2018. The huge increase of teu handled it is not matched by the same increase of number of vsls: this is due to the naval gigantism which is in force since last years and is having, today, ships up to 15,000/16,000 teu as capacity calling on weekly basis (2 times per week) Trieste Marine Terminal and capable to transport more and more cntrs.

In addition to the growth of the above-mentioned volumes, the rail infrastructure inside the terminal has significantly improved, as there are now 5 rail tracks 600 metres each and dedicated cranes for operations. In terms of handling cntrs. via train, the capacity of the rail siding inside TMT terminal is up to 7,000 trains per year and, in year 2019, TMT expects to move about 3,500 trains for more than 200,000 teu via rail.
Additionally, over the latest 5 years data suggest that there is a stable and very strong increase in the rail traffic growth in the number of trains and teu, as shown in the below picture.
THE PORT OF TRIESTE IN THE NEW EUROPEAN AND GLOBAL CONTEXT
The Contribution of Shipbuilding to the New Maritime Economy

MONICA POLIDORI*

SHIPBUILDING AND THE CONTRIBUTION TO THE MARITIME ECONOMY

Fincantieri is one of the world’s largest shipbuilding groups and number one for diversification and innovation. It is leader in cruise ship design and construction and a reference player in all high-tech shipbuilding industry sectors, from naval to off-shore vessels, from high-complexity special vessels and ferries to mega yachts, as well as in ship repairs and conversions, production of systems and mechanical and electrical component equipment and after-sales services.

Fincantieri is a large Italian company with a global dimension and an international outlook, as evidenced by the weight of exports: in 2018 revenues amounted to over 5.5 billion euros (+9%) and the percentage of export revenues was equal to 82%.

Fincantieri is a main player a promoter of the maritime economy we are talking about today.

According to the Fifth Report on the Economy of the Sea 2015, published by Censis, one euro invested in shipbuilding produces a value 4.5 times greater, mostly for the benefit of the area where the shipyards are located, mainly thanks to the involvement of a wide and differentiated network of suppliers, many companies are highly specialized small or medium-sized enterprises.

Fincantieri generates a huge additional impact on the national economy, strictly connected with its production model and its buying strategies, in fact:
- up to 70%-80% of the value of a cruise ship is handled by subcontractors, therefore the availability of a reliable network is a main strategic asset of the yard;
- and, on the other hand, 80% of the total spending in products and services is distributed across Italian companies, mainly small medium size companies.

It means that on average the construction of a cruise ship of medium-large size develops on average € 2.7 to € 3.6 billion of business volume for the Italian System, of which:
- about € 600 to 800 million, directly generated by Fincantieri;
- about € 2.1 to 2.8 billion, additional value produced by other economic sector involved in the construction of the ships.

* Head of Strategic Market Analysis, Fincantieri
In addition, the contribution to the growth of subcontractors is also in terms of quality and the company is able to guarantee a preferential observatory in terms of innovation and product development together with a continuity of workload thanks to the long investment programs of its clients.

The company has a total backlog of €34.3 billion (approximately 2% of the Italian GDP), with 104 ships characterized by deliveries scheduled until 2027, ensuring a long term workload visibility to the supply chain and technology districts, thus creating a flywheel effect on the subcontractor network.

Equally important is the multiplier effect in terms of employment: in Italy the approximately 8,650 direct resources of Fincantieri, support more than 50,700 jobs in the local industries, considering direct suppliers and indirect suppliers involved in the construction of the ships. Adding the induced effect deriving from family consumption, the global employment rises to 79,900 units (about). Or, in other words, for every direct worker there are about 5 external workers involved in the manufacturing process and globally 9 considering the induced effect.

As a leading player in the maritime economy, we are interested in all initiatives that deal with the maritime economy and promote its investment and competitiveness.

Our shipyards are largely located in port areas, managed by the port authorities, so we are directly interested in investments in ports and logistics, because we are users of those infrastructures from the docks, to the logistics system, to the roads necessary for moving the goods and products that feed our industrial plants.

Every improvement or modernisation of the port system contributes to the competitiveness of Fincantieri’s yards.

The Adriatic is a crowded sea in terms of traffic of passengers and good, and therefore the maritime system must face new challenges. Innovation is the driving force of shipping and shipbuilding industry, and the main directions of technological development include:

- **First of all, Green Ships**: The reduction of environmental impact has become one of the most important drivers for design and innovation in the ships building sector. The new regulation, coming into force in 2020, require a reduction of sulphur oxides (SOx) emissions.

  Fincantieri is building the first dual fuel or (LNG) liquefied natural gas powered cruise ships. The first LNG cruise ships are already active in the Mediterranean, in particular in the western Mediterranean Sea. These ships require new infrastructure for bunkering activity. No Italian port is still equipped to receive these ships and the cruise lines made agreements with Spanish ports for the LNG bunkering, other foreign ports are equipping themselves. In the Adriatic Sea the Port of Pireus could do the same thanks to the huge investments of Chinese.

  The spread of gas propulsion inevitably requires the construction of suitable bunkering stations, new infrastructure.

- **Secondly, another direction of innovation concerns Smart Ships**: the advent of smart technologies means that ships can develop the capability to adapt automatically and modify behavior to fit the environment. This involves automation and installation of sensors on-board. One powerful application is the “autonomous
vessel” or unmanned ships. VARD is building one autonomous and electric-driven container vessel for YARA in Norway. Again this innovation will imply changes in port infrastructure, in the logistic network and will increase the emphasis on cyber security issues in addition to security.

The autonomous and electric-driven container vessel will operate in Norway, in a cargo transit between YARA’s plant in Porsgrunn to ports in Brevik and Larvik. With a length of 80 meters and a beam of 15 meters, the vessel will have a cargo capacity of 120 TEU (twenty-foot equivalent unit), replacing 40,000 truck journeys a year. Yara Birkeland will reduce nitrogen oxides (“NOx”) and carbon dioxide (“CO2”) emissions, and improve road safety in a densely populated urban area. The vessel will incrementally become fully automated by 2022, as it is updated in accordance with the latest information. For the first year, it will have a crew placed in a bridge container with crew facilities. By 2021, it will gradually become ‘autonomous sail’, monitored from a control room on land.
The Key Drivers of Investment in the Port of Trieste

MASSIMO ALVARO*

The port of Trieste has seen overall a stable growth in the total throughput in the last years. The added value was mainly driven by dry bulk, number of containers and cruises, which increased respectively by 58% during the same period in 2018, while the other two by 17% and 1871.77% compared to last year.

On the other hand, there were significant reductions in the local and ferry passengers by 44% and in the Ro-Ro of commercial vehicles by 24%.

The key drivers for Trieste’s port can be categorised in three main categories, namely direct investments, indirect and induced ones. In the first one, the centrality on the Baltic-Adriatic Gulf and the increase of volumes led to an increase in investments in the Trieste Passenger Terminal, Operators such containers cranes and infrastructure by Samer & Co and in Train/Rail sector by simplifying movements.

Secondly, among the indirect drivers of investment refer to the entrance to Trieste of both and cruise and logistics firms, that contributed to the growth of the port there mainly through the arrival of new capital and owners to operators, a revitalisation of logistics such as Interporto and Truck transport & Rail and additional employment.

Finally, the induced drivers are the opening of commercial activities and tourism along with the arrival of hotel new firms and real estate investments.

* Vice President Supply Chain Assurance, BA&IS – Inspection, Lloyd’s register
THE BELT AND ROAD INITIATIVE

Last March President of China Xi Jinping visited Rome for a state visit in which Italy signed a Memorandum of Understanding to become the first Group of 7 Nation to officially endorse China’s ambitious plan of investments. The were different reactions from different media journals, which highlighted the risks the membership entails.

Nevertheless, the investment initiative could increase significantly the direct investments additional employment of the port along with being a small logistical centre for Italian goods such as wine etc.

There is lot of curiosity on MoU signed with China from Experts and due to typical inertia we’ve showed in the past decades on Port investments and relevant growth compared to other geographies the question is only one:

Are we going to be Fast Enough?

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The maritime sector is an extremely important sector for the global economy. In fact, in 2017, a total of 753 million units equivalent to twenty feet (TEU) were traded through ports around the world. Moreover, between 2016 and 2017 the global traffic on maritime transport grew by 6%, thus registering the highest growth in the last five years. Like all economic sectors, also the maritime sector as a whole is undergoing a massive digital transformation that leads to the progressive replacement of traditional technology and the human factor with automated, complex and interconnected systems. As a matter of fact, today the maritime activities are based more and more on Information and Communication Technologies (ICTs) which allow the optimization of the various procedures and activities, from navigation to propulsion, from freight transport management to communications on traffic control, etc.

The digital transformation aims to improve productivity and efficiency by simplifying general management and reducing costs, but it has exposed the maritime industry to new risks related to cyber security. These threats are particularly unpredictable both in terms of appearance and effects as computer systems create a context of strong interdependence. At the same time, the role of the human factor is very often marginalized to the mere technological monitoring, for example to the monitoring of navigation and communication systems that are now entirely governed by the Internet of Things.

This impressive automation and the reduction of the role of the human intervention on ships and in ports create fertile ground for the occurrence of cyber incidents. Nevertheless, cyber security must not only be perceived as a threat, but also as a great opportunity for innovation and growth. In fact, digital transformation introduces a new security paradigm that operators in the sector are called upon to address and include in their portfolio of activities and priorities.

The main topics covered are:

- ICTs and maritime sector.
- Main cyber risks to which the maritime sector is exposed.
- Brief description of some cyber attacks in the maritime context.
- Possible solutions of cyber risk management.

* Cyber security Expert, Deloitte Risk Advisory
CHAPTER III
AN OPEN AND INTEGRATED BANKING SECTOR
AT THE SERVICE OF THE REAL ECONOMY AND SMES
In the last 28 years, except for few investments in Serbia and Croatia, there has not been any equity fund investing in the region, especially in Albania.

Therefore, the question is if there is a structural problem in the Balkan region that prevent the market to develop as it did, eg. in Poland.

The lack of investments in this region is influenced by several drivers. There are two main critical issues. The first one is the size of these markets. In fact, it is the limited size of the markets that makes the latter commercial unreliable. Especially after the financial crisis of 2007, equity fund managers do not start operations in small countries where there aren’t exit options. The size is a relevant structural problem since it is difficult to make market instruments available in such markets that are too small to attract sizeable or reputable investors.

On the other hand, another relevant issue is related to limited size of companies. About 93.5% of the economy in this regional area is led by SMEs.

Companies need a certain level of size to have capacity, ability and money to manage innovation. For this reason, most of the companies in the SEE region lack fundamental structure key on growth pattern, including innovation.

These two main critical issues can be addressed by first creating a local market of people who can help SMEs.

With this aim in mind, EBRD has created a consult industry in this region providing thousands of qualified consultants and specific advisors helping SMEs get better access to advice for sustainable growth. In particular, the expertise provided covers a wide range of business area including advisory support to investment, strategy, innovation management, financial management, digitalization, marketing and trade promotion.

Another relevant issue is the lack of expansion of credit portfolio. Most of the money flowing in this region is due to refinancing. This led to a lack of market expansion. EBRD has pushed commercial banks to venture into more risky part of the market in response, by providing banks with incentives to invest in the SEE enterprises. An example could be the incentives to invest in so-called “women enterprises” (companies owned by women) where have tried to create products through which commercial banks expand to those segments. The result has been incredibly successful across the region in terms of appetite to commercial banks.

* Managing Director for SMEs Finance, EBRD
Banking in South Eastern Europe: The Strategy of the European Investment Bank

ROZÁLIA PÁL

BANKING IN THE SEE: OVERVIEW AND LATEST RESULT OF EIB BLS (MAI 2019)

The last twenty years have seen an impressive development of the banking market in the CESEE region. These large players became market leaders in almost all countries of the region, carrying fresh capital and new banking practices and strong credit growth before the 2008/2009 financial crises.

Economic benefits of ‘balanced’ cross-border banking:
• can stabilise wealth through risk diversification;
• reduce the likelihood of bank failures and credit crunches;
• lead to stronger competition, faster technology transfer, and more rapid spread of best banking practices, thus enhancing further financial stability.

Moreover, there are some potential costs:
• First, foreign funds are likely to be more mobile.
• Secondly, they expose the domestic economy to foreign shocks through contagion.

However, the benefits outweigh the costs, and in the EU political agenda, these economic benefits represent the key argument supporting the Banking Union.

* EIB economist
Exposure:

Figure 1. External positions of BIS reporting banks vis-à-vis CESEE countries – index 100 = 2007Q1

Source: Authors calculation based on BIS data.
Note: Index 100 = 2007Q1 based on billions of US$, exchange-rate adjusted, vis-à-vis all sectors; grey bars correspond to the global financial crisis and the Eurozone sovereign debt crisis.

Figure 2. International banking groups’ exposure to CESEE by type (net percentages)

Source: Authors’ calculation based on EIB – CESEE Bank Lending Survey.

Figure 3. ROA of your CESEE operations – % of responses with ROA lower than overall group ROA

Source: Authors’ calculation based on EIB – CESEE Bank Lending Survey.
Note: Question from the survey: profitability of the strategy in the CESEE region: is ROA of your CESEE operations higher/lower/equal to that for the overall group?

Figure 4. Groups’ intentions on aggregate operations in CESEE

Source: Authors’ calculation based on EIB – CESEE Bank Lending Survey.
Note: Question from the survey: longer-term strategic approach (beyond 12 months): looking at operations via subsidiaries in CESEE, your group intends to…
Financing:

Figure 5. Demand and Supply forces underpinning regional credit developments

Source: Authors’ calculation based on EIB – CESEE Bank Lending Survey and WIIW data for credit extensions. Note: * Credit growth is computed on a biannual window and the reference period is the previous six months to match it with the survey releases and survey information set and the perimeter reflects the BLS country coverage; ** net percentages: positive values indicate increased (easing) demand (supply); the credit aggregate is constructed based on growth rates aggregated via country specific GDP weights and the country perimeter reflects the EIB Bank Lending Survey country coverage. Questions from the survey: Credit Supply: bank’s (local subsidiary)’s credit standards applied when assessing credit applications (eased, unchanged, tightened); Credit Demand: demand for loans or credit lines to enterprises and households (increased, stable, decreased). Net percentages; positive figures refer to increasing (easing) demand (supply) (triangles refer to expectations derived from previous runs of the survey, lines report actual values and dotted lines expectations in the last run of the survey).
INNOVATION PATTERN AND FINANCING CONSTRAINTS IN CESEE

The lower level of investment in intangible assets seems to result in a lower innovation in the CESEE countries.

- **CESEE firms are lagging behind the EU average in terms of innovation activity.** Considering the share of firms with active R&D expenditures (i.e. those belonging to the groups of leading, incremental, and developing innovators), all CESEE countries rank below the EU average (Figure 18). About 77% of CESEE firms are either basic firms or are adopting innovation (i.e. no active R&D expenditures), compared to an EU average of 72%.
- CESEE firms are lagging behind the EU average in terms of productivity as well:

Correlation between GDP per capital and share (%) of intangible investment in total investment 2017

Source: EIB

- Compared to the EU average, the CESEE region relies more heavily on government financing and financing from abroad for R&D. This reflects, on the one hand, the importance of intra-group financing of R&D due to a large presence of multinationals based in the region, and, on the other hand, the importance of European funding (e.g. the European Structural and Investment Funds) in the financing of much of domestic R&D investment.

The importance of R&D financing from abroad reflects the importance of the European Structural and Investment Funds and the role of foreign investors in boosting R&D investment.
Decomposition of gross domestic expenditure on R&D (GERD) by sector of funding (%), 2015

Source: European Commission – DG Research and Innovation
Data: Eurostat
Note: (1) CESEE: BG+CZ+EE+HR+LV+LT+HU+PL+RO+SI+SK

HOW IS FIRM-LEVEL INNOVATION FINANCED IN THE CESEE COUNTRIES?

CESEE innovators rely on bank finance, but also on tap intra-group funding. They use relatively more external finance than basic firms, and they have access to intra-group funding (mainly foreign owned companies).

As to the sources of external finance, CESEE leading innovators stand out as being predominantly funded by banks (direct bank loans or other forms of bank finance). Capital markets funding – i.e. newly issued bonds and equity – also play a relatively stronger role in financing incremental innovators, in comparison to other firms.
In the light of these developments, a prospective “new growth model” is emerging as a candidate to be the driving force of the region’s economic convergence for the coming years:

- *the chain of suppliers is a starting point* for CESEE economies to move upwards on the value chain. While technology importation will still have a place in helping to close the productivity gap, a gradually increasing role for local innovation;
- *an emphasis on home-grown innovation*, policies to maintain and strengthen the skilled labour force, stronger reliance on domestic savings, and the development of public infrastructure using EU funds.
To foster an innovation-based economy, preservation and development of the productive labour force is crucial. A growth model based on skills can only be successful when supported by policies that enable a reversal of the brain drain, and help to preserve and develop a skilled labour force. Education and training plays a key role, and there is much room for improvement in the CESEE economies in this respect.

Economic growth should also be supported by a system of financial intermediation that supports domestic savings. While the region will continue to be a strong potential target for capital inflows, domestic savings should play an increasing role, by providing a stable source of local currency funding that supports investment. In addition, the efficient use of structural funds will help close the gaps in infrastructure.

Bank loans are the main source of external finance for innovators in CESEE. In order to further boost innovation activity, private equity and venture capital remain crucial, but they are currently underdeveloped in the CESEE region at large.
Prioritizing Innovation:
The Mission of SIMEST in South Eastern Europe

ALBERTO CASTRONOVO

SIMEST is well-known for prioritizing innovation above all else – a mission achieved by focusing on three core strategies: digitalization, new financial tools and integrated coverage. New financial tools made available by the company have been studied based on the needs of the SMEs, namely human capital and technical assistance, digitalization and equity investments.

SIMEST supports Italian internationalization abroad, mainly in SEE countries, by managing funds on behalf of the Italian government and providing soft loans activity support, namely feasibility studies, technical assistance programs and commercial penetration support.

Simultaneously, equity investments are a prerequisite in order to allow Italian SMEs to enter this market. A total of 23 investment projects for an amount of €22 billion has been undertaken by SIMEST during the last few years. It represents almost €1 million per project addressed to support of SMEs in their expansion in SEE countries, mainly Serbia and Bulgaria. This equity support has generated €85 million of equity investments and €123 million of total investments.

Concerning digitalization, SIMEST has indeed launched a new portal where Italian companies can get access to a full set of five financial tools. The aim is to facilitate the access to capitals through a totally digitalized and customer-friendly process. This new tool has enabled SIMEST to reduce response times to companies requesting financing for investment projects. Indeed, it has been diminished from 90 to 24 days, on average.

The second critical driver for Italian SMEs is the human capital. Researches by Confapi (Confederazione Italiana della piccola e media industria) showed that export manager is the most sought-after managerial figure by Italian SMEs. Indeed, almost 34% of Italian SMEs is looking for a manager for the internalization process. SIMEST has introduced two new tools in order to meet the basic needs and priorities of Italian companies. The first one, in order to finance the temporary inclusion of an export manager. The second one, the financing of IT platforms named to the e-commerce project of Italian companies, either directly or through the market.

The third innovation driver of SIMEST strategy is the integrated coverage. The plan has been part of a wider group initiative with SACE SIMEST and CDP (Cassa
Depositi e Prestiti). Italian companies approaching CDP offices will have access to all financial tools and, depending on the request, receive different offers, namely from CDP, SACE and SIMEST. The first CDP office has been opened in Verona (in May).
Financing Investment and Growth: a Lesson from the Italian Experience

Ciro Rapacciuolo*

I. DEVELOPMENT OF NEW FINANCIAL CHANNELS FOR ITALIAN FIRMS

The recent Italian experience in developing non-bank finance for SMEs can be a good practice to be studied for other European countries, like for example those in the SEE region. After the crisis, Italy did a lot to create new financial channels for firms. The most important new tools recently developed are: AIM stock market, mini-bonds, financial bills for micro-firms, instruments for private equity and venture capital, ELITE project, individual saving plans (called PIR).

Table 1 shows the flows of resources raised in Italy with the AIM market and the mini-bonds, from 2013 to 2018.

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<td>358</td>
<td>306</td>
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<td>number of issuers</td>
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<td>51</td>
<td>57</td>
<td>55</td>
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<td>AIM stock market</td>
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<td>278</td>
<td>208</td>
<td>975</td>
<td>1464</td>
<td>3291</td>
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<td>number of issuers</td>
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<td>22</td>
<td>11</td>
<td>21</td>
<td>30</td>
<td>119</td>
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<td>710</td>
<td>636</td>
<td>514</td>
<td>1164</td>
<td>1572</td>
<td>4844</td>
</tr>
</tbody>
</table>

Mini-bond: issues of amount smaller than 30 million euro.
Source: CSC calculations and estimates on Borsa Italiana data.

* Research Department, Confindustria (CSC)
Results suggest that these new financial instruments, as a whole, were quite a good success in Italy, even if total resources raised still have to grow, especially for small businesses. We must insist on the new finance for Italian companies, continuing to support these alternative channels, even with new interventions.

The SMEs that have made it so far with these two main channels are just 393, in 6 years, with 4.8 billion euro raised. The aggregate number of firms issuing minibonds has been higher than the number of firms going on the AIM market. But the opposite is true for the total amount of resources raised by firms with these two instruments.

Mini-bonds are new debt instruments for SMEs. This market started from scratch in 2013, with a new dedicated segment, ExtraMOT-Pro, managed by Borsa Italiana. The market recorded a growth up to 2014, but then progressively slowed down, reaching a low in 2018. The volumes remain modest (1.5 billion euro in 6 years). In the first five months of 2019 there were 16 new issues, for a total amount of just 59 million euro.

Up to now, it is a “niche” market for already healthy, dynamic and transparent companies. The identikit of the mini-bond is: average cut 6.9 million euro, average maturity 5 years, average coupon 5.1% yearly.

A possible explanation for the limited development of mini-bonds up to now is that, due to a cost which is structurally higher than that of bank credit, these bonds were more desirable in the period of credit crunch in Italy (2013-2015), when the constraint on volumes was binding for firms.

Italian SMEs able to issue mini-bonds are in the range 8,000-10,000, according to various initial estimates. Thus, the market could grow a lot in the coming years. Some estimates assess the potential stock of SME mini-bonds at 10 billion euro.

We need to expand the mini-bond market, leveraging on several newly created instruments.

First of all, new actors have born to participate in this market: a number of private funds with the aim of investing in mini-bonds and some new Italian rating agencies specialized in firms’ analysis (Crif, Cerved). Insurance companies and pension funds could feed the demand for bonds, including by SMEs, according to new rules, but we have registered little results so far. The Guarantee Fund for SMEs, since 2014, can guarantee also mini-bond portfolios. Italian Investment Fund (by CDP) has created a “fund of funds” for investing in debt instruments, including mini-bonds, with an amount of resources around 400 million euro. These instruments could help a lot to expand the market.

The AIM stock market dedicated to SMEs, on the contrary, is performing very well. In 2018 there were 30 new AIM listings and 1.5 billion euro of fundraising, with a strong growth compared to 2017. The first half of 2019 registered 15 more entries with IPO and 329 million euro of new resources raised in the market.

The AIM was created in 2012, with the goal of attracting small and medium firms by means of: low admission requirements, easier listing process, lower costs. It is already now a success in terms of entries (119 companies in 6 years), considering the historically small number of firms listed in the Borsa Italiana. It is even more a suc-
cess story in terms of resources raised for SMEs (3.3 billion euro), considering that this market did not exist at all before.

Many more companies are interested in joining the AIM. But we must continue to stimulate the demand side of the market. We need, first of all, more investors specialized in the selection of small caps. And a “fund of funds” would be useful, to invest in newly listed SMEs.

Confindustria strongly supports this process of strengthening the alternative finance for firms, since the beginning. For example, by means of discussions with the policy makers on various possible instruments and with analysis by the research department on the usefulness and the impact of this process. Moreover, Confindustria is directly participating into two of the main instruments: the Italian Investment Fund and the ELITE project.

The Italian Investment Fund, created in 2010, is a crucial player for stimulating private equity and venture capital. The IIF realizes direct and indirect investments in SMEs, also by means of a “fund of funds”. Private equity in Italy is rising, in the last years, mainly thanks to IIF. Confindustria is participating in IIF equity with a significant share, together with CDP, other institutions and large banks. Moreover, an agreement was signed in 2010 to help spread the activities of the Fund and let the local associations belonging to Confindustria to act as “local branches” for the IIF.

The ELITE Project of Borsa Italiana is expanding more and more, since the start in 2012. It’s a kind of “financial gym” for small and medium firms. The number of SMEs participating to the ELITE program continues to grow: about 1,000 companies, of which 650 are Italian, have been involved. And new companies are already on the list to join ELITE and to prepare for the stock market. The companies that complete their growth path receive the ELITE Certificate. Some ELITE companies have already been listed on the Borsa Italiana markets, typically in the AIM segment. The IPO is not the only objective of ELITE, useful also for firms to travel along other channels for opening up their capital, for example M&A and JV operations. Confindustria worked since the beginning of the project to favor the participation of firms to ELITE. Moreover, an agreement was signed between Borsa Italiana and Confindustria in 2015 to let the local associations of entrepreneurs to act as “ELITE desks” (53 desks are active up to now).

2. FINANCIAL HEALTH CHECK OF THE ITALIAN INDUSTRIAL COMPANIES

The financial situation of firms in Italy, on average, is now much better than it was at the beginning of the crisis, also thanks to the new financial instruments developed in the last years. We have now a more solid financial structure on aggregate, even if many firms should continue to strengthen it.

Table 2 shows the liability side of firms’ balance sheets, using BACH data, comparing its composition in Italy with that in other main European countries. Italian industrial firms were able, in the last decade, to substantially strengthen their balance sheets: the share of capital (and reserves) has almost reached the levels of firms in France and Spain. In 2007, instead, the gap was very large.
Germany is still far away, in terms of the share of capital in total liabilities. When comparing only large companies in the different countries, the gap between Germany and Italy turns out to be smaller (by two percentage points), but it’s still wide.

The share of bonds has also increased in Italy, even if this progress was limited to just one percentage point in ten years. Moreover, the entire increase of the share is attributable to larger firms’ issues of bonds. For SMEs, this could be explained by mini-bonds being not a big success, less an achievement than the AIM stock market.

Conversely, the share of bank loans in total liabilities decreased a lot in Italian firms in the last decade, much more than abroad. Anyway, this share is still significantly higher in Italy than elsewhere.

It is also very important to look at the values of stocks, not only to shares. We notice that the change in shares was achieved with less bank credit and more capital and securities. This means that the balance sheets’ strengthening is very solid, since it does not simply come from the reduction of the stock of bank loans due to the credit crunch.

A remaining fragility in Italy is that SMEs are still more dependent on bank credit. Table 3 shows the comparison between Italian SMEs and larger firms in terms of liabilities’ composition, using BACH data.

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<td>Spain</td>
<td>15.2</td>
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<td>15.3</td>
<td>2.9</td>
<td>40.1</td>
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<td></td>
<td>10.0</td>
<td>0.3</td>
<td>22.9</td>
<td>16.4</td>
<td>3.7</td>
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<td>France</td>
<td>8.1</td>
<td>0.7</td>
<td>23.4</td>
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<td>5.2</td>
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<tr>
<td></td>
<td>6.0</td>
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<td>22.4</td>
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<tr>
<td>Italy</td>
<td>19.5</td>
<td>0.5</td>
<td>17.1</td>
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<td></td>
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</table>

* Financial and non financial.
** Payments received on account of orders and deferred liabilities.
Source: CSC calculations on BACH data.
Italian SMEs have also succeeded in strengthening their financial structure, like the larger firms, with more capital and less credit. This confirms the success of AIM and other efforts on capital.

Anyway, the SMEs bank loans’ share in total liabilities remains much higher and their capital share much lower with respect to larger firms (both by 5 percentage points).

These data also show the absence of progress on bond issuance, when we look at the aggregate of SMEs in Italy. This confirms that the number of small firms successfully using mini-bonds (and financial bills) is still undersized, compared with the total number of SMEs in the country.

Various steps are still necessary for firms to further improve their financial structure: SMEs should gradually fill the gap with larger companies; all firms should rely more on bond issuance to finance productive projects; entrepreneurs should continue to increase their “financial culture” and knowledge of instruments other than capital and loans; some businesses, especially among the family ones, should increase their willingness to open capital, also with operations like PE and VC.
3. FINANCE FOR INVESTMENT AND GROWTH

The efforts by the Government and other institutions, like Confindustria, in diversifying financial channels for firms in Italy have been crucial for growth. The alternative channels have helped many Italian firms to finance new productive investments in a period, 2013-2015, in which bank credit was less abundant. And investment is the most important component of GDP, since it both adds to current and to future economic growth.

The alternative financial channels in Italy will be important also in a period in which bank loans are not falling abruptly, as in a credit crunch. The traditional banking channel, in fact, will structurally remain slowed with respect to pre-crisis dynamics. Thus, credit will hardly be able to provide all the resources necessary to firms for the economic growth in the coming years. That’s why, to support the growth of the Italian economy, we must continue to develop the alternative financial channels.

The strengthening of Italian firms’ balance sheets is also good news for banks. In fact, it tends to increase the individual ratings of firms, favoring the supply of credit. Banks in the coming years will remain crucial for investment and growth, by providing credit to many firms in Italy, above all the small ones. Banks, indeed, should also be part of the process of strengthening the capital markets in Italy. In fact, they own the core competences for a crucial activity: the screening of the firms, looking for the ones with the right characteristics to go on the stock or the bond market. That’s exactly why, for example, some of the new funds investing in mini-bonds were created by banks.
CHAPTER IV
THE DEVELOPMENT OF INSURANCE MARKETS
IN THE NEW RISK SCENARIO: SOCIAL PROTECTION
AND INVESTMENT OPPORTUNITIES
Socially Responsible Investments: the Experience of the Insurance Industry and the Potential of Eastern European Markets

FRANCESCO MARTORANA

Socially Responsible Investments: The Experience of Generali

Socially Responsible Investments are investments that take into account environmental, social and governance (ESG) criteria and, simultaneously, allow conciliating financial performance with the environmental and social impact, contributing to a sustainable development of the economy.

Covering globally $23trl in AUM – over 26% global AUM – ESG/SRI investments are a growing reality, with Europe at the forefront for dimension and innovation. Indeed, the European market is the largest one (52% of global AUM), led by France as largest market in Europe ($3.4trl, c.29% of EU13 total), and the most developed on defining what constitutes “ESG/SRI”.

Figure 1

Sources: Global Sustainable Investment Alliance 2016 for aggregated data, Eurosif 2016 for European data. Data as of January 2016. Data n.a. in 2014 for Japan. Eurosif adopted a more restrictive definition of AuM SRI starting from 2015, which results in underestimation of CAGR and growth rate %.

* CEO @Generali Insurance Asset Management S.p.A., Società di gestione del risparmio (GIAM)
Companies embracing ESG (environmental, social and governance) perform better and mitigate risk – which means better results for investors.

Especially, there are three main benefits for investors in embracing ESG/SRI investments:

- **Better operational and financial performance.**
  More effective management of human capital and innovation. Consequently, companies with high ESG rating generate above-average returns and distribute higher dividends compared to their peers with lower rating. Furthermore, high ESG rating imply lower volatility of returns over the long term.

- **Lower risk and volatility**
  Companies with high ESG rating have better risk management and compliance frameworks. This implies not only reducing risk of negative events/business practice (e.g. bribery, corruption) but equally concerns a reduced tail risk and stock volatility for their investors.

- **Driver for improvement of financials**
  Lower risk exposure and improvement of ESG rating translate into decreased beta, lower cost of capital and, as a consequence, higher multiples. Over the long period, companies with high ESG rating overperform their peers.

**ESG/SRI Framework at Generali**

Figure 2

Initiatives on Sustainability supported by Generali Group:

- UN Global Compact (2007).
• Just Transition (2018).
• Task Force on Climate-related Financial Disclosures (2018).

Active Ownership: We encourage investee companies to adopt/improve ESG practices through voting activities and dialogue (Engagement).

Exclusions: We exclude from our “investable Universe” companies presenting poor ESG practices not meeting Generali Ethical Principles.

Impact Investing: We promote positive social impact by sponsoring/financing initiatives tackling global key social and demographic issues.

Selection: We select and invest in Companies which show best effort in implementing good ESG practices.

On February 21st, 2018, the Board of Directors of Assicurazioni Generali S.p.A. approved the Climate Change Strategy, setting Generali’s Group commitment for a transition to a more sustainable economy

1. Green and Sustainable Investments: Commitment by 2021: €4.5 bln of new investments (Green Bond, Green and Sustainable Infrastructures).

2. Positioning coal-related businesses/companies on: No new investment, Divest € 2 bln: Sell equity (6/12 months) and Run-off Bond Portfolio.

3. Engage (Countries strongly dependent on coal): Instead of simply excluding coal-related companies, Generali Group can support the sustainable transition to a low-carbon economy by engaging with issuers and stakeholders to guide and monitor the transition process and investing in green sectors to drive the economic transformation.

GREEN BONDS AND THEIR POTENTIAL FOR CEE MARKETS

Nowadays, there exists several types of Green bonds.

Green use of proceeds includes a widespread set of instruments associated with certain benefits such as the standard recourse-to-the-issuer debt obligation or the commitment to invest quantity equal to amount raised for projects with environmental benefits. GIAM Investment effort focused on this category through the Green bond market.

Green covenant is a debt instrument where the company commits to a certain green performance or ranking. This kind of instrument have been seen in the commercial paper market.

Green margin/sustainability performance is a debt instrument where the margin/credit spread is partially linked to a company’s sustainability performance, as measured by an external agency. This instrument is typically used for revolving credit facilities (Renewed Revolving Credit Facility at Group level for Eur 4bn in 2018 – Innovative ESG feature linking the cost of financing to Green bonds investments targets).
Green collateralised/covered debt is a bond collateralized by one or more specific green projects, including but not limited to covered bonds, ABS, and other structures. The first source of repayment is generally the cash flows of the assets. It can also have non-green collateral with green use of proceeds.

A brief snapshot of the current outstanding volumes of ESG-labelled bonds (USD 541bn) shows that Green Bonds represent around 88% of the market share (Volume terms) and Social and Sustainable bonds account for 12%. US, China and France are the leading countries (respectively for USD 130bn, USD 88bn and USD 63.5bn). Nevertheless, Euro continues to represent the currency of choice for ESG-related bonds issuance (51% in 2018, up from 45% in 2017).

Corporate bonds represent more than half of the total ESG bond market. Broadly balanced contribution between Fins and Non-Fins following the higher issuance of the former during 2018 (Eur 53bn). Social and Sustainability bonds are gaining increasing attention in the market supported by the wide range of projects financed (2018 issuance: Eur 24.7bn, +35.6% YoY).

Figure 3

![Figure 3](image)

Sources: BNP and BBVA, 2019

Figure 4

![Figure 4](image)

Sources: BNP and BBVA, 2019
According to HSBC analysis, Slovenia scores the best in terms of ESG among Eastern European countries and 17th on a Global basis. CEE countries active in the Green bond market rank among the first 40 countries (the sample includes overall 77 countries worldwide).

Economic and capital market characteristics differ across Central and Eastern European countries. This affects the issue potential and the size of the green bond market which is still very limited.

Green bond market in CEE essentially restricted to five different countries, namely Poland, Latvia, Lithuania, Slovenia and Estonia with a total amount of EUR 4.54bn of green bonds issued, all EUR denominated – representing only 1% of the total outstanding green bond market.

CEE green bond market is dominated by Poland government bonds whose amount issued (EUR3.75bn\(^15\)) represents around 80% of total issuance of the asset class in the area.

Poland has the largest CEE economy and bond market, and FTSE Russell has upgraded the Country to Developed Market in September 2018. Energy sector issuers are the next largest category after Polish government bonds in the CEE area. The Baltics instead have a small debt market, with combined overall outstanding bonds of EUR 27bn.

The region has an excellent record for external reviews with 94% of issued bonds benefiting from a second party opinion: Sustainalytics provided Second Party Opinion (“SPOs”) for 79% of deals by volume and CICERO provided 59% of SPOs by deal count.

\(^{15}\) The sovereign Poland [POLAND] on 7 March 2019 issued two green bonds, the EUR1.5bn 1.00% of 7 March 2029, and the EUR0.5bn 2.00% of 8 March 2049. These represent Poland’s third and fourth green bonds. Poland issued the first ever sovereign green bond in December 2016, the EUR750m 0.5% of 20 December 2021. In January 2018 Poland then issued a EUR1.0bn 1.125% of 7 August 2026.
<table>
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<tr>
<th>COUNTRY</th>
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<td>50</td>
<td>4.24</td>
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CEE countries

Other references Countries
Eight countries globally so far have issued green bonds – Poland ranking third in terms of overall amount outstanding in the Government space. Polish green bond framework notes five areas of eligible green projects: Renewable Energy, Sustainable Agriculture, Afforestation, National Parks and Clean Transport.

ESG BONDS IN CEE – FOCUS ON POLAND

Poland is the first sovereign green bond issuer worldwide with debut EUR 750mn bond in 2016. Recently issued in March 2019 further 2 green bonds for a total amount of Eur 2bn (after having issued also in 2018). Bank Zachodni WBK, a BBVA subsidiary, is the other Polish green bond issuer which under a PP format raised funding aimed at lending on clean energy, green buildings and “climate-smart” equipment.

Poland’s energy sector and economy are heavily reliant on coal – country has been opposing more stringent restrictions on coal-based emissions. The country has also undertaken several green projects. The country has significantly improved its share of renewable energy, with biofuels and waste representing the biggest share of primary energy supply. Companies using debt to finance waste to energy projects such as EZO SA could start leveraging green debt.

Other good practice examples of this path of conversion include the alignment of new building standards to the EU Energy Performance of Buildings Directive and the target of one million electric vehicles by 2025.

Companies such as PKP Intercity SA, Miejskie Przedsiębiorstwo KO in the railway sector are potential green bond issuers.

BANKS AS THE MAIN PLAYERS IN THE FINANCIAL SERVICE SECTOR

Since the markets of the countries included in the analysis are bank-centric, after a short introduction related to the legal institutional framework, we will focus on the comparative analysis of banking sector indicators among these countries as well as their comparison to developed European countries. We collected banking sector data
for the SEE countries from the official reports of their relevant national supervisory institutions and with support of central banks and banking associations of some countries.

**Legal and institutional framework**

The observed countries differ in the monetary regime implemented, although the main goal of central banks in each country is price and monetary stability. The supervision is assigned to central banks with an exception of BiH, where the entities’ agencies supervise the banks and Turkey, where the Banking Regulation and Supervision Agency is responsible for supervising the banking sector.

Most of the countries are in the process of adopting Basel III standards. In Greece, as it is a member of the Eurozone, the regulatory framework is based on and incorporates Basel III framework and related provisions. In Croatia, the Government and the Croatian National Bank have started the activities for Euro adoption process. Croatia also initiated the implementation of Basel III in Croatian legislation in 2013 with the adoption of the new Credit Institutions Act transposing CRD IV, following its accession to the EU. Consequently, there have been some changes in the regulatory framework regarding the coverage of risky assets in capital and capital buffers. Banks across the region have also overtaken fraud prevention and cyber security activities in recent years.

In the observed period in Croatia, bankruptcy proceedings were opened against two banks with the total market share of 0,4%. In Serbia the banks with 2,3%, 2,1% and 1,0% share in the total banking assets failed in 2011, 2012 and 2013, respectively. In Greece, 16 banks were resolved with the total share 13,0% of the total assets as of the end of 2012. Since the Greek banking sector was heavily hit by the financial and debt crises and confronted serious problems, the key challenge is the resolution of non-performing exposures and the improvement of liquidity position.

**Comparative analysis of the banking sector indicators**

Figure 7 shows that the size of the banking sector differed among the countries of the region in 2017, with the largest share of banks’ assets in GDP in Greece (166,9%) and the lowest in Ukraine (41,4%). The average banking assets as a percentage of GDP for the observed countries in 2017 was 85,8%.

In the period analysed in this report (2012-2017), the size of the banking sector increased in Albania and BiH, while it decreased in Croatia, Greece, Romania and Slovenia. In other countries of the region there was no clear trend in the banking sector size over this period (Figure 8).

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16. An asterisk (*) in the graphs means that the data for 2017 were not available and the data for the previous year was used
Figure 7. Banks' total assets as % of GDP in 2017

Figure 8. Total banks' assets as % of GDP in the period 2012-2017
Total assets of domestic banking groups and foreign-controlled subsidiaries and branches in relation to GDP in Eurozone in 2016 was approximately 250%, which was significantly higher compared to region’s average. However, this indicator differed significantly among the Eurozone member countries (from less than 100% in Lithuania to 1,500% in Luxemburg).

The number of banks varied from 10 in Kosovo to 84 in Ukraine in 2017 (Figure 9) and did not change significantly since 2012 (except in Ukraine where it dropped from 176 to 84 and Greece where it dropped from 52 to 40).

Figure 9. Number of banks in 2017

On a consolidated basis, the total number of credit institutions in the Eurozone amounted to 2,290 (domestic banking groups and stand-alone banks) at the end of 2016, down from 2,904 in 2008 and 2,379 at the end of 2015. The number of foreign branches declined slightly, from 706 in 2008 to 688 in 2016. If we divide this number with the number of Eurozone member states we get 157 banks per country, while the average for the countries analysed in this report was 30. However, the number differed significantly among the countries in both Eurozone and the SEE region.

The size of banks in 2017, measured as average assets per bank, differed significantly among the observed countries, from EUR 13,181 million in Turkey, 7,520 million in Greece to 388 million in Kosovo (Figure 10). If we compare this to 2012, the average assets per banks increased significantly in BiH (55.9%), North Macedonia (39.6%), Albania (36.5%) and Bulgaria (36.3%), while in other countries it increased by less than 30% and in Greece it decreased by 11.4% (Figure 11).

As the total assets of the Eurozone, domestic banks stood at EUR 24,183 billion on a consolidated basis at the end of 2016 and the number of domestic banks was 2,290. The average assets per bank in the Eurozone in 2016 was EUR 10,560 million, which is much higher than the region average (EUR 2,602.4 million in 2016). 19

Figure 11. Average assets per bank (2012-2017)

Figure 12. Market share of five largest banks in 2017 (%)
Figure 13. Market share of the largest bank in 2017 (%)

Figure 14. Share of banks with majority foreign ownership in the total assets in 2017 (%)
Figure 15. Composition of banks’ assets in 2017 (%)

Figure 16. Composition of banks’ liabilities in 2017 (%)
The market concentration in 2016, measured as the share of five largest banks in the total banking assets, was the highest in Greece (97.0%), although it was lower in 2012 (79%) and then increased significantly as a consequence of failed banks in 2012 (Figure 12). The lowest market concentration in 2017 was reported in Serbia (54.9%). Figure 13 shows that, if we observe the share of the largest bank, it was again the highest in Greece (37.0%) and the lowest in Turkey (14.3%).

Figure 14 shows that in all countries, except Slovenia, Turkey and Ukraine, there was a high share of foreign ownership in the total banking assets (from 68.0% in Greece to 90.1% in Croatia). In Slovenia, Turkey and Ukraine, the banking sector was dominated by domestic banks (85.0%, 69.2% and 70.8% of the total assets were held by domestic banks, respectively).

In the observed countries, net loans had the highest share in banks’ assets (Figure 15), while households and corporation deposits had the highest share in total banks’ liabilities (Figure 16).

Regarding the maturity of deposits in 2017, there was a significant mismatch among the countries as we can see in Figure 17. While Albania and BiH had almost the same share of short-term and long-term deposits, the share of short-term deposits in other countries was much higher than long-term, except in Turkey where the share of short-term deposits was significantly lower than long-term (26.0%). The highest share of short-term deposits in total deposits was in Romania (92.8%). The share of long-term loans was significantly higher than short-term loans in all countries, except Romania, Turkey and Ukraine. In Romania and Turkey, the share of short-term
Figure 18. Maturity structure of loans in 2017 (%)

Figure 19. Currency structure of deposits in 2017 (%)
loans was much higher than long-term (84.0% and 78.5%, respectively), while in the case of Ukraine the share of short-term and long-term loans was almost equal (46.1% and 53.9%, respectively). All the other countries had a much higher share of long-term loans and Croatia, with 85.8%, had the highest share of long-term loans (Figure 18).

Currency structure of deposits in 2017 in Figure 19 shows domination of deposits in the local currency, especially in the countries where Euro is local currency (in Greece 95.2%, Kosovo 95.2% and Montenegro 92.9%). In Croatia and Serbia, there was a high share of deposits in EUR (53.3% and 61.0% respectively). Other countries had more than 50% deposits in their local currency, while Turkey and Ukraine had large share of deposits in other currencies (39.3% and 37.4%, respectively). From Figure 20 we can see that loans in the local currency were dominating in the currency structure of loans in 2017 in Kosovo (99.9%), BiH (99.3%), Greece (91.9%) and Montenegro (93.3%). The highest share of loans in EUR, where EUR is not local currency, was in Croatia (60.0%). Like for deposits, Turkey and Ukraine had a large share of loans in other currencies (24.3% and 40.4%, respectively).

20. Official data about currency structure of deposits and loans for Greece and Slovenia were not available.
Regarding the basic features of the banking sector in 2017, in Figure 21 we can notice that the capital adequacy ratio in the countries varied between 15.7% (BiH and North Macedonia) and 23.8% (Croatia). The ratio was relatively stagnant over the period 2012-2017, with an exception of Greece, where it had a positive trend (from 9.7% in 2012 to 17.0% in 2017) and Romania (14.9% in 2012 to 20.0% in 2017) and a decreasing trend in BiH (17.0% in 2012 and 15.7% in 2017). For comparison to the developed European countries, all capital ratios for the group of significant institutions in the Eurozone, i.e. the banks supervised by the ECB, slightly increased in the third quarter of 2018 compared to the previous quarter. The Common Equity Tier 1 (CET1) ratio stood at 14.2%, the Tier 1 ratio at 15.4% and the total capital ratio at 17.8%. Average CET1 capital ratios at participating Member State level ranged from 11.8% in Spain to 25.3% in Luxembourg.

The highest ratio of non-performing loans (NPLs) was recorded in Ukraine. It increased from 8.9% in 2012 to 35.6% in 2017. In Greece, the ratio of NPLs in total loans increased significantly from 29.9% in 2012 to 43.9% in 2015, and fell in 2017 to 33.3%. In Romania the ratio of non-performing loans decreased from 18.2% in 2012 to 6.4% in 2017. In other countries, this ratio was relatively stable, and the lowest 3.0% was recorded in Turkey (Figure 22). Figure 23 shows that return on equity (ROE) was negative in Greece (-0.5% in 2016) and Ukraine (-15.3% in 2017). The highest ROE in 2017 was recorded in Kosovo (21.3%) and Albania (15.7% in 2017).
Figure 22. Ratio of non-performing to total loans in 2017 (%)

Figure 23. Return on equity in 2017 (%)
The global financial crisis has seen a strong uptake in NPLs in banks’ balance sheets, leaving policymakers worldwide concerned by this challenge. This trend has been exacerbated for some countries by the Eurozone crisis, particularly in the SEE region, resulting in an EU-wide peak NPL ratio of 7.5% in 2012. However, NPL ratio trajectories point to a significant decline across the EU which can be attributed to enhanced loan selling activities of banks in recent years. In fact, as of 2017, the ratio for the EU has stood just below the World average of 3.74%, at 3.7%, which suggests that NPLs are no longer a specific European problem. With the ECB maintaining its ultra-low interest rates, profitability remains a key challenge facing European banks. The ROE, a key indicator to assess the bank sector’s attractiveness for investors has been slowly recovering. The ROE of European banks was 5.6% in 2017 for EU28, practically half of the 10.6% registered in the burst of the financial crisis, but the highest since 2007. The ROE across EU countries diverged after 2007 signalling growing fragmentation particularly across the Eurozone. After reaching a peak in 2013 (25.8%), the dispersion around the average ROE substantially decreased falling to 8.3% in 2014, 7.4% in 2015, 5.7% in 2016 and further into 2017 to 5.1%, the closest so far to the 4.5% seen in 2007 before deviation started.\footnote{https://www.ebf.eu/facts-and-figures/banking-sector-performance/}
Figures 24 and 25 show that Ukraine and Romania recorded the highest ratio of liquid assets to total assets (53.1% and 53.0%, respectively) and Romania largest liquid assets to short-term financial liabilities ratio (146.0%), which are far above the observed group’s average. Liquid to total assets were the lowest in Bulgaria and Serbia (0.3% and 2.0%, respectively), while the lowest liquid assets to short-term financial liabilities in 2017 (for nine observed countries with available data) were in Croatia and Montenegro (32.6% and 35.6%, respectively).

**FEATURES OF INSURANCE MARKETS**

As far as the functioning of the SEE region insurance markets in 2017 is concerned, we can state that most markets continued to grow as in the previous years. At the beginning, it is very important to emphasize that a comprehensive picture of the region insurance markets would be still less remarkable without Turkey’s contribution.

We collected insurance market data for the SEE countries from the official reports of their relevant national supervisory institutions and with support of insurance associations of some countries. Consequently, we could do a comparative insurance market analysis among the observed thirteen countries using different parameters and, which is also very important, comparison to the parameters for the Insurance Europe (IE), the European (re)insurance federation that represents the developed part of the European insurance market.
In order to gain knowledge of the trends, we used the data from the reports since 2002, but comparative analysis was focused on 2017 and a deep market review will be presented. Besides, in PART II of this publication, a detailed report of particular country insurance market indicators is provided for all countries. We collected the basic market indicators for all countries as well as the other relevant data necessary for comparative analysis for 2017 from their annual reports published by the relevant national institutions, as mentioned before.

A year after new regulatory regime

The previous year will be remembered as the starting year of implementation of the new regulatory framework for insurance and reinsurance undertakings in the EU, Solvency II. Considering a period of several years for the preparation (six years or more), it did not cause much difficulties for most of the EU member states.

However, the SEE countries that are non-EU member states will not remember 2016 as the year of a huge change in the legal and institutional framework. These countries are still implementing the Solvency I rules and their insurance markets are still making initial steps in the preparation for new prudential and supervisory regime. Some of them are focusing on further liberalisation of motor third party liability (MTPL) insurance, a prevalent line of insurance business, while others are struggling with plenty of burdens, trying to provide a better supervision process and improve market discipline.

In the observed year, 2017, the SEE countries that are the EU members continued to focus on meeting Solvency II requirements and establishing the related reporting process. The other countries continued to improve the regulation regarding MTPL insurance as well as popularize risk management practices in the insurance undertakings. Additionally, throughout the process of joining the EU, SEE countries that are non-EU member states will have the opportunity to use the technical support and projects to establish the EU’s Solvency II regime.

Generally, even during 2017 most SEE countries did not make serious preparations for a new legal and institutional framework in their insurance sectors. Unlike in the developed part of Europe, insurance is still not perceived as an important factor of financial stability as well as economic development in these countries. In the following chapter we will see why.

The insurance markets overview

The following comparative insurance market analysis among SEE countries as well as their comparison to the Insurance Europe members reveals their diversity concerning various criteria.

A year after the largest growth of the SEE insurance market since 2012 (at a rate of 11.1%), in 2017 the total premium of the SEE region countries was EUR 24.744 million and it decreased by 1.5% compared to 2016. This was mostly caused by similar trends of Turkish market in the last two years. On the other hand, the total in-
The total insurance premium of the Insurance Europe members was EUR 1.213 billion and it increased by 2,0% compared to 2016, while the comparability of the Insurance Europe members data with those of the previous years is not relevant because of the changes in the methodology of data collection in 2016.

In order to better illustrate the market potential, the total insurance premium of the Insurance Europe members in 2017 was as many as 49 times higher than the premium of the SEE countries. Due to the recent movements in the insurance premium volume, the spread was even bigger compared to the previous year (47,3). More clearly, as far as the insurance premium is concerned, SEE insurance markets stayed at the level of only 2% of the share in the Insurance Europe members’ premium, or at a primordial stage in the insurance culture development.

From Figure 26 we can easily notice that the total premium of the SEE insurance markets in the period 2002-2017 (EUR millions)
Figure 27. Insurance penetration of the SEE insurance markets in the period 2002-2017 (%)

Figure 28. Insurance density of the SEE insurance markets in the period 2002-2017 (EUR)
Figures 27 and 28 illustrate the trends in insurance penetration and insurance density in the region, i.e. the trends in the share of insurance premium in GDP and the insurance premium per capita, respectively. The insurance penetration and insurance density of the SEE region in 2017 followed the trend of the total insurance premium. An average insurance penetration for the region was 1.7% and it was slightly less than in 2016 (1.8%). Insurance density for the region in 2017 was EUR 133.9, also less than in 2016, EUR 136.4, by 1.5%. In the Insurance Europe members in 2017, insurance penetration was 7.5% (4.4 times higher than in the SEE region) and insurance density was EUR 2,030 (as much as 15.2 times higher than in the SEE region). As we can assume, both parameters increased in the case of the Insurance Europe members in 2017 compared to the previous year (from 7.2% and EUR 1,981, respectively).

More analytically, the largest level of insurance penetration was traditionally recorded in Slovenia (5.0%) and that is the closest to the Insurance Europe average. Slovenia also had the best indicator of insurance density (EUR 1,055). All the other countries of the region, except Greece (EUR 368) and Croatia (EUR 294), continued to have features of poor insurance markets with insurance density around EUR 150 or less (for example, EUR 156 in Bulgaria, fourth largest penetration, and the lowest in Ukraine, EUR 34).

Considering the structure of insurance premium of the SEE insurers, a positive change regarding life insurance was noticed. Namely, the average share of life in-

Figure 29. Share of life insurance in the total premium of the SEE insurance markets in the period 2002-2017 (%)
Figure 30. Total premium of the SEE insurance markets in 2017 (EUR millions)

Figure 31. Number of companies on the SEE insurance markets in 2017
In total premium of the SEE region in 2017 was 22.8%, by 1.3% higher compared to 2016. Simultaneously, in the Insurance Europe members, the average share of life insurance in the total premium stayed unchanged, at the level of 58.5%. Figure 29 shows that the largest share of life insurance in 2017 was traditionally registered in Greece (47.3%). Moreover, Croatia (32.5%), Slovenia (30.0%), Serbia (24.5%), Romania (20.8%) and BiH (20.4%) were the only countries among the remaining ones that had the share of life insurance above 20%, a fifth of the premium. Kosovo had the smallest share of the life insurance in the total premium in 2017 (2.9%).

The further data about insurance markets of the SEE region in 2017 confirmed diversity among the countries regarding different criteria. In the following figures we will present specific market indicators, starting with the market size data shown in Figure 30. The total premium of EUR 24,744 million in 2017, where Turkey’s contribution was EUR 11,299 million or, in relative terms, 45.7%, made the SEE region as one of the least developed parts of Europe when it comes to insurance. Like in the previous year, apart from Turkey, Greece (EUR 3,965 million), Slovenia (EUR 2,179 million) and Romania (EUR 2,125 million) were the countries with the amount of the insurance premium above EUR 2,000 million in 2017. Nevertheless, considering the volume of the SEE economies (banking sectors, as their inherent parts, for example), one of their mutual characteristics refers to a high potential for insurance market growth.
As Figure 31 illustrates, the total number of companies operating in 2017 was 324 and the data were collected for twelve markets (Ukraine was not involved). This indicates that most countries of the region had a disproportionately large number of companies in relation to market’s premium. As it is shown in Figure 32, this is most evident in Kosovo, Montenegro, North Macedonia as well as Albania and BiH, where an average premium per company was between EUR 6 and 13 million, far less than in Turkey (EUR 185 million) and, especially, the Insurance Europe members (EUR 357 million).

To be more precise, although Kosovo, Montenegro, North Macedonia, Albania and BiH generated less than 3.2% of the total insurance premium in the SEE region, with overall 80 insurance companies they participated with 24.7% in the total number of companies operating on the selected thirteen markets. The average premium per company for the selected markets in 2017 was EUR 76 million, that is 4.7 times less than the average premium of the Insurance Europe. Only Turkey (EUR 185 million) and Slovenia (EUR 121 million) had an average premium per company above EUR 100 million. These indicators show that further mergers and acquisitions of the insurance undertakings can be expected, especially because of the new or upcoming regulatory requirements (Solvency II).

Several indicators of the market concentration are shown in figures 33 to 36. Figure 33 illustrates that Montenegro continued to have the highest market share of the largest company in 2017 (36.6%), which was the successor of the monopolistic state company that existed in the earlier economic and political system. Regarding this criterion, Montenegro was followed by Croatia (28.9%), Slovenia (27.7%), Serbia (26.8%) and Albania (24.3%), while in other countries the largest insurance company covered below 20% of the market.

Figures 34 and 35 present market shares of three and five largest companies, respectively, where we can see that in all the analysed countries three largest companies covered more than 25% and five largest companies covered more than 40% of the total markets (except Turkey with 27.3% and 38.7%, and BiH with 24.9 and 39.2%, respectively).

Participation of small companies in the markets was best indicated by the number of companies with market share less than 3% and it is shown in Figure 36. The total number of companies with the market share less than 3% in the observed countries was 189. Turkey and Greece continued to have the largest number of these companies (50 and 39, respectively, or 47.1% both of them). The number of these companies declined over the last years as a consequence of not only mergers and acquisitions, but also bankruptcies. The average share of the largest company for all eleven observed markets (the data for Ukraine and Kosovo were not available) was 13.9%, while the average share of the largest three was 32.8% and the largest five 45.7%.

In order to make comparison, the share of the largest company in the Europe Insurance member states was 7.6%. The parameters regarding the largest three and five companies were 19.6% and 27.2%, respectively.
Figure 33. Market share of the largest company on the SEE insurance markets in 2017 (%)

Figure 34. Market share of three largest companies on the SEE insurance markets in 2017 (%)

SOCIALLY RESPONSIBLE INVESTMENTS
Figure 35. Market share of five largest companies on the SEE insurance markets in 2017 (%)

Figure 36. Number of companies with market share less than 3% on the SEE insurance markets in 2017
Figures 37 shows the structure of the insurers according to the type of insurance they were focused on. We can notice well-known dominance of nonlife insurers. Namely, it is easier for small domestic and/or local insurers to conduct their activities in the nonlife than life business lines, while life business is mostly in the hands of the insurers that come from the EU. A composite type of insurers is prohibited in some countries, in other words, life and nonlife insurance have to be separated.

A low competition level of domestic companies in life business forced them to focus on less profitable, nonlife business. On the other hand, efficiency of foreign insurers was reduced by the lack of insurance culture and predominant interest of the insurers in auto insurance, especially in mandatory MTPL insurance. Figure 38 indicates that the share of life insurance on the selected markets in 2017 was 22.8%, while MTPL covered 25.8% and other nonlife 51.45%.

A high share of MTPL insurance on the market was evident in Albania (61.9%), BiH (50.1%), North Macedonia (45.3%), Montenegro (42.5%) and Romania (39.4%), where it contributed to the total premium around 40% or more (see Figure 39). For comparison, an average share of the MTPL insurance in the total premium of the Insurance Europe members was 5.1% and the share of the other nonlife insurance was 36.4% in 2017. The share of life insurance in the total premium of the Insurance Europe was mentioned before (58.5%).
Figure 38. Share of life, MTPL and other types of nonlife insurance premium on the SEE insurance markets in 2017

Figure 39. MTPL shares on the SEE insurance markets in 2017
Figure 40. Number of companies with majority of domestic and foreign ownership on the SEE insurance markets in 2017

Figure 41. Market share of companies with majority of domestic and foreign ownership on the SEE insurance markets in 2017
Figures 40 and 41 show the numbers and market share of companies with the majority of domestic and foreign ownership for the countries with available data. Foreign insurers were prevalent in almost all observed markets, covering a half or more of the total premium, but there were many examples of insurers from one SEE country (such as Slovenia and Croatia) operating on the markets of other countries of the region. The largest market share of foreign insurers was registered in North Macedonia, where foreign insurers covered more than 90% of the market.

**OTHER RELEVANT FINANCIAL INSTITUTIONS IN SOUTH-EASTERN EUROPEAN FINANCIAL STRUCTURES IN 2017**

Apart from banks and (re)insurance companies, when we analyse other financial institutions in the SEE financial structures, we can notice a wide range of different types of financial intermediaries such as investment funds and voluntary pension funds, micro-credit organizations (or microfinance institutions), leasing companies, saving and loans associations etc., but regarding their investment potential they are far below the banks. Banks still play a decisive role in all these financial markets. Individual reports for each country based on official reports published by their relevant national institutions include the part related to other relevant financial institutions. Therefore, we shall give an overview of the countries in order to shed some lights on the basics of their other relevant financial institutions.

As far as Albania is concerned, the share of other relevant financial institutions in the overall assets circulated in the financial system was 8.1% in 2017. There were three pension funds and they invested mostly in government bonds. Also, three investments funds operated on the market. According to the official data, in 2017 they invested 61.3% of their assets in government bonds, 17.7% in treasury bills, 9.7% in cash and cash equivalents, 5.3% in corporate bonds, 5.0% in other investments and 1.0% in other assets. In 2016 through the mergers, by absorption, the process of the reorganization of 98 existing saving and loans associations finished. At the end of 2017 there were 13 saving and loans associations and one union savings and loan associations. Micro-credit organizations (or microfinance institutions) as well as leasing companies operated on Albanian financial market. When it comes the object of leasing, in 2017 the leasing portfolio was dominated by financing for personal transport vehicles (55.1%) and working transport vehicles (26.1%).

The share of other relevant financial institutions in BiH financial system was 6.1% in 2017. The pension insurance reform is still not over, it is in some kind of transition. But in 2017 the first voluntary pension fund management company was founded and the first voluntary pension fund (European Voluntary Pension Fund) started to work. Investments funds are mostly closed-end, as a result of legally permitted transformation from privatization funds in the 2000s. Regarding the investment structure of BiH investment funds, they invested the main part of the assets in cash and cash equivalents in 2017 (63.7% the investment funds located in the Federation BiH and 69.9% the investment funds in Republic of Srpska). The micro-credit sector of BiH has played a significant role in reducing poverty and supporting the develop-
ment of entrepreneurship among the socially vulnerable parts of the population, which have no access to financial resources at traditional banks. The results achieved for the period since the establishment of the micro-credit sector rank BiH among the countries of the world that have gone further in the development of this area of financial offer. In 2017 on the BiH market 29 micro-credit organizations were functioning, out of which 15 operated as micro-credit foundations and 14 as micro-credit companies. They invested mostly in the net loans (in Federation BiH 77.0% of their assets and 80.0% in Republic of Srpska). When we consider the portfolio of leasing companies, 88.0% of all arrangements were financial and 12 operational leasing. The object of the leasing were mainly vehicles for business purposes and, expectedly, the users were mainly legal entities.

Compared to Albania and BiH, the share of other relevant financial institutions in the financial structure of Bulgaria was much greater in 2017, at the value of 17.3%. Currently, supplementary pension insurance is implemented by participation in mandatory universal and/or professional pension funds, supplementary voluntary pension funds and/or supplementary voluntary pension funds with occupational schemes, which are established and managed by pension insurance companies licensed by the Financial Supervision Commission. At the end of 2017, the structure of the pension insurance market remained unchanged compared to the previous year in terms of the number of licensed pension companies (9) and the number of pension funds (28). They invested predominantly in debt securities issued or guaranteed by the EU member states, other states or by their central banks (63.0%). Investment funds in Bulgaria can be classified into two broad groups – resident and non-resident. As far as their portfolio structure is concerned, it is interesting that the funds mainly invested in shares and other equity (35.9%), then deposits (26.7%) and securities other than shares (25.1%). Moreover, in the portfolio of Bulgarian leasing companies the highest share had loans (85.4%). Much more leasing was financial (95.0%) than operational (5.0%), on the observed two-year continuity. The object of both leasing contracts were usually cars, transport and commercial vehicles as well as machinery and industrial equipment.

In 2017, slightly more than a quarter (25.6%) of the financial structure of Croatia referred to other relevant financial institutions, such as pension and investment funds, credit unions and leasing companies. There were voluntary pension funds, which may be of an open-end or closed-end type, and mandatory pension fund, which may belong to the one of the three categories (A, B or C). Mandatory pension funds invested 97.5% of their assets in securities and deposits, out of which the most in domestic government bonds (71.6%). Similarly, while voluntary open-end investment funds had 93.8% of the investment structure in securities and deposits (out of which 58.2% in domestic government bonds), voluntary closed-end funds had 92.8% in the same items (out of which 56.7% in domestic government bonds). There were two types of investment funds in Croatia — open-ended investment funds with public offering (UCITS) and alternative investment funds in 2017. UCITS funds predominantly invested in government bonds (41.0%), then money market instruments (24.6%), deposits (17.9%), shares (12.2%), other UCITS funds (3.0%) and corpo-
rate bonds (1.4%). Regarding the country of the origin of issuers, these funds invested the most in domestic securities (for example, 90.8% in 2016 and 84.3% in 2017).

There was the special investment fund governed by the Act on the Fund of Croatian Homeland War Veterans and Members of their Families, but this fund stopped to operate on December 28, 2017. Beside this, credit unions nowadays play the role of micro-credit organisations in Croatia. As a result of the initiative of nine credit unions, the Croatian credit unions association was established on July 1, 2011, with its residence located in Zagreb, in order to achieve mutual interests. Furthermore, the majority of leasing companies in Croatia belong to the group of financial institutions and they traditionally offer financial as well as operational leasing services/products. In 2017, the most of the leasing contracts referred to passenger cars, commercial vehicles, plants, machinery, transport machines and equipment. The most frequent users were non-financial institutions (i.e. companies).

In spite of the fact that there are three pillars of the pension system, the first pillar on the social security accounts for more than 99 percent of the whole system in Greece. Voluntary occupational and private pension plans existed in 2017, but they still were of minor importance. Greek UCITS included two basic types of collective investment undertakings — mutual funds and variable capital investment companies. Both fund types were open-end or mutual. According to type, in 2017 out of 286 mutual funds in Greece, 74 were equity, 33 balanced, 75 funds of funds and 14 specialized. The existing Banking Law requires a minimum capital of EUR 18 million to carry out financial or credit activities. A partnership with a licensed bank is required by all legal entities such as NGOs (including associations, foundations etc.) that are interested in serving the micro-credit market. Moreover, we noticed that 22.6% of the liabilities of leasing companies represented liabilities due to credit institutions, compared to 8.3% for factoring companies in 2016.

Pension funds, micro-credit organizations and leasing companies as other relevant financial institutions in Kosovo participated with 31.3% in the financial structure in 2017. Kosovo Pension Fund ("Trusti") was established in August 2002 to administer and manage mandatory and voluntary pension contributions of Kosovo's employers and is supervised by the Central Bank of Kosovo. Since 2008, there were two voluntary pension fund management companies. The vast majority of microfinance institutions in Kosovo has non-governmental organization (NGO) status. They are supervised by the Central Bank. The leasing sector in Kosovo is at early stage of development and the Raiffeisen Leasing Kosovo was the only financial institution that offered this kind of financial services in the country in 2017. The main activity of this leasing company was to provide financial leasing for vehicles, equipment or machinery as well as real estate.

We can say that the financial system of Montenegro has still not recognized the role of the third part – other financial institution because of their contribution of only 2.4% in 2017 (relatively stable or in decreasing since 2012). There were two voluntary pension funds, out of which one invested 58.0% of its assets in money deposits and the other one 65.0% in the investment funds. Five closed-end and four open-end funds operated in the industry of the investment funds. They invested 88.0% of the assets
in securities. Micro-credit organizations invested 96.2% of the assets in loans to citizens. Moreover, in 2017 four leasing companies conducted businesses, while 78.0% of the leasing activities referred to financial leasing and 22.0% to operational. The main object of the activities were passenger cars (89.0%).

In North Macedonia 13.4% of financial assets in the system referred to other relevant financial institutions in 2017. The fully funded pension insurance included two pension companies. Both companies managed one mandatory pension fund and one voluntary pension fund. They predominantly invested in bonds issued by domestic issuers. Investment funds had small contribution among institutional investors. In 2017 there were 15 open-end funds and not a single closed-end fund. The existing funds invested 52.9% of the assets in deposits. In 2017, the number of leasing companies remained seven, unchanged compared to the previous year. Unlike the previous four years, when the scope of activities of this sector was continuously decreasing, in 2017, the total assets of the leasing companies increased by 19.9%. All companies were with 100.0% foreign capital but the leasing market was still underdeveloped. Also, there were two saving houses and four financial companies on the market, relatively small according to the volume of their activities.

In Romania 18.4% of the financial assets were possessed by other relevant financial institutions in 2017. There were 17 pension funds, out of which 10 voluntary and seven mandatory, which functioned on the markets. They invested 61.3% of the assets in government bonds. Apart from pension funds, investment societies operated in Romania as well as open-end and close-end investment funds. The number of the non-bank financial institutions in the General Register increased from 177 in 2016 to 183 in 2017. Their primary activities were multiple lending activities (81.4% in 2017, by 1.4% more compared to the previous year).

Slightly more than for Montenegro, 3.0%, was the share of other institutions in the financial structure of Serbia. The pension reform finished in 2006, since when only voluntary pension funds were operating. Four companies managed seven voluntary pension funds, one custody bank and five agent banks in 2017. As far as the investment structure of the pension funds is concerned, they invested 83.6% of their assets in the government debt securities. Besides, there were two types of investment funds on the market – open-end investment funds with public offering and alternative investment funds. In total, 17 investment funds on the market in 2017 mostly invested in short-term cash deposits (68.7%), more in EUR (54.0%) than domestic currency (36.0%). Micro-credits in Serbian financial system are approved exclusively by banks, and money control is carried out by UNHCR donors and tax authorities. Moreover, 16 leasing companies operated on the market and at the end of 2017 their financing of freight vehicles, minibuses, and buses (43.1%) continued to account for the largest share of financial lease as well as passenger vehicles (33.2%).

Regarding the financial system in Slovenia, 12.1% of the financial structures referred to other financial institutions in 2017. The First Pension Fund is a special type of a pension fund designed to cover for payments of pension annuities from insurance policies under supplementary pension insurance and is managed by Modra Zavarovalnica. At the end of 2017, seven management companies operated, which
managed six umbrella funds with 96 sub-funds and four mutual funds. The Leasing Committee, established as a leasing office within the Bank Association, represents the leasing industry in Slovenia. Related to the leasing activities, there were relevant trends in 2017 such as the sale of the portfolios of the leasing companies, the sale of certain leasing companies, the specialisation of the member institutions, the changes in business models, etc.

From 2012 to 2017, the contribution of other relevant financial institutions in Turkey was around 8.9%. The number of active pension investment funds as of the end of 2017 was 299, which were managed by 18 pension companies. Standard Pension Investment Funds and Variable Pension Investment Funds were put up for sale on 01 January, 2018. Also, 456 investments funds on the market operated. The funds invested dominantly in private sector debt securities.

Other relevant financial institutions in Ukraine involve pension funds, investment funds, credit unions as well as leasing companies. Pension reform was introduced in October 2017. This reform has been one of the IMF’s key demands for Ukraine in order to release an USD 8,4 billion tranche of finance, part of its USD 17,5 billion loan program. However, 49.0% of Ukrainians do not support the pension reform. In 2017, 1,160 investment funds operated on the market and 50.4% of their assets was invested in equities. Microfinance is not developed in Ukraine and the microfinance segment is mostly served by banks or credit unions, though NGOs are present on the market. Credit unions are the main non-bank financial institutions serving the financial needs of small and medium enterprises. The overall size of the credit union segment is very small, relative to the financial system. Similarly, the leasing market has been developing slowly. In 2000, the overall contribution of the leasing assets was registered at the level of 1.0% (the lowest in Europe). Vehicles (cars, trucks, LCV) were still the main subject of leasing in Ukraine, comprising more than 70.0% of all items leased during 2017. Lessors were most interested in the leasing of equipment that is highly liquid and can be easily repossessed and resold.

THE ROLE OF FINANCIAL INSTITUTIONS IN FINANCING SMALL AND MID-SIZE ENTERPRISES: RECOMMENDATIONS FOR SOUTH-EASTERN EUROPE

Financing is one of the most important problems that small and mid-size enterprises (SMEs) face. The level of economy development and the development of financial system in particular, largely affect the sources of finance available to SMEs.

Possible source of finance for SMEs

As a term, financing includes the process of provision of financial resources. The sources of finance for enterprises, including SMEs, can be defined as all financial resources owned by the enterprises regardless of their origin (own and/or borrowed, internal and/or external, etc.). Awareness of the existence of various sources and their appropriate usage are the main factors for maintaining continuity and success in enterprise’s business operations.

The sources of enterprise’s financing may be divided with regard to different criteria:
• by origin – internal and external,
• by ownership – own, borrowed and hybrid,
• by availability term – short-term, medium-term, and long-term.\textsuperscript{22}

Own resources, as the source of finance, include the resources of the founder (owner), partnership shares, issued regular or preferential stocks, etc. This source can further be divided into internal own resources (amortization and retained earnings) and external own resources (stock capital paid in and the issuance of stocks or shares). Unlike own resources, borrowed resources are the sources that an enterprise is obliged to return to lenders (creditors, bondholders) while paying a certain fee (interest). Short-term sources of finance are those with maturity date up to one year. Most often they include: liabilities to suppliers (trade credits), issued short-term securities, short-term loans, etc. Long-term sources of finance have maturity date longer than a year. They are particularly important as they affect long-term stability of enterprise’s financing.

In developed market economies, the range of sources of finance (financial instruments) available to enterprises is much wider when compared to the countries with emerging markets. However, regardless of the level of economy’s development, certain sources of finance, particularly the borrowed ones, are less available to SMEs than large enterprises due to the fact that creditors and lenders perceive SMEs as a group of risky clients.

\textit{Financing model dependence on macroeconomic environment}

The size distribution of enterprises in emerging markets is rather different from that in developed economies. In the least developed countries on average almost two thirds of workers are employed in very small (micro) enterprises – that is, enterprises with less than five employees – and most of the rest work for large enterprises that have more than 100 employees. SMEs are underrepresented in these economies. In total, they employ less than 10,0\% of the total workforce. By contrast, in the most developed countries, more than two thirds of all employees work for large enterprises, the majority of the remaining work for SMEs while only a fraction for micro enterprises\textsuperscript{23}. Although large enterprises have the largest share of aggregate economic activity in the most developed countries, SMEs play a much more important role than their proportion of total employment might indicate. They not only make up the majority of enterprises (they are most numerous) but they also dominate many sectors of economic activity and are the generators of new products and technological innovations more generally.


A common explanation for the comparative absence of SMEs in underdeveloped countries when compared to developed countries nowadays is that SMEs cannot obtain access to capital. According to a World Bank survey, large enterprises in any country generally have better access to bank credit, in both local and foreign banks when compared to small enterprises that mainly rely on internal funds and retained earnings. In addition, the survey also showed that there is significant heterogeneity across countries when it comes to the sources of finance for SMEs, with the share of small enterprises without external finance ranging from 19.2% in Croatia to 72.9% in Armenia. In approximately a quarter of the countries, small enterprises obtain more than 10.0% of their funds from trade credits (liabilities to suppliers), while some 40.0% of them get the equivalent share of finance from local commercial banks. In general, moreover, the countries in which SMEs have access to such types of external sources are precisely the countries with more advanced financial systems, which indicates a potential causal relationship between financial development and the viability of SMEs.

Many economies of northern and western Europe as well as of North America have developed a wide spectrum of modern financial institutions quite early in their history and then successfully underwent industrialization over a period from the late 18th to the early 20th centuries. There is no doubt that modern financial institutions were of crucial importance for the overall registered growth of these economies. However, it does not necessarily mean that these institutions played an important role in the finance of SMEs. Indeed, the evidence suggests quite the opposite. SMEs in these regions rarely raised their capital on the equity markets or obtained credits from large banks in financial centres. Although SMEs used external sources for the provision of working capital, withstanding unfavourable business conditions and using the benefits of new technologies, they received assistance from a significant number of local financial intermediaries. Furthermore, it seems that these intermediaries emerged endogenously in order to satisfy their own needs wherever sufficient demand existed. Governments of these countries did little to prevent their formation but they also played little role in their creation by providing the environment which included reliable property rights and the establishment of national financial institutions such as central banks, which helped in mitigating local shocks. Governments were generally not able to initiate economic growth by promoting local financial institutions in regions where there was insufficient demand for their services. Admittedly, the specialized intermediaries that emerged to satisfy the needs of SMEs had significant weaknesses but they were able to get through local information networks and consequently extend credit to enterprises that were too “young” or small to secure funds from large regional or national institutions. Moreover, by raising the return to sav-

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24. The survey into the sources of finance for enterprises was conducted under the World Bank investment climate program in 2002-2003 (Investment Climate Surveys – ICS) in 38 developing countries in Europe, Asia, Africa, and Latin America. For more details see http://research.worldbank.org/ics/jsp/index.jsp.
ings for households in their vicinity, they helped to mobilize significant resources for economic development.

SMEs in developing countries nowadays use various sources of finance just as those in the North Atlantic Core during the 19th century. Also, as enterprises grow, reliance on banks and other similar types of formal intermediaries increases, while dependence on informal sources of funding decreases.

Table 1. Main external sources depending on enterprise’s size

<table>
<thead>
<tr>
<th>ENTERPRISE SIZE</th>
<th>N</th>
<th>FAMILY, FRIENDS, INFORMAL SOURCES (% ENTERPRISES)</th>
<th>BANKS AS MAIN EXTERNAL SOURCES (% ENTERPRISES)</th>
<th>EQUITY CAPITAL, SALE OF STOCK (% ENTERPRISES)</th>
<th>LEASING, TRADE CREDIT, CREDIT CARDS, DEVELOPMENT FUNDS AS MAIN SOURCES (% ENTERPRISES)</th>
<th>% ENTERPRISES WITH NO EXTERNAL FINANCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>1.756</td>
<td>14,4</td>
<td>9,5</td>
<td>3,2</td>
<td>8,9</td>
<td>64,0</td>
</tr>
<tr>
<td>Small</td>
<td>2.988</td>
<td>9,4</td>
<td>17,6</td>
<td>3,0</td>
<td>15,4</td>
<td>54,6</td>
</tr>
<tr>
<td>Medium</td>
<td>1.036</td>
<td>4,6</td>
<td>25,2</td>
<td>2,8</td>
<td>16,6</td>
<td>50,8</td>
</tr>
<tr>
<td>Large</td>
<td>1.036</td>
<td>3,6</td>
<td>29,5</td>
<td>4,1</td>
<td>17,0</td>
<td>45,9</td>
</tr>
<tr>
<td>Very large</td>
<td>1.317</td>
<td>2,7</td>
<td>31,5</td>
<td>2,9</td>
<td>14,7</td>
<td>48,1</td>
</tr>
</tbody>
</table>

Notes: (a) The survey included the enterprises in 38 countries – Albania, Armenia, Azerbaijan, Bangladesh, Belarus, BiH, Brazil, Bulgaria, Croatia, Czech Republic, Ecuador, Estonia, Ethiopia, Macedonia, Georgia, Honduras, Hungary, Kazakhstan, Kenya, Kirgizstan, Latvia, Lithuania, Moldova, Nicaragua, Nigeria, Philippines, Poland, Romania, Russia, Slovakia, Slovenia, Tajikistan, Tanzania, Turkey, Uganda, Ukraine, Uzbekistan, and Yugoslavia. (b) N is the number of enterprises included in the survey. Only enterprises with complete data for all four forms of external finance were included. Enterprises for which the category “other” was the leading source of external finance were also excluded. Micro enterprises have less than 10 full time workers; small enterprises have more than 10 but less than 50; medium have more than 50 but less than 100; large have more than 100 but less than 250; and very large enterprises have more than 250.

As was the case in the 19th century, only few enterprises of different size raised their capital for new investment by issuing stocks. Even today, SMEs simply do not raise capital in this way but provide their external finance by some form of credit. However, there is still a problem of relative absence of financial support to SMEs – the problem which is most acute in the poorest countries with the least developed financial systems. Historical analysis of the North Atlantic Core points to the one possible explanation of the evident absence of financial support to SMEs – these countries are like the Massif Central, financial “deserts” due to little demand for this type of finance. It is also simply possible that SMEs in developing economies, unlike their historical counterparts in the most of the North Atlantic Core, operate without the position their counterparts had in world economy, too far away from productivity line to be competitive. However, it is also possible that there are regulatory and other institutional barriers that block the formation of local financial intermediaries or that “supress” demand for such financial services.26

Financing models at various stage of SME life cycle: recommendations for South-Eastern Europe

The characteristic of undeveloped financial systems is the so-called shallow market with few financial intermediaries (financial institutions) where the most important intermediaries are deposit-credit institutions or commercial banks. On the other hand, developed financial systems are characterised by a large number of financial institutions that are able to satisfy any form of demand for financial services and a “decline” of the relative importance of banks with an increase in the importance of some other financial institutions, primarily investment and pension funds. In other words, more developed systems have the developed mechanisms of the so-called indirect finance as a result of more financial institutions and intermediaries.

There is a set of specificities in SME financing. Concrete differences between corporate (business) finance and finance for entrepreneurs and small and medium-sized business are evident in the following:

• inability to separate investment from financial decisions,
• less capacity for diversifying risks in SMEs,
• ability to include outside investors in the management,
• information problems in the realization of investment projects, and
• different perception of the top target function of the enterprise – creating (maximizing) owner value.27

Regarding two main groups of sources of finance for the SME sector (own and borrowed), there are certain specificities, explained as follows:

• Finance by own sources is based on self-financing by entrepreneurs, using the funds owned by family members and close friends. Very often, employees are included in financing, as at the beginning they receive lower salaries. Apart from these, there are also other sources, primarily franchising, factoring, property as collateral, etc. The dominant role in personal sources of finance is given to internal sources, which means that, particularly at the initial stages of business development, all the profit made is reinvested. External personal sources are, however, extremely limited and cannot be obtained without the change in the legal form, either by including new partners in the form of limited liability enterprise, by modifying the registration of the enterprise from limited liability enterprise to shareholding enterprise, which would enable the issuance of securities (stocks).

• Finance by borrowed sources is characterised by the creation of debt relations and takeover of the obligation to return the borrowed funds to the creditor. The lender, that is entrepreneur, is usually required to obey repayment plan which includes not only the payment of the principal but also of interest fees. Finance by borrowed funds is rather limited due to little capital and small value of the enterprise. At initial stages there are not financial reports for previous years, which is why the focus is limited to microfinance, bank loans, state development programs, leasing, debt securities, etc.

As SMEs are the result of an entrepreneurial venture, it is necessary to understand financial needs of SMEs through their life cycle. Enterprise’s life cycle can be presented through the following stages: experimental or seed stage, start-up, expansion, recapitalization, and buyout. Figure 42 shows the sources of finance in enterprise’s life cycle.

During the seed phase enterprise’s cash flow is negative due to cost of product development, legal and tax counselling, business plan preparation, etc., and non-existent sales income. As this is an extremely risky stage, which many enterprises never pass, external sources of finance are mostly friends, family and grants or subventions. Besides them, angel investors may show up as well as funds of risky capital, providing that the idea is rather promising and that investors are willing to take such a large risk. When the product is introduced to the market, during enterprise’s start-up stage, angel investors and funds of risky capital come to the top of the list of investors, although family, friends and other investors may appear by means of grants. During the expansion stage cash flow is finally positive with the potential of rapid growth, which makes enterprises able to use credits and other debt instruments under favourable conditions. Funds of risky capital have an important role during

28. There is evidence that banks restrict lending for firms that are less than two years old and then slowly build up lending as they develop a relationship (Leitner, S. M. (2016) Financing constraints and firm growth in emerging Europe. *South East European Journal of Economics and Business*, 11(1), p. 33).

this stage, through financial and non-financial support. The recapitalization stage, in which enterprise’s capital structure changes, includes the use of credits and other debt instruments as well as the emergence of funds of private equity capital. The buyout stage refers to the sale of a controlling share or takeover of the entire enterprise, where strategic partners, managerial teams of funds of private equity capital emerge as buyers. In some cases, buyout is made through the initial public offering. Funds of risky capital, along with funds of private equity capital, are the institutions providing support to enterprises at all development stages, whereby support is most evident during the start-up and expansion stages while somewhat less evident during other stages. On the other hand, the funds invested by friends and family during the experimental stage are extremely important at this stage while finance through financial market and commercial banks is available at the stages when the enterprise rapidly grows or has stable operations. Angel investors need to be mentioned as well, as together with family and friends they provide support at the riskiest stages of enterprise’s development. Hence, any type of investors can contribute to enterprise’s development and it is up to entrepreneur to decide which of these options is the most appropriate at a certain stage of development.  

Since financial structures in the countries of the SEE are bank-centric, the existence of diverse non-banking institutions such as microfinancial institutions, investment funds such as funds of risky capital, leasing companies, etc., aimed at financing var-

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ious needs/stages in SME life cycle, points to the imperative of strengthening or improving the segments of other relevant financial institutions, primarily the ones that operate locally. For example, in 2018, Culkin and Simmons conducted a survey\textsuperscript{32} of SMEs in the Western Balkan countries and found that the access to funding is a significant obstacle. They noted that aspiring entrepreneurs in the Western Balkans are generally not in sectors with access to venture capital, and even if they are, may find it difficult to connect. Therefore, they depend on lending from banks.

More broadly, small firms financial constraints in the area of the Western Balkans may be illustrated as shown in Table 2.

<p>| Table 2. Small firm financing constraints (firm data)\textsuperscript{33} |
|--------------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|</p>
<table>
<thead>
<tr>
<th>FIRM FACING FINANCE CONSTRAINT</th>
<th>SHARE IN %</th>
<th>LOAN REJECTED</th>
<th>TOO COMPLEX</th>
<th>INTEREST RATE</th>
<th>COLLATERAL NEEDS</th>
<th>POOR LOAN TERMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>60</td>
<td>2,0</td>
<td>11,8</td>
<td>80,4</td>
<td>3,9</td>
<td>2,0</td>
<td>0,0</td>
</tr>
<tr>
<td>BiH</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>35</td>
<td>14,0</td>
<td>20,7</td>
<td>55,2</td>
<td>5,2</td>
<td>1,7</td>
<td>3,4</td>
</tr>
<tr>
<td>Kosovo</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>45</td>
<td>5,0</td>
<td>16,4</td>
<td>58,2</td>
<td>13,4</td>
<td>4,5</td>
<td>3,0</td>
</tr>
<tr>
<td>North Macedonia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>45</td>
<td>4,0</td>
<td>0,0</td>
<td>95,7</td>
<td>0,0</td>
<td>0,0</td>
<td>0,0</td>
</tr>
<tr>
<td>Montenegro</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>60</td>
<td>7,0</td>
<td>2,3</td>
<td>84,1</td>
<td>2,3</td>
<td>4,5</td>
<td>0,0</td>
</tr>
<tr>
<td>Serbia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>35</td>
<td>5,0</td>
<td>8,6</td>
<td>74,1</td>
<td>2,5</td>
<td>2,5</td>
<td>7,4</td>
</tr>
</tbody>
</table>


In some SEE countries, such as Serbia and Ukraine, microfinancing is almost nonexistent while in other countries such as BiH and Montenegro, it is an extremely expensive source of finance for SMEs. The possibility for opening micro-credit organizations in Serbia or certain business transformation of micro-credit organizations in BiH and Montenegro (which might include the possibility for dispersion and cheaper sources of finance for the very micro-credit organizations) would mean accessibility or better accessibility of micro-credits for SMEs. Micro-credits with mutual accountability might serve as a special type of micro-credits.

Furthermore, the efforts aimed at the improvement of credit finance for SMEs in SEE countries might head towards the reduction of costs of credit by means of credit-guarantee funds as well as funds for crediting small businesses. The appropriate Internet platform, the so-called peer-to-peer (P2P) lending, might reduce SMEs’ dependence on bank loans and facilitate direct access to institutional investors and retail investors. Such positive example comes from the USA and it refers to the JOBS Act that came into effect in 2016. The JOBS Act legalized the so-called crowdfunding or financing by a large number of people. Investment crowdfunding provides SMEs with the possibility to sale equity shares to non-accredited investors via online platforms and social media. In other words, start-up enterprises and small entrepreneurs in the USA do no longer need to depend on large investors. Their equity shares are available to all citizens, whereby American start-up scene and small entrepreneurs are given access to significantly larger financial resources.
The topic is really interesting and above all provocative. The main purpose of which I set out as a participant in this forum is to give my vision of how more advanced investment can be achieved that will meet broader goals.

The investment position of insurance companies in a country such as Northern Macedonia has been described previously and remains largely unchanged. Insurance companies use conservative investment strategies as they mostly consist of investing in government debt securities and bank deposits. Investments in equity securities are almost marginalized, and the only shift in favour of better asset management is through the investment in UCITS (Table 1).

| Table 1: Insurance companies’ investments (assets covering technical provisions and own funds) EUR |
|---|---|---|---|
|  | 2016 | 2017 | 2018 |
| Debt securities | 110,457,507 | 121,887,155 | 133,979,591 |
| Bank deposits | 78,429,403 | 84,316,886 | 92,895,650 |
| Real estate | 20,984,192 | 23,846,867 | 23,397,741 |
| UCITS and other participations | 6,852,461 | 7,643,213 | 10,115,181 |
| Cash and cash equivalents | 7,660,549 | 6,825,601 | 6,409,703 |
| Equity securities | 1,533,223 | 2,626,257 | 3,267,408 |
| Other | 2,581,130 | 2,605,665 | 2,412,968 |
| Loans and advance payments | 567,953 | 589,003 | 664,449 |
| TOTAL | 229,066,420 | 250,340,647 | 273,142,691 |

Source: ISA

* PhD. Insurance Supervision Agency, North Macedonia
It’s a fact that the country’s financial market is underdeveloped and the supply of financial instruments and secondary trading in instruments is weak. In a research that Insurance Supervision Agency conveyed on capital market insurance companies at the end of 2018, almost all insurance companies responded that one of the barriers to trading in continuous government securities is that they are not listed on the stock market and that they must trade only on OTC where there is less transparency and the market is thin. Since the beginning of the year, the Ministry of finance has listed all government securities on the stock exchange and until the forum was held, truth be told, there was no transactions at all.

Further explanation from the institutional investors was that they are all on the same side, that there is not enough on the supply side and that they are willing to buy more. However, criticism remains directed at institutional investors. On one occasion, a former finance minister criticized pension fund management companies for taking an inappropriately high management fee for a strategy his “grandmother” could prepare.

Also, a contributing factor to the more innovative investment strategy of insurance companies and other institutional investors is the launch of second phase of the Stabilisation and Association Agreement for EU membership, which provides access to foreign capital markets.

On the other hand, worldwide, on a global level there has been an increasing demand for integrating Environmental, Social, and Governance (ESG) criteria into investment decisions. The result has been an increasing demand for integrating Environmental, Social, and Governance (ESG) criteria into investment decisions. In the beginning of 2018, $11.6 trillion of all professionally managed assets – one $1 of every $4 invested in the United States – were under ESG investment strategies, a sharp increase from 2010, when the amount was close to just $3 trillion overall.

Interestingly, these instruments and investment strategies have a history dating only for more than a decade when in 2007 the European Investment Bank issued its first green bond, a EUR 600 million equity index-linked security, whose proceeds were used to fund renewable energy and energy efficiency projects. A year later, the World Bank followed suit, and by 2017, over $155 billion worth of public and corporate green bonds had been issued, paving the way for the Seychelles government to issue the first ever “blue bond” in 2018 year – a $15 million bond to fund marine protection and sustainable fisheries.34

All of these factors, such as the small market, the reluctance to invest, the inadequacy of professional staff and investment strategy can be overcome with the active participation of the state and International Financial Institutions (IFIs). I believe that some of the IFIs, such as the EBRD and the World Bank, should pave the way for ECG investment recognition, and the state could promote it with its own resources and offer incentive mechanisms, or even invest itself. That may not mean instant development, but it certainly is a way to further develop better investment and promote

a better society. Finally, the last word is left to the insurance companies’ shareholders and management who are the ones that should be more keen to promote better social role within the investment opportunities.
Infrastructure and SME Financing: The Role of Institutional Investors

EDOARDO MARULLO REEDTZ

FINANCING THE REAL ECONOMY: THE NEED FOR NEW SOURCES OF LONG-TERM FINANCING

All modern banking theories stress the privileged role of banks in financing the real economy. Current unsatisfactory growth performance points to the need for long-term investments that can foster economic recovery. With banks still concentrating on the need to raise additional capital and penalized by impaired assets, it is fundamental to extend the range of sources of long-term funding. In this context, insurance companies can play an important role in this framework.

The insurance industry, especially in Europe, has a very significant investment potential, which needs to be matched with suitable long-term assets.

The interest of insurers for long-term investments in the real economy stems from their need for greater diversification of asset allocation, higher returns in the persistent low-interest-rate environment and a better match of assets with long-term liabilities.

The European insurance industry is accordingly interested in investment in asset classes that can have an immediate impact on growth, such as infrastructure (debt, equity) and credit.

As of January 2016, European insurance companies have been operating the new Solvency II regulatory framework, which has drastically altered the mix of restrictions and incentives governing investment decisions.

Moreover, the new rules privilege treatment to government securities, even though differently from the past, discourage investment in shares, penalize long-term and low-rated bonds, perhaps excessively in relation to effective risk and disproportionately favour direct investment over securitization.

Despite some recent improvement in the prudential treatment of some asset classes – like infrastructure investments, unrated bonds, unlisted equities – European undertakings still privilege government bonds and indirect investment through investment funds.

* Office of Financial Studies, ANIA
Figure 1. Investments – excluding linked policies – represent over 75% of total assets*. Around 690 billion in December 2018.

* Total assets includes also mortgages, loans, cash and equivalents to cash, property for own use.
Source: Elaborations on ANIA InfoQRT database; based on a sample representing 90% of the market.

Figure 2. Assets held for linked policies represent almost 20% of total assets*. Around 150 billion in December 2018.

* Total assets includes also mortgages, loans, cash and equivalents to cash, property for own use.
Source: Elaborations on ANIA InfoQRT database; based on a sample representing 90% of the market.
As regards the SMEs, investments represent around 30% of total investments (excluding linked securities) amounting to 220 billion in 2018. An increase of +2% compared to December 2017.

Investments issued by Italian companies amount to around 70 billion and they involve different sectors:
> Financial and insurance activities (63%).
> Manufacturing (12%).
> Electricity, gas, steam and air conditioning supply (7%).
> Information and communication (5%).
> Real estate activities (4%).

Concerning infrastructure investments, they amount to 6,4 billion in 2018, around 1% of total investments (excluding linked securities) with an increase of +2% compared to December 2017.

Investments issued by Italian companies amount to 2,2 billion. With 1,5 billion are Solvency II compliant investments (“Qualifying infrastructure investments”). Sectors:
> Financial and insurance activities (35%).
> Electricity, gas, steam and air conditioning supply (24%).
> Activities of extra territorial organisations and bodies (10%).
> Information and communication (9%).
> Construction (9%).
> Transportation and storage (5%).
> Manufacturing (6%).
Despite the availability of many debt instruments for SME financing, insurance companies do not invest in SMEs.

Obstacles to SMEs investments can be split according to the debt instrument. There are essentially four market-based debt instruments for SME financing: Securitizations, covered bonds, private placements and small/mid-caps bonds.

- **Securitizations**
  The main obstacles for investors are represented by lack of a relevant market, regulatory problems and information asymmetry.

- **Covered bonds.**
  Highly fragmented market, small and new SME segment and regulatory restrictions limit flow of investment resources to SMEs.

- **Private placements.**
  Need for higher security in terms of due diligence, price discovery and deal execution and greater contract harmonization and standardization.

- **Small/mid-caps bonds.**
  Not favorable treatment in Solvency II.

As regards the capacity insurance undertakings have to sustain the financing of small and medium-sized enterprises, the answer depends crucially on two factors. Prudential regulation must avoid excessive capital charges for certain types of investment. Formation within the capital markets of asset classes, other than traditional corporate bonds, expressly designed for the financing of SMEs.
FINANCING INFRASTRUCTURE

The pipeline of infrastructure projects in Italy is large (€ 176bn) and with a segment of attractive projects (€ 25bn). There is a financing gap of € 72bn on the pipeline of existing projects (€ 176bn), of which around 53% brownfield.

Investors complain about various critical issues that limit access to the pipeline (e.g. origination difficulties, project quality). A gap can initially be identified on attractive projects (€ 11bn) mainly in transport and energy.

Insurers are interested in infrastructure investments, for example, for such features as: long duration, low correlation with other asset classes, higher returns than “traditional” investments and their particular source of default risk (primarily physical/technical factors).

In particular, they are interested in infrastructure investments with stable and predictable cash flows and low correlation with financial market movements. However, technical and regulatory barriers have so far made it difficult for insurance companies to identify an infrastructure market suitable to invest in.

| Project identification       | • Absence of a showcase of available projects.  
|                             | • Existing pipeline with little investment.  
|                             | • Origination activities cost intensive.  
|                             | • High time to market.  |
| Attractiveness evaluation    | • Limited availability of necessary information.  
|                             | • Low quality information available.  
|                             | • High administrative risks*.  |
| Operating and financing structure | • Limited access to credit enhancement.  
|                             | • Competition with banks on short-term debt.  
|                             | • High administrative risks*.  |
| Asset management and monitoring | • Regulatory risks with retroactive effects. Operating partner with equity participation.  |

*Approval and approval times, regulatory changes, financing release
Source: BCG

In this context, the role of the public sector is fundamental. Many advanced countries have adopted a model of support to small enterprises based on “promotional banks”. A number of initiatives have been undertaken in recent years to encourage long-term investment in the real economy. For example, “Investment Plan for Europe” (the Juncker Plan) was approved in June 2015 or the European Fund for Strategic Investments (EFSI) was launched immediately thereafter.

It is essential to be aware that the success of such initiatives must be judged exclusively by their ability to involve private capital in the financing of “additional projects.”
ANIA Infrastructure Fund Project envisages:
• Development of an origination platform and preferential access to Italian infrastructure projects.
• Greater transparency and quality of projects accessible to investors through a “showcase”.
• Privileged interface with Government and partnerships with Italian Blue Chips.
• Educational function on projects that apply on the platform.
• Potential forms of credit enhancement made available by institutional actors.
• E.g. subscription of junior tranches by EIB.
• E.g. concessions on regulated infrastructures with more protective returns.
• Possibility of leveraging economies of scale thanks to high critical mass.
• Reduction of fixed structure costs per individual investor (e.g. set-up costs, legal costs…).
• Strong negotiating power towards delegated managers (e.g. cost, customization).
• Sharing of investment risk in Italian projects among multiple investors with diversification benefits.
• Greater portfolio diversification with financial risk reduction and capital absorption.
• Reduction of reputational risk linked to the financing of major works.
The world we live in, regardless of the part of this planet we occupy, financial (responsible) decisions, as well as managing financial products and funds, knowing advantages, disadvantages and limitations, represent daily activities of the population, including children who enter the financial world at a very early stage of their lives.

The way of living in XXI century when we daily familiarize with new technologies and financial instruments implies that an individual as of early age and most certainly before adultery has sufficiently developed competencies for their successful use. The young ones today, much earlier than before, face significant financial challenges, responsibilities and decisions. Thus, financial education has become a need for successful living. Therefore, it is justifiable to discuss responsibilities of the State to improve financial competencies of society as a whole. As regards to education, it relates to responsibilities of schools to gain financial literacy, concept, to master skills and to develop attitudes that will enable a student to make rational and efficient financial decisions.

WHAT DO WE REFER TO UNDER THE TERM OF FINANCIAL LITERACY?

The Organization of Economic Cooperation and Development has defined financial literacy: “the knowledge and understanding of financial concepts and risks, as well as skills, motivations and self-confidence to apply this knowledge and understanding in order to make efficient decisions in different financial contexts, improve financial well-fare of individual and society and enable active participations in economic events” (OECD, 2012)
THE SIGNIFICANCE OF EDUCATION FOR DEVELOPMENT OF INSURANCE MARKET

OECD in its Recommendation on Good Practices for Enhanced Risk Awareness and Education on Insurance indicates that:

- insurance is an increasingly important source of protection for households and that this also enhances its impact on financial markets worldwide;
- insurance particularly in terms of products and providers is one of the most complex, sophisticated and diverse fields in the financial sector;
- not only do households consistently demonstrate low levels of financial literacy in general, but often lack sufficient awareness of the risks to which they are exposed, the ability to correctly assess their risk exposure, and good literacy, knowledge, and skills regarding insurance products and issues.

OECD recommends that Member Countries promote awareness and education in relation to risks and insurance issues and that, in this regard, governments and relevant public and private institutions take due account of and implement the Good Practices for Enhanced Risk Awareness and Education on Insurance Issues.

The education on insurance issues should help to promote two core objectives:

- first, to heighten awareness and responsibility vis-à-vis the potential risks to which individuals are exposed and the means by which insurance can best cover those risks;
- second, to enable citizens to develop the knowledge, understanding, capacities and confidence needed to adequately appraise and understand the policies they require, to know where to look for additional information, objective advice or help if they need it, to take informed decisions about how to protect themselves and their relatives and to adopt a proactive and responsible behaviour as regards their risk exposure and insurance coverage

ROLE OF GOVERNMENTS AND AUTHORITIES

Governments’ involvement in this education process should be mainly aimed at enhancing awareness of major risks and the need for adequate protection, including through various insurance instruments, and at enabling individuals to attain a sufficient level of knowledge, understanding and skills in order to adopt a responsible stance and make sensible choices as regards insurance products.

Promoting and developing prevention and information programmes and campaigns regarding seriously damaging risks, vulnerable populations, innovative or complex insurance products and products implying a greater transfer of risks to individuals — such as unit-linked — possible underinsurance (the insured sum is lower than insured value), overlapping and/or over—insurance, key contract clauses and conditions as well as applicable rights and obligations of consumers as regards insurance products and insurance market players.

This promotion could involve the development of specific websites or a sub-site of the supervisory authority dedicated to consumers’ information
ROLE OF INSURANCE MARKET PLAYERS

Good selling practices should include the development of mechanisms for the assessment by sales staff or agents of clients’ level of understanding, who should be adequately qualified and trained in this respect.

This should particularly apply to complex insurance products, insurance products involving long-term commitments (such as life insurance) or products implying that a substantial proportion of risk is transferred to policyholders (unit-linked).

Insurance market players (and/or their national associations) should be encouraged to create and develop internet sites to make general information on products and on companies freely available.

ROLE OF OTHER SOCIAL AND BUSINESS PARTNERS

Depending on the country context, associations of insurance market players, consumers’ associations, employers, trade unions, other non-governmental organizations and institutes specialized in insurance issues, should also contribute to financial education programmes.

These partners should be encouraged to conduct surveys on the needs of consumers as regards risk awareness and education on insurance issues and on how consumers prefer to receive such information.

They should endeavour to provide information, advice and training on insurance issues or to inform consumers or their employees (in the case of legal entity) about where they can receive such help.

CONCLUSION

It is evident that the financial literacy is a long-term process. The success depends on the engagement of all society players, and not only those in the insurance market.

However, financial literacy opens up a new area for market development, directly through common investments implemented to enhance citizen’s awareness on significance of insurance or indirectly through growth of insurance market and new products. Citizens thus gain better understanding of surrounding risks and methods of protection and Insurance Companies gain clear picture on which product they can most efficiently offer in the market.

Finally, we can certainly conclude that investing in financial literacy is a necessary precondition for further development of insurance market.
CHAPTER V
DEVELOPING SOUTH EASTERN EUROPE CAPITAL MARKETS: PERSPECTIVES
Although there were some efforts to activate debt and equity capital markets in Southern and Eastern Europe in the early post-1991 period, a large amount of the development effort was directed toward financing through a European Banking System model. The Asian Crisis of 1997 and the latter Global Financial Crisis has shown that this approach has limitations as it creates an over-reliance on a single source of finance through the banking system.

This problem is not unique to Southern and Eastern Europe – the Eurozone itself is relatively bank dominated. Recognising this, the European Commission (EC) has been very active in attempting to address this imbalance through initiatives and projects under the Capital Markets Union (CMU) Action Plan launched in September 2015.

It is recognised by most policy makers and market participants that investor diversity is crucial for the development of a successful capital market. A deep capital market is characterised by various classes of investors with different investment goals and different investment horizons. A relatively homogenous investor base adds greatly to the risk of “herding”; a bank dominated investor base tends to focus on intermediation and shorter term instruments; too many long term institutional buy-and-hold investors such as pension funds ends up restricting secondary market turnover; and too many foreign investors can pose a financial stability risk as we observed in various emerging market jurisdictions such as Russia.

Retail participation is important, but it is often difficult to achieve. In certain instances, it can be attained by the design of retail fund products by market intermediaries; or in the case of South Eastern Europe by potentially activating dormant retail share accounts that exist as a bi-product of the mass privatization process. Each of these groups has their own special requirements, and often requires different types of products and regulation. This will be the focus of the investor panel.

To provide the basis for discussion about institutional investors it is convenient to examine some of the more contentious statements made with respect to developing domestic capital markets and developing the institutional investor base.

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* Associate Director Local Currency and Capital Markets Development, EBRD.

35. Peiris, Shanaka “Foreign Participation in Emerging Markets’ Local Currency Bond Markets,” (IMF, 2010). Please see link here. Although this is broadly a discussion in LCY Bonds Markets many of the findings can be applied to the broader domestic capital markets.
Statement I: Banks Don’t Support Capital Markets Because It Cuts Into Their Market Share

This statement glosses over the role of banks as intermediaries in capital markets. An efficient capital market is invaluable to asset and liability management – as well as capital raising. Even in an institution characterised by a highly stable short-term deposit base, banks must address a maturity mismatch between these short-term deposits and loans that are typically longer term. They may also encounter a currency mismatch on their balance sheets where there is an excess of local currency demand deposits and a demand for hard currency loans (such as dollars or Euro). Capital markets represent a highly effective vehicle for efficient maturity transformation – with almost endless permutations on balance sheet management.

Banks may issue longer dated bonds to address a maturity or currency mismatch in their lending portfolio, or purchase liquid government debt instruments for their regulatory ratios and to earn a return on their deposit base. They may undertake interest rate swaps to address maturity mismatches and currency swaps to correct currency exposure. Additionally, with the expanded capital requirements required pursuant to Basel III they may raise capital through ordinary share sales as well as the issuance of hybrid instruments such as Contingent Convertible bonds (CoCo).

In jurisdictions where capital markets are poorly developed, bank maturity transformation suffers and they tend to adopt silo lending approaches with the resulting relative absence of product choice and financing flexibility for their clients.

Statement II: International Capital Markets Are Inherently Efficient and Domestic Capital Market Development Is Largely Pointless, Particularly Given Ultimate Adoption of the Euro

For a highly rated corporation with large scale financing requirements this might be arguably true. But the assumption of perfect markets ignores the “tyranny of size” issue and other issues related to market access – such as the cost of attaining a credit rating. Small and Medium Enterprises (SMEs) often find themselves capital rationed and unable to borrow in the correct currency. That is precisely where local investors come in. Asian economies discovered during the 1997 crisis that a strong correlation of local currencies to USD may not remain stable when the economy comes under pressure. And the work to develop local currency domestic capital markets in the period 1997-2009 under the Asian Bond Market Initiative paid dividends during the global financial crisis when it proved easier to raise capital in some local capital markets than it was in the Eurodollar market after the Lehman default.
STATEMENT III: INTERNATIONAL INVESTORS EXHIBIT HERDING BEHAVIOUR IN EMERGING MARKETS – THEY EXIT THEIR POSITIONS AT THE SAME TIME AND CAN POSE A FINANCIAL STABILITY RISK

This does occasionally occur, most often during an economic crisis. And sometimes it is exacerbated by rumours such as capital controls which should make all foreign investors nervous. Again, the solution is for an emerging economy to promote investor diversity – foreign investors tend to get categorised as a single category – but there is a vast difference between a pension fund seeking investment in long term infrastructure assets and a hedge fund taking an opportunistic short term play on the level of domestic interest rates. Access to capital market instruments to hedge rate and currency risk – such as FX forwards, swaps and options, can reduce investment outflow as these allow investors to reduce exposures when volatility spikes. International emerging market investors also provide many benefits to an emerging market – they tend to invest in longer duration assets, are often more active traders, and can champion reform in areas such as corporate governance.

STATEMENT IV: BANKS CAN PROVIDE ALL THE FINANCIAL NEEDS REQUIRED IN A SMALL ECONOMY AND THERE IS NO POINT IN DEVELOPING A CAPITAL MARKET

This is less true today than it was previously. Capital requirements under Basel III are likely to curtail the ability of banks to provide long term finance – particularly fixed rate – to the market, and specifically to the SME sector. There is also a “tyranny of size” argument – capital markets are generally characterised by large volumes. Nevertheless, smaller economies can have functional capital markets through focussed expectations and regional integration. The Baltic States have addressed the issue of small size by consolidating regulation, merging capital market infrastructure, focusing on key areas of expertise such as Green Finance, and lobbying for a single Baltic classification by index providers such as MSCI. In this region, and despite a slow start, the SEE Link and CSD Link projects aim to promote international investor access via a single access point.

Expanding the footprint of the stock exchange can also help to develop the market. Apart from being a trading platform for listed equity, stock exchanges can evolve towards company financing hubs where there are crowd funding platforms for early stage investors, and listing support programs for promising SMEs. They can also expand their role to include listings for corporate bonds and even some generic derivatives such as futures.

STATEMENT V: LOCAL CURRENCY CAPITAL MARKET DEVELOPMENT IS ONLY ABOUT THE STOCK EXCHANGE

There is a prevailing view in some developing market economies that every financial product should be listed on an exchange or traded in an organised marketplace and that this is the optimum process for improving transparency and market liquidity.
Whilst the exchange remains important, the bulk of capital market operations are in non-exchange traded products such as foreign exchange, money and repo markets, government and corporate bond markets and derivative products. Many of these markets trade more effectively in an Over-The-Counter (OTC) environment for a variety of reasons. Government bond operations often trade and settle through a central bank sponsored trading venue because they are expensively used in open market operations – and many transactions tend to be negotiated. Foreign exchange and money market and derivative markets are high volume and have particularly effective settlement infrastructure outside of the stock exchange venues. Connectivity of settlement infrastructure to global clearing and settlement institutions is a greater priority.

**STATEMENT VI: A VENTURE CAPITAL AND PRIVATE EQUITY INDUSTRY IS NOT VIALBE IN SEE BECAUSE ENTREPRENEURS DON’T WANT TO GIVE AWAY CONTROL**

V Venture Capital and Private Equity are two distinct assets classes but the lines between the two are often blurred and there is some crossover between the two. Venture Capital is usually made early; at the seed or start-up stage. The investments made in private companies by private equity investors, are usually made at a later expansion stage. Ceding control is an issue, and there is often a reluctance to disclose financial statements to the public and competitors. On the other hand, there are some demographic factors that suggest that there is good growth potential in ceding said control – primarily because the first generation owners of many successful businesses are now looking at retiring or monetizing their business. Additionally, many asset managers and exchanges in the region complain that there is not a large enough pipeline of companies looking at IPO and PE/VC can facilitate this by exits through public share sales.  

**STATEMENT VII: DOMESTIC PENSION SCHEMES HAVE BEEN INEFFECTIVE IN PROMOTING CAPITAL MARKETS BECAUSE THEY PRIMARILY INVEST IN DOMESTIC GOVERNMENT BONDS**

A separate paper has been provided addressing this and other issues pertaining to the role of domestic pension funds in emerging market economies. Some commentators argue that it is counterproductive to have a state sponsored pension scheme

36. Duncan Lamont, “What is the point of the equity market?” – Schroder Investment Management (2018). This paper provides a very useful summary of the current trends and challenges involved in promoting listed equity markets. Please see the link here.

37. Heilbronn P., Turnbull, J. and Galvin, K.; Pillar II pension schemes in South Eastern Europe – are they needed? Expanded from an original Op Ed article prepared for EUROFI Bucharest April 3-5, 2019, the article provides a much more detailed analysis of the various issues pertaining to Pillar II pension funds.
if the fund contributions are financed through government bond issuance and the bulk of the investment flows back into the bond market. There is some relevance to this argument, however, pension funds do need the freedom to invest in safe annuity products to meet redemption requirements but also as a safe haven investment when equity markets are under pressure. By their participation in fixed income markets, pension funds can also catalyze the development of other annuity products such as covered bonds, corporate bonds and structured products. While the over-investment in government bonds maybe the direct result of the under-development of the local market, it can equally be due to highly restrictive investment guidelines imposed by the regulator.38

The development of capital markets is clearly a more complicated process than simply creating a stock exchange, issuing securities and hoping for the best. There are many pieces to the puzzle. Institutional investors form an integral part of the demand-side of the market development equation. And government and regulatory policy remains a critical ingredient in promoting the enabling environment for a broad spectrum of investors to access and utilise the capital markets.

Many academic studies and research reports have highlighted the contradiction in Europe’s savings structure: high household savings rates but with savings pools allocated into conservative low-return instruments.

The average EU household accumulates savings at a higher rate than in other jurisdictions (EU net savings rate of c. 6%, compared with 3.3% in the US, and 2.6% in Japan), but invests 35% of those savings in conservative instruments like cash or deposits, while in the US households allocate only 15% in such instruments.

The situation is more complex in CEE countries. According to Eurostat, households in Croatia, Slovenia, Estonia, and Czech Republic have gross savings rates above the EU average but allocate c60% of the pool of savings pools in cash and deposits. Households in Lithuania, Bulgaria, Slovakia, Latvia and Hungary have both low savings rates and between 40-60% of those savings allocated in cash and deposits. See chart 1.1

![Cash & Deposits Savings and Household Gross Savings Rate: 2017](chart)

Source: Eurostat

* SEE expert, AFME
Assets of open-end investment funds and % of market-based finance

Source: AFME and Eurostat

Pension fund asset allocation for EU, US and EU11* countries (% of total investment)

Source: OECD and Eurostat. EU11 are the 11 EU CEE countries: PL, SK, SI, LV, LT, HR, BG, HU, RO, CZ, EE
One of the key elements to enhance capital markets depth is building strong pools of capital. Companies require a deep savings pool of capital that is ready to invest on instruments issued by local companies.

The relationship between the availability of deep savings in capital markets instruments and the capacity of corporates to raise finance in markets is strong, as illustrated in chart 1.2. This shows the correlation between assets of open-end investment funds and the percentage of market-based finance in NFC annual external funding. A deep and liquid local capital market can facilitate the issuance of market-based instruments.

It is encouraging that CEE countries have made significant progress over the last 20 years developing their local pension systems. However, it is important that the CEE region continues to improve the depth of local pools of capital as a significant gap remains against the rest of the EU. According to Eurostat, CEE households invest only 17% of GDP in pensions and insurance products compared with 66% by EU27 households (excluding the UK, including EU11 countries).

An even more complex barrier are the statutory limits on pension funds’ investments. In some countries, pension funds have statutory limits requiring them to invest only in a limited number of securities, usually with a bias towards allocating assets in low-yield fixed income instruments and government bonds.

Minimum limits on equity investment as those set in Poland can make pension funds’ returns excessively vulnerable to equity downturns. Likewise, overly conservative regimes that limit the maximum allocation in e.g. foreign assets, venture capital funds, infrastructure or private equity, reduce long-term returns and discourage the development of alternative sources of financing. For example, in CZ, SI, SK and HU, the allocation on equity instruments is significantly low (below 10%), notwithstanding the long-term investment horizon of pension fund assets.

OECD data shows that pension funds in the EU11 underinvest in non-traditional instruments such as private equity, mutual funds, infrastructure and structural products (see chart 1.3). A more flexible regime that facilitates investment in these instruments not only improves risk-adjusted returns but also promotes the local venture capital ecosystem and SME financing.

For example, to promote pension fund financing of SMEs, regulators in both Sweden (1996) and the United States (1978) relaxed regulatory regimes by allowing pension funds to invest in venture capital funds. The regulatory change stimulated the local start-up ecosystem. In the US, the share of funds committed to venture capital by pension funds increased from 15% in 1978 to 47% in 1988, and the total annual new commitments increased from US$ 427m to US$ 3.7bn. See chart 1.4.
The prospect of a panEuropean pension pool

Unlocking household savings, for example through pension and insurance savings, could contribute to a more rapid accumulation of capital and investment.

For EU CEE countries, there are optimistic prospects with the recently approved EU legal framework for a Pan European Pension product (PEPP) – a voluntary personal pension scheme that will offer consumers a new pan-European option to save for retirement that can be marketed by providers on a pan-European scale.

Given the current fragmentation in Europe’s retirement savings markets, this initiative is important to provide a pan-European framework that could boost pools of capital and channel more savings towards long-term investments in the EU. However, much will depend on the accompanying level 2 measures and support from Member States in the tax treatment and other factors if the PEPP is to become an attractive option for savers and providers.
Exchange Traded Funds in Central and Eastern Europe

IVAN TAKEV*

Exchange Traded Funds (ETFs) have been known for many years and have played a pivotal role in reshaping financial markets into what they are now. The growth of passive investments intensified even more in recent years and the total assets currently being managed passively are at par with the actively managed assets. Less than ten years ago they accounted to one third of active schemes in the US and significantly less in Europe. The reasons for that transfer are numerous, starting from lower costs, better transparency, guaranteed liquidity and easy selection among other things. Yet, ETFs are relatively not known in Central and Eastern Europe (CEE). Even in Poland, which now belongs to the developed world, they are quite small in size as opposed to the total market capitalization of the Warsaw Stock Exchange. In the rest of the CEE countries the figures look the same way or even worse. In fact, the majority of the underdeveloped markets have not been investable via ETFs at all until recently.

Their absence was quite perplexing as the positives they could bring to the markets would justify the high relative costs of creating such funds in a low-liquidity environment which is typical for the CEE markets. While the size of the markets is prohibitive for the lead European ETF provides to launch funds tracking most of the CEE indices as they will not be able to contribute much to their profits, there is a lot of space for local players to take that niche. This is exactly what happened in Bulgaria where a local fund manager ventured into the ETF business in 2016 by launching a product on the leading index of the Bulgarian Stock Exchange, soon following with 10 more ETF offerings and effectively covering the entire CEE region, from Poland to the north and down to Greece.

But would such a product make sense from an investor’s perspective when it comes to generally illiquid and isolated markets? Let’s look at the positives they bring:

• Lower costs to make an investment.
  ETFs provide an opportunity to gain exposure to the entire market via a single transaction. The alternative way is to buy each index constituent in the specific proportion but most of the time that would require at least 10-15 transactions, each of which has a fixed cost component. Let us not forget that on illiquid markets the tail of an index of fifteen companies is even less liquid regardless of the

* CEO, Bulgarian Stock Exchange
fact the ETFs tend to cover the most actively traded stocks. Entering into transac-
tions with illiquid instruments will thus involve significant implicit costs such as high spreads. Emerging and frontier markets ETFs, on the other hand, even though their management fees might not be as low as in Western Europe and the US, will always be a better and cost-effective solution.

• Higher liquidity.
It is of course not possible to totally eliminate the liquidity as a concern by just creating a single instrument. Less liquidity in the constituents will surely translate into higher spreads on the secondary market of the ETF. However, one specific characteristic of ETFs is that they always have market makers and most of the time, more than one. While their spreads might be less tight than the spread of an ETF on the German DAX, for instance, the market maker is a significant improvement over the cash equities market where just the most liquid instruments have such. Last but not least, the mere existence of an ETF brings the spreads together of the underlyings as the ETF will invest in the index constituents.

Secondly, one of the best features of ETFs is the option to buy large chunks of shares directly from the issuer or redeem already issued shares without having to sell on the secondary market with unknown price impact. Such an option is almost by definition highly liked by institutional investors who can hedge themselves against low liquidity of the equities markets. Even if a major meltdown is expected to occur, which in a low-liquid environment will translate in a significant drop in equity prices, an institutional ETF owner will be able to redeem its entire investment with the ETF provider thus capping its costs to the corresponding redemption fee which is usually less than 1%.

• Easy exposure to the entire market.
For investors, it is always tempting to outperform the market but the figures demonstrate what very few have made that in the long term. That is why it makes a lot of sense to rely on the primary benchmark of the stock exchange if you are positive on that specific market instead of trying to beat it. This is especially true from a foreign investor’s perspective where stock picking could be hindered by lack of adequate information for a particular stock which is quite typical for immature markets. Analyzing individual stocks also takes a lot of time and is an ongoing process as updates should be provided after each financial statement as well as on an ad-hoc basis. That effectively means higher opportunity costs for investors who are not familiar with the marker. On the opposite side, this concern is entirely eliminated by an ETF offering which among the other things offers good diversification (although the constituents are not included on expectations of better performance).

• Opportunity to trade on more than one venue.
While the major ETFs in Western Europe are accessible via more than one exchange or multilateral trading facility (MTF), the stocks and the other instruments in the CEE region are usually tradable only on their local stock exchanges. This could be a hindrance for an international investor who may not want to open an account specifically for trading just one instrument, the ETF itself. However, it may
make sense to list an ETF on a second trading venue which the investors already have access to. Of course, it is always difficult to make a breakthrough abroad and attract more liquidity there than on the primary listing venue but foreign potential investors will nevertheless appreciate such an option.

• More than just keeping up with the market.
The ETFs are versatile enough to serve many purposes, not just being a tool to capture market performance. While it will take some time for the existing ETFs to gain traction in CEE, once that happens it is almost certain that other types, like short ETFs and leveraged ETFs will follow. While short ETFs certainly have deficiencies like limited ability to fully replicate the benchmark in an inverse manner, quite similarly to their long counterparts, short ETFs may provide the ability to gain inverse exposure to the entire marker although not of the constituents may be shortable. And when it comes to other types of funds like bond ETFs, for instance, they tend to create liquidity where it is non-existent by enabling investors to trade bonds the same way they trade shares.

As every start, the first steps are always difficult. The CEE region has been outside the international investors’ focus for quite some time as the latter have had that low-hanging fruit that the well-established markets provided, mostly as a result of all the money the European Central Bank and the Federal Reserve System in the US have pumped into the financial system. However, once the existing investment opportunities are exhausted, it is absolutely sure that it will be precisely the ETFs that will serve as a conduit of foreign portfolio investments to local markets in the CEE region.
CHAPTER VI
BUILDING AN ENABLING ENVIRONMENT FOR THE FINANCING
OF ECONOMIC GROWTH: THE IMPORTANCE OF OPEN MARKETS
AND DOMESTIC REFORMS
Economic growth accelerated from 2.6 percent in 2017 to 3.8 percent in 2018 and is projected to average 3.7 percent in 2019-20. Low debt/GDP and relatively high sovereign rating. Encouraging progress has been made in the past two decades in terms of regional cooperation and advances towards eventual EU membership, and these trends are likely to continue, boosting growth and investment. However, vulnerabilities stem from growing external and domestic risks, including geopolitical and trade disputes. Moreover, it has been recorded a slower-than-expected pace of structural reforms needed and the presence of domestic risks such as growing public discontent. Dissatisfaction with the economic and political situation is reflected in recent anti-government protests in Albania, Bosnia and Herzegovina, Montenegro, and Serbia. Political instability erodes the confidence of investors and consumers (increasing political polarization in Albania, Montenegro, and Serbia).

Countries in the region now have an opportunity to advance reforms to mitigate these risks amid growing public demand for greater economic opportunities. Reforms boost productivity, stimulate growth, and create jobs. Policy options in areas such as taxation, financial sector diversification (ex-bank financing channels), economic connectivity (trade infrastructure), education.

* Senior Equity Strategist, Head of Group Insurance & AM Research, @Generali Insurance Asset Management S.p.A., Società di gestione del risparmio (GIAM)
Source: GIAM elaboration on IMF data, 2019

Note: CEE = Central Eastern Europe; EU = European Union; SEE-EU = Southeast Europe EU members; SEE-XEU = Southeast Europe non-EU members.
Baltics: Estonia (EST), Latvia (LVA), Lithuania (LTU)
Central Eastern Europe (CEE): Czech Republic (CZE), Hungary (HUN), Poland (POL), Slovak Republic (SVK), Slovenia (SVN)
Southeast Europe EU members (SEE-EU): Bulgaria (BGR), Croatia (HRV), Romania (ROU)
Southeast Europe non-EU members, or Western Balkans (SEE-XEU): Albania (ALB), Bosnia and Herzegovina (BIH), Kosovo (UVK), FYR Macedonia (MKD), Montenegro (MNE), Serbia (SRB)
Source: European Department, Public Infrastructure in the Western Balkans Opportunities and Challenges, 2017.
Source: GIAM elaboration by Datastream, 2019
SEE COUNTRIES: SOVEREIGN RATING

<table>
<thead>
<tr>
<th>Country</th>
<th>Internal rating</th>
<th>Outlook</th>
<th>Trend</th>
<th>Agencies’ rating</th>
<th>Anchor score</th>
<th>GDP per capita</th>
</tr>
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<tbody>
<tr>
<td>Bulgaria</td>
<td>AA-</td>
<td>stable</td>
<td>↑</td>
<td>BBB</td>
<td>↑</td>
<td>↑</td>
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<tr>
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<td>BB+</td>
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<td>↑</td>
<td>A-</td>
<td>↑</td>
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<td>↓</td>
<td>BB-</td>
<td>↑</td>
<td>↑</td>
</tr>
</tbody>
</table>

Source: Generali Insurance Asset Management, Macro Research, 2019

The “CEE & Central Asia” region showed the best net rating drift (+36%, in line with Q4 2018)

Looking at the net rating drift by region:

- Euro Area & other Western Europe: +12%.
- CEE & Central Asia: +36%.

- In February both S&P and Fitch upgraded Hungary to BBB, with stable outlook, citing strong growth and a relatively high households saving rate. Fitch raised the outlook to stable. We upgraded it in Q4, from A to A+.
- We upgraded Bulgaria to AA-. The country enjoys stronger growth than its peers (3.2% in 2018), which will further strengthen public finances. The outlook remains stable.
- Croatia was upgraded to A+, on the ongoing improvement in public finances, and solid growth prospects (just below 3% this year).
- Overall, the upward drift in the region increased slightly since Q4, from 36% to 36.4%, as fiscal consolidation continues.
### Eastern European Countries

<table>
<thead>
<tr>
<th>Governance score</th>
<th>Macro score</th>
<th>Growth prospects</th>
<th>Fiscal metrics</th>
<th>External accounts</th>
<th>Banking system</th>
<th>FX reserves adequacy</th>
</tr>
</thead>
</table>

Very weak, Weak, Average, Strong, Very strong

#### Internal rating breakdown by area

Data as of Q1 2019, in % of total

- **Total**
- **Euro area & other Western Europe**
- **CEE & Central Asia**
- **South, Eastern Asia & Oceania**
- **Americas**
- **Middle East & North Africa**
- **Sub-Saharan Africa**

#### Global net rating drift

Based on 1-year change in the internal rating, in %

- Down by 0.25 to 0.50 notches
- Down by 0.50 to 1.00 notches
- Down by 1 notch or more
- Up by 0.25 to 0.50 notches
- Up by 0.50 to 1.00 notches
- Up by 1 notch or more
- Net rating drift
Change in the internal rating
1-year change (Q1 2019 vs Q1 2018), in notches

Source: Generali Insurance Asset Management, Macro Research, 2019

Effect on GVA from a 22.5pp Rise in US Import Tariffs on Vehicles

Source: Morgan Stanley Research, April 2019
EE COUNTRIES: VULNERABILITIES

- A 22.5pp tariff increase would shave off around 0.25pp from Hungary’s growth, with the Czech Republic just behind.
- Poland would be somewhat less affected (-0.15pp), by virtue of its less trade-focused nature.

<table>
<thead>
<tr>
<th>Country/Territory</th>
<th>Voice and Accountability</th>
<th>Political Stability</th>
<th>Government Effectiveness</th>
<th>Regulatory Quality</th>
<th>Rule of Law</th>
<th>Control of corruption</th>
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<tr>
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<td>50</td>
<td>61</td>
<td>55</td>
<td>48</td>
<td>43</td>
</tr>
</tbody>
</table>

Source: Generali Insurance Asset Management, elaboration on World Bank WGI indicators

**Voice and Accountability**: Reflects perceptions of the extent to which a country’s citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.

**Political Stability**: measures perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism.

**Government Effectiveness**: Reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies.

**Regulatory Quality**: Reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

**Rule of Law**: Reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

**Control of corruption**: Reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests.
POLICY REFORM NEEDS IN SEE COUNTRIES: REDUCING RISKS TO FISCAL SUSTAINABILITY & IMPROVING TRANSPARENCY

1) Fiscal (tax) revenue composition: direct too low vs indirect. Inequality and black market risk.
   The average SEE country collects about 37 percent of GDP in revenues, of which less than 5 percent come from direct taxes (PIT and corporate income tax), a sizable 16% from indirect taxes (VAT and excises), and the rest from SSCs and other sources.
   The revenues of Western Balkan governments are similar to those of Eastern European EU member countries in terms of both total collection and general composition. But the new EU member countries rely more on direct taxes, especially PIT, and less on VAT revenues. Western Balkans PIT rates are also generally lower. As a result, PIT collection in the Western Balkans averaged 2.7 percent of GDP in 2017, compared to 3.0–6.6 percent in comparator countries.
   A possible solution could be improving the progressivity of the personal income taxation.

2) Fiscal (tax) transparency: modernizing tax administration, encouraging formalization.

3) Take welfare expenditure under control and targeted.
   North Macedonia recently reformed the social protection system to safeguard pension and health services by amending the pension indexation, limiting early retirement, increasing social contributions. Montenegro instead centralized the procurement of pharmaceutical.

4) Public expenditure efficiency: local governments need more fiscal discipline and greater accountability, especially as related to budget arrears and municipal bor-
rowing, as well as stronger capacity to deliver public services efficiently and effectively.

In North Macedonia, for example, the World Bank’s forthcoming Public Finance Review notes that the country could save 13 percent of total public spending by improving its efficiency.

Improving access to finance is a priority. In terms of achievements, all of the SEE economies have taken steps to establish institutional and regulatory frameworks for access to finance. They have developed frameworks for timely payments and insolvency and also made progress in developing asset registers and credit information systems.

Efforts have been made to improve insolvency frameworks to tackle lengthy bankruptcy procedures and reduce administrative backlogs. Progress has also been made in delineating between liquidation and restructuring and introducing clear priority schemes.

All of the SEE economies have implemented SME financing support programmes. These are primarily credit guarantee schemes and grants or loans at reduced interest rates.

Much remains to be done, however, since new challenges for the future are still persisting. Complete the implementation of legal frameworks for ensuring timely payments and managing insolvency. Lengthy processes and legal backlogs make restructuring and liquidation burdensome for bankrupt SMEs and increase the risk of bankruptcy among cash-constrained SMEs facing late payments.

Other challenges are the reduction of the high collateral requirements in most of the SEE economies by creating security rights over movable assets and the support of alternative financing instruments across all of the SEE economies. While factoring and leasing are technically developed, the markets have shrunk since the financial crisis and uptake by SMEs remains small. Government support for venture capital and business angel networks is limited in the region and access to stock markets for SMEs constrained.

Access to financial services is a major obstacle for SEE businesses that are too bank-centric. In the SEE, banks account for about 85 percent of financial sector assets, considerably more than the Euro Area’s 45%39. According to the survey by the European Commission, an average of 15 percent consider access to finance to be the most important problem faced by their firms, compared to 7 percent in the EU28. Access to finance was cited as their biggest problem by 24 percent of SMEs in Montenegro, 17 percent in Bosnia and Herzegovina, and 15 percent in Albania.

Of those SMEs that found bank loans to not be relevant to them, an average of 33 percent in the region saw high interest rates as the main obstacle, far more than the 8 percent in the EU28.

Ultimately, insurance, pensions, mutual funds, factoring, leasing, and capital market instruments are not frequently in use in the SEE countries.

**INSURANCE TRENDS**

Insurance market in this region is still at an early stage of its development. Indeed, it is characterized by low penetration rate, non-life prevalent (physiological consequence of immature market), life underdeveloped (also due to issues on pension systems in some countries), some markets are polarized with state or ex state-owned monopolistic firms and other numerous very small ones, banks still more relevant.
### Penetration Index, 2017

<table>
<thead>
<tr>
<th>Country</th>
<th>GWP*</th>
<th>GDP*</th>
<th>PENETRATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>130.9</td>
<td>1736</td>
<td>8%</td>
</tr>
<tr>
<td>Poland</td>
<td>14.4</td>
<td>470</td>
<td>3%</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>5.6</td>
<td>193</td>
<td>3%</td>
</tr>
<tr>
<td>Hungary</td>
<td>3.1</td>
<td>125</td>
<td>2%</td>
</tr>
<tr>
<td>Slovenia</td>
<td>2.1</td>
<td>44</td>
<td>5%</td>
</tr>
<tr>
<td>Romania</td>
<td>2.4</td>
<td>189</td>
<td>1%</td>
</tr>
<tr>
<td>Croatia</td>
<td>1.2</td>
<td>49</td>
<td>2%</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>1.1</td>
<td>442</td>
<td>0%</td>
</tr>
</tbody>
</table>

* in € bn

Source: Insurance Europe, Eikon datastream, 2019

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Germany, 1970-2010: it’s a long journey
Life premium per capita by country (2016-2017)

Source: Insurance Europe, 2019
Opportunities in the market are related to the early stage of its development. Indeed, the insurance market in these countries is at a lower stage of development than in EU. Moving towards European macroeconomic standards will increase demand for insurance products.

Concerning gross written premiums projections, Poland and Czech Republic insurance forecasts show a dynamic growth in Non-Life at or above EU average (in line with the last years), while Life premiums should keep growing at a slower pace.

Unfortunately, opportunities are accompanied by their counterpart, indeed there are numerous critical issues. Main focus of insurance companies: P&C, life insurance underdeveloped (usually left to non-local companies), pension systems, strong presence of non-local companies.

Moreover, the ex-monopolistic companies are in many countries the largest companies, while there is a large number of very small companies. Not all countries are compliant with Solvency II, especially those not in the EU and banks perceived more important than Insurers for Government policies.
The ESRB Mandate is to prevent and mitigate systemic risks to the stability of the EU financial system that could hamper the real economy. Thereby, it is charged with the macroprudential oversight of the financial system, with the aim of ensuring that the financial sector fosters sustainable economic growth. The definition of financial system in the ESRB mandate is holistic, including all sectors like banks, insurance companies, and funds. Its instruments consist of soft law tools, namely the ability to issue warnings and recommendations to authorities and Member States in the EU. ESRB membership includes central banks, financial market supervisory authorities, the other three ESAS (ESMA, EIOPA, and EBA), as well as the European Commission. The governing body of the ESRB is the General Board. The ESRB Secretariat provides analytical, policy and administrative support to the ESRB General Board and its subcommittees.

The ESRB was established in 2010 and is part of the European System of Financial Supervision (ESFS), established following de Larosière report (2009):

* Senior Financial Stability Expert, ESRB
“The ultimate **objective of macroprudential policy** is to contribute to the safeguarding of the stability of the financial system as a whole. This includes **strengthening the resilience** of the financial system and **decreasing the build-up of vulnerabilities**, thereby ensuring a sustainable contribution of the financial sector to economic growth.”

A stable financial system is one where (Schinasi, 2004):
- Financial resources are being efficiently and smoothly reallocated from savers to investors.
- Financial risks are being assessed and priced reasonably accurately and they are being efficiently managed.
- Financial shocks can be comfortably absorbed.

In line with the definition given by the European Central Bank in the preface of the Financial Stability Review:

“A condition in which the financial system – comprising of financial intermediaries, markets and market infrastructures – is capable of withstanding shocks and the unravelling of financial imbalances, thereby mitigating the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities.”

**Prevent and mitigate systemic risk is defined as:**

“Systemic risk means a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy.” ESRB (EU Regulation No 1092/2010, Art. 2, 2010)

The risk of disruption is taken into account through the lens of the Time and Cross-sectoral dimensions. The former Reflects cumulative (procyclical) risk build-up in financial system with excessive risk exposure in boom phase and excessive risk aversion in bust phase accompanied by high volatility in leverage and maturity mismatch. The latter reflects distribution of risk in financial system at given point in time depending on size and concentration of financial institutions interconnectedness of activities (direct and indirect linkages) covering risks of contagion.

Additionally, The ESRB acts as an information hub and coordination role. In the former case it publishes both national macroprudential measures in its database while in the latter it reviews annually macroprudential policy. The following are direct links to the above-mentioned sources:
In its Coordination role, it is given various roles according to Union Law as there are two important coordination frameworks:
- Framework for reciprocation within the EU.
- Framework for recognising and setting countercyclical capital buffer rates in 3rd countries.

<table>
<thead>
<tr>
<th>INTERMEDIATE OBJECTIVE</th>
<th>INDICATIVE INSTRUMENTS</th>
</tr>
</thead>
</table>
| Excessive credit growth and leverage                        | - Countercyclical capital buffer.  
- Sectoral capital requirements.  
- Macroprudential leverage ratio.  
- Loan-to-value (LTV), loan-to-income (LTI) ratios.         |
| Excessive maturity mismatch and market illiquidity          | - Macroprudential adjustment to liquidity ratio.  
- Macroprudential restrictions on funding sources.  
- Macroprudential inweighted limit to less stable funding (e.g. loan-to-deposit or LTD ratio).  
- Margins and haircuts requirements.                        |
| Exposure concentration                                      | - Large exposures restrictions.  
- Clearing requirement for central counterparties (CCPs) and management of clearing exceptions. |
| Misaligned incentives                                       | - Capital surcharge for systematically important institutions (SIIls).                 |
| Resilience of financial infrastructure                      | - Margins and haircuts requirements.  
- Increased disclosure.                                     
- Structural systemic risk buffer.                           |

Source: Macroprudential database ESRB.
Notes: Chart only includes measures which were still active on the 1st of October 2018 and which were considered substantial. An active measure is a measure which has not been discontinued; updated measures are only counted once. All measures are deemed to be substantial apart from measures of a more procedural or administrative nature, such as the early introduction of the capital conservation buffer and exempting small and medium-sized investment firms from the capital conservation buffer. The figure also does not include the CCyB because it is set periodically.
Yes, but: in practice: what about domestic reforms?

It is not about just about banks as the ESRB looks at Insurance, investment funds, securitisation, and financial markets (AKA Shadow Banking).

It is not just about the Euro, The ESRB looks at all EU currencies.

It is not just about the EU, The ESRB monitors risks to the EU from third countries.

It is not just about the EU as a whole, The ESRB look at systemic risks to the Union AND to each Member State.

It is about coordination, reciprocation, and unifying vision in the context of CMU and the 4 freedoms (free movement of goods, capital, services, and labour) such as:

• Reciprocation: pan-European reach of local policies.
• EU-wide monitoring and warning system.
• Both incentive framework and implementation buffer for reform programs.
• Information and experience sharing platform.

An important example is the monitoring of the EU-wide derivatives market & impact of BREXIT relocation of activities. In conclusion, one should look at the whole, at the parts and at how they fit together
Macroeconomic overview

Over the past years, countries across the SEE and CEE enjoyed strong economic growth thanks to combination of strong domestic demand and supportive external situation. However, we are likely already behind the cyclical peak and the future development is clouded by high level of uncertainties. Nevertheless, the future growth pace is expected to remain solid despite some slowdown.

The period of strong growth and low interest rates was favorable for fiscal position, so public debt went mostly down. In many cases, better fiscal position allowed governments to invest more into infrastructure which should improve attractiveness of respective countries for investors and result in more sustainable growth. Some countries decided to use this opportunity to boost consumption via tax cuts or wage hikes. In most cases, such steps are more or less manageable for the fiscal position, but Romania is an exception, as the government has done market unfriendly decisions mainly due to lack of proper consultation ahead of the decision making. As a result, imbalances in the economy are broadening.

Figure 1. CEE: Economic Growth Projection
However, other countries also face some level of imbalances, but their nature does not come directly from political source but from production structure of respective economies and are unlikely to be changed any time soon.

Cyclical sensitivity is frequently driven by openness of economies (measured for example via share of exports to GDP) and is even strengthened by exposure toward single sector, for example automotive industry – in this production area, SEE countries are relatively safe, excluding Slovenia with circa 100 car a year produced per thousand inhabitants but it is half compared to Slovakia, which is the world leader in this indicator, followed by the Czech Republic.

Besides that, there are individual country’s specifics like high dependence of Croatian economy on tourism which is concentrated in the coastal regions in the summer period, so seasonality effects economic variables. In Serbia, high share of agriculture impose sensitivity to weather conditions. Montenegro is highly dependent on imports or tourism.
EU INTEGRATION EFFECTS

The EU enlargement and integration is a comprehensive process and serves as a catalyst for reforms. It has its costs, depending on development of individual country. The European Commission regularly gives advices to each country and the enlargement recently covers 35 chapters.

Benefits of the membership compensate costs of the enlargement for the candidate thanks to inflow of European funds & grants while new opportunities for the foreign trade further ads.

For example, in Croatia, which is the newest EU member who applied in 2003 and joined ten years later, allocation of funds rose almost nine times after it joined. As the EU financial support for candidate countries is rather modest (2% of GDP), there is a huge potential to benefit on.

Effect on the trade front is not that important for the SEE region as Balkan countries enjoy free trade area with the EU since 2000. However, the EU is not the only supranational institution which contributed to improvement of business environment in the region. Note a significant improvement of economic conditions in Serbia done under the successful IMF program.

EU integration at a glance:
• European Commission’s Economic Reform Programmes advice each country on a regularly basis. Enlargement currently covers 35 chapters, including financial control.
• Serbia and Montenegro are frontrunners among candidate countries.
• Deeper integration toward convergence. In the SEE only Slovenia fully integrated.
• Economic benefits from funds & trade.
  ◦ Pre-accession support from the EU relatively modest (circa 2% of GDP).
  ◦ EU allocation for Croatia rose nine times after entrance in 2013.
• Crucial trade partner – EU’s covers 73% of Western Balkan trade.
  ◦ Free Trade Areas with the EU already established since 2000.

Figure 4. SEE, Exports of Goods and Services
Other supranational institutions also play role for reforms.

- Successful IMF program with Serbia.

However, the recent development suggests that the integration is losing steam. That said, level of integration across the CEE region will remain uneven in a near future.

- Enlargement seems unlikely before 2025.
  - Rule of Law criteria is becoming increasingly important amid rising authoritarian tendencies.
  - Emerging issue also in several CEE member states.
  - Lack of political will in the core EU member states.
- SEE countries want to join the EU. Euro adoption aimed by SEE-EU member states.
- Major CEE countries are reluctant to give up national currencies but perception of the EU membership is solid.
  - Increased turnout in the recent EP elections (CEE average up 7.1pp to 36.8% vs. 2014).
- Not a one-way journey – Brexit remains a big question mark.
- Prosperity even beyond the EU.
  - Iceland suspended application, Norway and Switzerland even twice.
  - Rejection mostly based on referendums or decision of domestic politicians.
- Risk of regionalism within the EU – broke up of some national states.

**BUSINESS ENVIRONMENT**

Structural reforms which aim to fulfill EU’s criteria are important but steps which are beneficial for business and financial markets play a major role in achieving sustainable economic growth. For example access to primary issuance of government bonds, re-structure of state owned enterprises, IPO and inclusion of local bonds or equities into indices of major global banks help to increase liquidity and draw attention of investors.
However, there are signs of deterioration of institutional quality which is unfavorable for the business and is usually mirrored by rating agencies.

On the other hand, there is solid reforms momentum but quality of reforms matters. For example, in Croatia, number of reforms done in six years before the EU membership equals to 13, in six years after it was even a bit higher. However, number of reforms with negative effect for the business environment rose four times (from 1 to 4). That said, the effect of the EU accession process as a catalyst for reform is not one-sided.
Two different examples of Doing Business ranking.
The following graphs are showing two different examples of almost neighboring countries but with very different scoring in terms of World Bank’s Doing Business concept.
It provides a good view on field where reforms are desired.

Figure 8. North Macedonia Doing Business Rank (out of total 190)
Macedonia is within world’s top 10 ranking with excellent minority investors protection and the highest ranking and number of reforms in the CEE region.

Source: WB Doing Business

Figure 9. Bosnia and Herzegovina Doing Business Rank (out of total 190)
Bosnia and Herzegovina has instead the lowest ranking across the whole Europe. Country is characterized by a complicated political and social situation resulting in weak reform momentum and a poor environment for starting a business due to time constrains.

Source: WB Doing Business
Corruption is key obstacle for predictable business operations and undermines institutional quality. Corruption is a long-lasting problem across the CEE, with Balkan countries having a bit worse score, according to the Transparency International. However, they are still doing better than most Emerging economies. Solid improvement has been achieved in the Czech Republic and Baltic countries, while Hungary worsened the most across the whole EU. Interestingly, Italy, Spain or Greece are also not doing very well and are even worse than some core CEE countries.

Justice system reforms are hot topic across the former Soviet bloc. No doubt that systems have to be modified – in many countries, it is still based on Communism inherited structure or legislation. However, in recent years we have witnessed trend where politicians are trying to gain control of the justice system in order to preserve power beyond electoral terms or to partially decriminalize corruption.

This problematic approach is monitored by supranational institutions or is subject to national referendum. We can see that EU countries are doing a bit better in terms of corruption than non-EU countries, as illustrated by the following table.

Table: Corruption Perception Index – Ranking & Score

<table>
<thead>
<tr>
<th>Country</th>
<th>Rank 2018</th>
<th>Score 2018</th>
<th>Score 2012</th>
<th>change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>99</td>
<td>36</td>
<td>33</td>
<td>3</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>89</td>
<td>38</td>
<td>42</td>
<td>-4</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>77</td>
<td>42</td>
<td>41</td>
<td>1</td>
</tr>
<tr>
<td>Croatia</td>
<td>60</td>
<td>48</td>
<td>48</td>
<td>2</td>
</tr>
<tr>
<td>Kosovo</td>
<td>93</td>
<td>37</td>
<td>34</td>
<td>3</td>
</tr>
<tr>
<td>North Macedonia</td>
<td>93</td>
<td>37</td>
<td>43</td>
<td>-6</td>
</tr>
<tr>
<td>Montenegro</td>
<td>67</td>
<td>37</td>
<td>41</td>
<td>-4</td>
</tr>
<tr>
<td>Romania</td>
<td>61</td>
<td>47</td>
<td>44</td>
<td>3</td>
</tr>
<tr>
<td>Serbia</td>
<td>87</td>
<td>39</td>
<td>39</td>
<td>0</td>
</tr>
<tr>
<td>Slovenia</td>
<td>36</td>
<td>60</td>
<td>61</td>
<td>-1</td>
</tr>
<tr>
<td>CEE average</td>
<td>49</td>
<td>47</td>
<td>47</td>
<td>2</td>
</tr>
<tr>
<td>EU average</td>
<td>61</td>
<td>60</td>
<td>60</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Transparency International, score 0 - 100
Media & speech freedom

Political influence or pressures on media also lead to deterioration of general perception of freedom and undermines the business environment. Combined with corruption or general disillusionment with politicians, it leads to a wave of public protests in several countries like the Czech Republic, Hungary and Serbia.

Banking sector

Situation in banking sector keeps improving thanks to solid economic growth but there were several issues across the regional banking systems over the past years and some of them are still present. High FX risk remains the key issue. For example the issue around Swiss franc loans conversion is politically sensitive topic. Asset quality also remains an issue but level of capitalization is solid and well above the regulatory requirements.
The example of banking crisis in Bulgaria in 2014 could illustrate interesting development based on behavior of public and private institutions. Firstly, the regulator lost credibility due to inconsistency of its measures despite the crisis hit only 1% of total banking system’s assets. Secondly, the stress was magnified by media, bearing in mind that media freedom is not considered as satisfactory by Reporters Without Borders. Thirdly, short–term effects of reforms as an answer to the crisis was rather negative for the economy, as banks had tightened corporate credit amid preparing for stress tests. Moreover, the impact was not wide spread across the whole system when affected mainly corporate sector while household sector remained almost intact.
Nowadays, the recovery is under way but share of non-performing loans still NPL remains an issue (NPL share at 7.6% by end-2018). Adding to that, local banks are under the spotlight due to approaching ERM 2/Banking Union entrance.

Figure 14. Bulgaria: Loans Structure

![Figure 14. Bulgaria: Loans Structure](image)

Source: BNB

Figure 15. Bulgaria: Deposits Structure

![Figure 15. Bulgaria: Deposits Structure](image)

Source: BNB
DEMOGRAPHIC OUTLOOK

Demographic outlook is the key long-term challenge. It starts to be an issue in most CEE countries due to combination by aging population and economic migration to the West.

Besides impact related to increasing public spending on ageing, which should go up particularly in Slovenia, according to projection of the European Commission, there are challenges for labour market as well. However, it also opens opportunity for the private sector to satisfy unmet demand.

Figure 16. Projection of Age-related Spending

<table>
<thead>
<tr>
<th>Country</th>
<th>2016</th>
<th>2040</th>
<th>change</th>
<th>2070</th>
<th>change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>18.5</td>
<td>19.5</td>
<td>1.0</td>
<td>20.8</td>
<td>2.3</td>
</tr>
<tr>
<td>Croatia</td>
<td>20.7</td>
<td>18.5</td>
<td>-2.2</td>
<td>17.3</td>
<td>-3.4</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>18.2</td>
<td>21.2</td>
<td>3.0</td>
<td>24.4</td>
<td>6.2</td>
</tr>
<tr>
<td>Romania</td>
<td>15.1</td>
<td>15.8</td>
<td>0.7</td>
<td>17.3</td>
<td>2.2</td>
</tr>
<tr>
<td>Slovenia</td>
<td>21.9</td>
<td>26.6</td>
<td>4.7</td>
<td>28.2</td>
<td>6.3</td>
</tr>
<tr>
<td>EA average</td>
<td>26.0</td>
<td>28.2</td>
<td>2.2</td>
<td>27.1</td>
<td>1.1</td>
</tr>
<tr>
<td>EU average</td>
<td>25.0</td>
<td>26.8</td>
<td>1.8</td>
<td>26.7</td>
<td>1.7</td>
</tr>
</tbody>
</table>

Source: EC, in percentage points of GDP, changes vs. 2016

Figure 17. Case study: Bulgaria

Source: UN World Population Prospects
On the Bulgarian example, we could illustrate the impact of the approaching demographic crisis. Why Bulgaria? Because its population is expected to shrink by a half until the end of this century, the most across the globe, according to projection made by the UN. The effect is even more painful due geographical distribution of the projected decline.

But it’s not only about Bulgaria or SEE. Baltic states will be also hit heavily, based on similar projection.

Such unfavorable outlook calls for comprehensive steps and reforms:

1. One group of them would face consequences – reforms of pension system, labour market, healthcare or education. For the labour market, workers from less developed countries could temporarily substitute domestic shortage, while investments into productivity growth and robotization looks more costly but is key for the sustainability.

2. Second group of measures are rather preventive – aims mostly on young families (for example mortgage support, child care, flexible working hours, medical treatment). But to increase natality, it usually takes years or decades to bear some fruit in democratic countries. The other possibility is to rely on external migration. However, the current political sentiment across the CEE does not favour this scenario.

Figure 18. Demographic structure of Bulgarian society will change dramatically

Source: UN World Population Prospects
CONCLUSION

The economic environment within the region should remain supportive for reforms but external uncertainties are high. The role of the EU integration is significant, but quality of reforms matters. The deterioration of institutional quality, high corruption and Rule of law issues. The negative demographic outlook implies a need of comprehensive reforms but creates opportunity for private sector. The politics – despite growing public disproval, situation is relatively stable and creates a good time to act.
Several studies confirm a positive relationship between financial sector development and economic growth. By supporting wider diversification of investment and financing tools, the development of securities markets – in a supportive regulatory environment – can crucially complement traditional bank intermediation to channel households’ savings towards corporate investments, thereby fostering growth.

With reference to developments in this regard in the CEE and SEE regions, the focus of this brief intervention is on the following three points:

a. the relationship between economic growth and the development of financial markets (bank credit and securities markets) including evidence regarding the relative positions of CEE and SEE countries;

b. the characteristics of the supply and demand sides of local financial markets; and

c. on the supply (of funds) side of financial markets, the dynamic of financial wealth accumulation and the portfolio allocation of (in particular) the household sector in CEE and SEE countries.

FINANCIAL AND ECONOMIC DEVELOPMENT

Several studies have found positive correlations between financial development (FD) and economic development (ED). There are several metrics for measuring this.

If we consider the Index of Financial Development introduced by the IMF staff\(^{40}\) and the GDP per capita (at PPP) as proxies for financial and economic development, respectively, the correlation is around 50% at both the global and Emerging Europe levels (see Graph 1).

The FD index for CEE/SEE countries ranges from a maximum of 0.5 for Poland (ranking 39th) to a minimum of 0.2 for Albania (ranking 107th) (see red circle in Graph 1). CEE countries are generally better positioned than SEE countries (especially non-EU SEE). Advanced countries range from a maximum of c.1 for Switzerland (ranking 1st) to a minimum of 0.6 for Greece (rank 31st) (see blue circle in Graph 1).

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\(^{*}\) Head of International Research Network Coordination, Research Department, Intesa Sanpaolo.

The Index of Financial Development introduced by the IMF is a composite indicator of two sub-indexes on the development of financial institutions (FI) – banks, insurance, mutual and pension funds – and of financial markets (FM) – stock markets and bond markets – based on a sample of 183 countries. The Financial Institution Index (FI) and the Financial Market Index (FM) are derived, respectively, from indicators constructed to assess depth (size and liquidity), access (ability to access financial services) and efficiency.

The correlation between financial institution development and GDP per capita, and between financial market development and GDP per capita turn out to be almost the same, at around 45%, both at the global and at the emerging Europe level.

The Indexes for CEE/SEE countries range from 0.7 for Croatia (31st position) and 0.4 for Albania (90th position) for FI development and from 0.4 for Hungary (37th position) and 0.01 for Albania (147th position) for FM development. In terms of the FM index, Advanced countries range from 1.0 for the US (1st position) to 0.5 for Iceland (34th position) (see blue circles in Graph 2).

CEE countries are generally better positioned than SEE countries with reference to both indexes. Overall, CEE and SEE countries – with bank-oriented financial systems – have higher rankings for the FI Development index than for the FM Development index (see red circles in Graph 2). Compared with Advanced countries, the US and the UK (with market-oriented financial systems) rank respectively first and sixth for FM. In continental Europe, Italy ranks 14th for FI and 12th for FM.
CEE and SEE countries have bank-oriented financial systems. The ratio of bank credit (to the private sector) over GDP in 2017 was 45% on average in the two regions (vs 87% for the Euro Area), with a CEE average of c.50% and a SEE average of c.37%. The ratio of stock market capitalization/GDP was c.24% on average in the CEE and SEE regions (vs 78% for the Euro Area), with a CEE average of c.28% and a SEE average of just around 15%.

We would note that capital markets are not necessarily to be regarded as substitutes for banks in financing. Rather, they can complement bank financing by channeling additional resources to the economy, bringing advantages not only to borrowers (more funds) but also to investors (higher portfolio diversification).

In terms of the Financial Market Development index, with the exceptions of Hungary and Poland, CEE and SEE countries still perform poorly. The low rankings mainly relate to a low performance of Financial Market Depth (FMD) and Financial Market Access (FMA) indicators. The FMD indicator was highest in Hungary, Poland and Croatia (in a range of 0.2-0.25). The FMA indicator (except for Poland and Hungary, in a range of 0.4-0.5) was overall below 0.1. Compared with Advanced countries, the FMD was reported to have reached 0.98 in the UK (0.69 in Italy) and the FMA 0.71 in the UK (0.63 in Italy).
In order for CEE and SEE capital markets to catch up with the capital markets of other European regions and to see higher integration of Emerging Europe within the EU, these regions will need to make specific actions regarding the factors influencing their development on the demand side (by developing local capital markets and improving accessibility for SMEs), on the supply side (by a larger array of finance sources), and regarding financial regulation (so as to strengthen the level of investor (including retail investor) trust).

From the demand (of funds) side, the development of local capital markets is particularly important for small- and medium-sized enterprises. Larger local issuers and investors can easily bypass local markets and access foreign markets. In contrast, SMEs cannot easily access funds cross border. They would benefit most, therefore, from stronger local capital markets in terms of depth and especially in terms of accessibility. In several surveys, up to 15% of SMEs mentioned access to finance as a major problem (as compared to 9% in the EU)\textsuperscript{41}. Easier access to local capital markets

41. On the catch-up potential for CESEE capital markets and the actions needed to support convergence and integration with the EU, see European Commission (2018), European Financial Stability and Integration. Review 2018.
could improve the availability of long-term financing for local investment projects by also attracting the interest of private equity and foreign investors/capitals.

HOUSEHOLDS’ FINANCIAL WEALTH ACCUMULATION AND ALLOCATION IN CEE AND SEE REGIONS

On the supply (of funds) side of capital markets and on their potential development in the CEE and SEE regions, it is worth looking at the dynamics (and perspectives) related to local households’ financial wealth accumulation and portfolio allocation.

The total wealth/GDP and financial wealth/GDP ratios relate positively with per-capita GDP levels. In 2016, the (total) wealth/GDP ratio \((W/Y)\) was estimated to be around 500% in the EA3 (Germany, France and Italy) and around 220% in the CEE Area\(^{42}\). In the same year, the financial wealth/GDP ratio was estimated to be slightly above 100% in the CEE Area (vs c.210% in the EA3 and c.320% in the UK).

To put things into perspective, on the assumption that per-capita GDP (at PPP) in the CEE Area in the 10-year period of 2016-2025 increases by at least 50% (as was roughly the case in the previous 10 years) and per-capita GDP (at market values) moves in parallel at 50% (as was again the case in the previous 10-year period), then, given an estimated elasticity of financial wealth/GDP of approximately 2 in the area in the last few years, per capita financial wealth could more than double. This would imply strong potential for the development of both the supply (of funds) side of capital markets and assets under management activity.

Graph 5.

\[
\text{Graph 5.}
\]

Source: Our Calculations on Eurostat and Research Institute Data, 2016.

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\(^{42}\) These ratios appear to be in equilibrium with the correspondent household (gross) savings ratios \((S/Y, \text{c.10}\% \text{ in the EA3 and c.7.5}\% \text{ in the CEE region, including capital gains/losses})\) and GDP growth rates (g, circa 2% and 3%, respectively, in the two regions) in the prior five years, by using the following relationship \([W/Y] = (S/Y)/g\), which resembles the Harrod-Domar model relating capital/output ratios with investment intensity and GDP grow
The bank-oriented feature of the CEE and SEE regions’ financial systems, with bank financing taking a primary role with respect to capital market financing, is evident when looking at the structure of households’ financial wealth.

Financial wealth is mainly held as bank deposits, at around half (with the only exceptions being Hungary and Bulgaria) vs a third for the Euro Area, and less than a quarter for the UK. In contrast, the sum of mutual funds, insurance and pension fund items is often below a third in the CEE/SEE regions vs c.45% in the Euro Area, and c.75% in the UK.

The development of CEE/SEE capital markets on the supply side is affected, however, not only by the evolution of households’ portfolio allocation strategies, but also by the size and activity of local institutional investors.

Capital markets’ development and households’ diversified asset allocation actually go hand in hand with the development of institutional investors activity. In addition to mutual funds, pension funds can play an important role in this regard by pointing to professional management of diversified asset portfolios and by providing a stabilising role in view of their long-term investment horizons. Other Investors, such as private equity funds, can potentially complement capital markets by providing eq-

<table>
<thead>
<tr>
<th>Table 1. Households’ Financial Wealth Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fin. Assets</td>
</tr>
<tr>
<td>Liquidity/FA</td>
</tr>
<tr>
<td>Equity and Part.</td>
</tr>
<tr>
<td>Mutual Funds/FA</td>
</tr>
<tr>
<td>Ins. Tec. Res. &amp; other/FA</td>
</tr>
<tr>
<td>Fin. Liabilities/FA</td>
</tr>
<tr>
<td>- Loans</td>
</tr>
<tr>
<td>- OtherFin. Liab.</td>
</tr>
<tr>
<td>Net. Fin. Assets/FA</td>
</tr>
</tbody>
</table>

Source: Eurostat Households’ own consolidated data. 2016
uity to unlisted companies. This is particularly the case regarding VCs and business angels that invest in companies in their early stages of development.43

When looking at households, wealth accumulation attitudes, saving preferences, and levels of financial literacy are additional relevant factors influencing capital market development.

<table>
<thead>
<tr>
<th>SVN</th>
<th>BG</th>
<th>HR</th>
<th>RO</th>
<th>EA</th>
<th>UK</th>
<th>IT</th>
</tr>
</thead>
<tbody>
<tr>
<td>49.7</td>
<td>37.0</td>
<td>52.3</td>
<td>36.7</td>
<td>32.7</td>
<td>23.9</td>
<td>32.1</td>
</tr>
<tr>
<td>0.3</td>
<td>0.1</td>
<td>0.4</td>
<td>1.1</td>
<td>3.1</td>
<td>0.2</td>
<td>8.9</td>
</tr>
<tr>
<td>22.1</td>
<td>42.9</td>
<td>17.5</td>
<td>20.8</td>
<td>19.3</td>
<td>9.4</td>
<td>24.1</td>
</tr>
<tr>
<td>3.9</td>
<td>0.5</td>
<td>2.2</td>
<td>4.1</td>
<td>8.5</td>
<td>4.3</td>
<td>11.6</td>
</tr>
<tr>
<td>24.0</td>
<td>19.5</td>
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<td>37.3</td>
<td>36.4</td>
<td>62.2</td>
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</tr>
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<td>31.0</td>
<td>20.0</td>
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</tr>
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<td>71.1</td>
<td>70.7</td>
<td>72.6</td>
<td>81.0</td>
</tr>
</tbody>
</table>

The focus of the addressing will be on private SME companies and their role in the economic growth of regional economies. SME sector is universally recognized to be a strong contributor to GDP and employment in developed economies, and one of major factors of stability.

Financial needs of private companies throughout the region are mainly served by banking sector via traditional short- or medium-term bank loans, especially in countries whose EU accession process is delayed. Underdeveloped capital markets, lack of securities being issued, low liquidity and trading volumes of local stock exchanges and extremely limited availability of equity instruments picture the economic landscape in which SME companies have to operate.

We will be discussing relevant experiences of BAC Securities in different EMTN, Shuldshein and local bond programs with case analysis, touch upon usual choice of raising debt vs. raising equity in different stages of company life, and some local IPOs/public listings will be addressed as well.

The major limitation SME companies are facing when trying to obtain finance either through bank loans or bond emission, is a low equity base and lack of adequate collaterals. In this context, we will discuss some potential institutional framework that has to be built, consisting of special investment vehicles like a growth funds, guarantee funds and alike.

Black Sea BAC Fund in Romania will be elaborated and needs for similar institution for WB countries will be assessed.

SMEs are inherently risky, but the funds of this kind are, among other things, aimed to protect its downside risk through efficient structuring: (aligning interests through earn-out structures, financial incentives for founders and management to perform, efficient corporate governance etc.).

Fund focus on industry verticals/market segments with scope for consolidation, where Fund’s investee companies could emerge as a top 3 player, achieve critical mass (EBITDA over EUR 2.5mn) and generate interest from regional PE funds and strategic investors. Companies with innovation and intellectual property capacities, mainly export-oriented ones.
The Fund management team would look to add value to the investee companies by providing hands-on support on strategy, business development initiatives (through add-on local and/or regional acquisitions), capital raising (debt, new equity rounds), guidance/advice on improving cost management and reporting systems, leveraging IT/technology, streamlining operational processes, helping to address senior recruitment issues.
CHAPTER VII
EASTERN EUROPE IN THE WIDER ECONOMIC,
FINANCIAL AND GEO-POLITICAL SPACE
The New Geopolitical Challenge in the Western Balkans: China

GORAN SVILANOVIĆ*

There are different geopolitical challenges, some of them present in South East Europe and in the Balkans for centuries. Without pretention to discuss in great detail, and only as a part of the description of relevant developments influencing the region, both economically and politically, there is a need to mention increased presence of China. As the region is investment hungry, one has to agree that every investment is welcome. Same goes for investments coming from EU, US, Russia, Turkey, Arab Emirates and recently, from China. “One belt – one road” (OBOR) initiative, bringing some EU member states, together with some states from EU’s neighbourhood, Balkans, Eastern Europe and Central Asia, in the format “16+1”, became a new reality we need to acknowledge and respect. The discussion about the importance and effects of this initiative of China, was belated but has finally started.

With increased engagement of China through OBOR, we may see two different concepts of doing business in the region. The first one consists in the attempt to broaden EU legislation among non-EU member states, e.g. the Transport Treaty for South-eastern Europe and Energy Community. These initiatives are intended to stimulate the harmonization of transportation legislation as well as energy legislation and policies in the region and to bring southeast European countries in line with EU laws. All this is based on our belief to enter, at some time, the EU. But now, we are seeing the emergence of an investor that is not from the EU and is operating completely differently. One big advantage of this way of doing business is that it is fast. Nobody claim that these credit lines are cheapest, but competent politicians from the region are firmly saying that with China, everything goes quickly and therefore during their term in office they may agree about the project and complete it in time for re-elections. As it was explained by one of prime ministers from the Balkans: “The EU is not anymore the only game in town. What is in the offer coming from China, it is “the lifelong power”. “And” as he commented: “once you are in power, this is not the worst offer you can get”. He said this publicly in Brussels in the Friends of Europe event in December of 2016, and again, cynical, brutal and non-diplomatic, but not untrue.

The fault-lines of the two different business concepts are clear. If the Chinese are finishing projects like the bridge in Belgrade quickly and efficiently, questions about

* SEE expert
costs and tender procedures are hardly asked. But if the accession process is still strong, the EU can put caveats into business with Chinese investors. EU should use the existing leverage over the governments in the region and insist on integrating at least some of these four caveats into the agreements which are to be signed in the context of 16 + 1 initiative:

• Projects into which China is investing, should be previously agreed upon in the framework of the Berlin Process (as in the context of the Berlin Process, there is substantial engagement of European Commission together with respective governments from WB Six; there is a prioritization of different projects on both national and regional level and there is a full harmonization of agreed projects with the EU).

• Business should be done according to EU standards (tendering procedures and adding competitiveness clause).

• Environmental sustainability must be maintained (adding environmental clause into the deals).

• Consider engaging EU businesses as partners, together with domestic and Chinese companies.

I am proposing this in order to make sure that China and its businesses are continuously welcome in this region as well as in the wider Europe, but at the same time in order to make sure that convergence between Western Balkans and EU continues increasing, particularly when it comes to economic development based on full respect for the rule of law.
INTRODUCTION: THE NEW GEOPOLITICS

In the decade since the global financial crisis, two significant geopolitical developments have occurred, with material and lasting implications for investment and finance in Central, East and Southeast Europe (CESEE): the rise of China (and its increased competition with the US), and a sharp break in relations between Russia and the West. Much of CESEE, including the Western Balkans, finds itself on the faultline of these two geopolitical and geo-economic divisions. This paper will explore the implications for finance and investment in the Western Balkans.

At the global level, the rise of China to the level of full global power over the past decade has huge significance. Although the Soviet Union, and later Russia, has long been important in a military sense (not least because of its nuclear capabilities), this was not the case in terms of economics and finance. For the first time in at least 30 years (and probably much longer than that), the US is faced by a serious competitor in these fields, thanks to China’s huge and strategically-driven investments abroad (most importantly with its Belt and Road Initiative, BRI). Moreover, since 2016, the US Federal Reserve has taken China into account when formulating monetary policy decisions. The current US-China trade war, underpinned by widespread concern in the US that China has gained an unfair advantage in trade, is probably the policy area where US President Donald Trump has most bipartisan support.

Meanwhile at the regional level, the divisions between the Western and Russian-led blocs in Europe have become much more entrenched over the last five years. The exchange of sanctions since Russia’s 2014 annexation of Crimea have led to a material decline in trade and investment flows between Russia and the EU. Whole industries that had built up around Russian firms trying to sell debt and equity in London or Frankfurt – incorporating finance, marketing, PR and other functions – have basically disappeared.

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* Deputy Director, The Vienna Institute for International Economic Studies.

44. In this paper I focus on the “Western Balkan 6”, meaning those that are not members of the EU – Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia. However, where relevant, I also include Croatia and Slovenia in the analysis.
THE POSITION OF THE WESTERN BALKANS

The split between Russia and the West has formalised two distinct blocs within Europe. On the one hand, there are the EU member states, all of which have imposed sanctions on Russia. Meanwhile on the other is a Russia-led bloc, which loosely correlates with the states of the former Soviet Union (FSU), minus the Baltics and Ukraine. This group operates in part under the umbrella of the Eurasian Economic Union (EAEU).

Within this more formalised division, the position of the Western Balkans (and, it should be said, Turkey) is difficult. Among Western Balkan countries, there are different attitudes towards Russia, and many are sympathetic, especially in Serbia and the Republika Srpska of Bosnia and Herzegovina. Most significantly, for example, Serbia has a Free Trade Agreement (FTA) with Russia. Montenegro, Kosovo and Albania have joined international sanctions on Russia. However, Serbia, Bosnia and Herzegovina and Macedonia have not.

Despite differing attitudes towards Russia, the assumed direction of travel for the Western Balkans, shared by most actors both within and outside the region, has been towards the EU. Albania, North Macedonia, Montenegro and Serbia are all officially candidate countries for accession. Kosovo and Bosnia and Herzegovina are potential candidates.

Many economic and financial indicators reflect the impression that the Western Balkans is orientated towards the EU. From the perspective of FDI, trade and banking, it is hard to overstate the integration of the Western Balkans with the bloc.\textsuperscript{45} Across the Western Balkan 6 plus Slovenia and Croatia, the EU15\textsuperscript{46} share in the total inward FDI stock (Figure 1) ranges from around one third (Kosovo, Montenegro) to almost three quarters (Slovenia, Croatia). On this basis, outside actors such as Russia hardly register. Russia’s share in the total inward FDI stock in the Western Balkans is highest in Montenegro (10.7%). It also has a small presence in Serbia (5.9% of the total) and Bosnia and Herzegovina (5%). Otherwise, nowhere is Russia’s share higher than 1.3% (Slovenia). The FDI presence of Turkey and China in the region is generally even lower.

The data for total exports to the EU15 are roughly similar: the EU is a key export market for all countries of the region, accounting for well over half of the total in some cases. Meanwhile the strong role of EU banks in the Western Balkans financial sector is well documented\textsuperscript{47}. In some parts of the region, over three quarters of the banking sector is owned by EU-based lenders. A recent wiiw study found that the banking sectors of the region, especially those countries not currently part of the EU, are growing quite dynamically, especially in the consumer loans segment, and supported by a strong role for EU-based lenders.

\textsuperscript{46.} EU15 means the members of the bloc that joined before 2004 (roughly Western Europe).
Despite strong links between the EU and Western Balkans in an economic and financial sense however, the region finds itself struggling badly to attract sufficient (infrastructure) investment (Figure 2). According to the EBRD, the Western Balkans 6 (excluding Kosovo) needs 8-12% of GDP per year for infrastructure investment up to 2022, split across replacement and maintenance, supporting future growth, and catch-up investment. This compares to 5% for Romania and Croatia, and 4% for Slovenia. In particular, compared to their EU peers, the Western Balkan 6 countries require a large amount of catch-up investment according to the EBRD.

The lack of investment has many implications, not least the barrier it presents to higher productivity, regional integration and broader economic development. A big factor behind this is the small share of funds allocated to the region by the EU, in contrast to member states. We calculate that Bosnia and Herzegovina, Serbia and Montenegro all received substantially less than 1% of GDP in IPA funds from the EU budget in 2017. This compares with net EU fund inflows for EU member states in CESEE than can generally amount to 2-5% of GDP per year.

THE ARRIVAL OF CHINA

It is in the context of the huge investment needs of the Western Balkans, and a difficulty in accessing capital, that China has arrived in the region. The Western Balkans constitutes an important part of China’s Belt and Road Initiative (BRI), a huge programme of infrastructure development designed to export excess capacity and increase control of supply routes between China and its main markets. The Western Balkans is located between the Greek port of Piraeus (where China has acquired a controlling stake) and the major markets of Western Europe. It has the added advantage from the Chinese perspective of not being part of the EU, meaning less stringent rules on public procurement and environmental standards.

The Chinese focus on infrastructure development, and the Western Balkans’ infrastructure needs, therefore represent a potentially mutually beneficial situation. Between 2007 and 2017, (announced) Chinese construction projects linked to the BRI in CESEE amounted to over EUR 12bn according to wiiw calculations.\(^\text{50}\) Within this, the Western Balkan countries dominate, with around 30% of the total going to Serbia, 20.7% to Bosnia and Herzegovina, and 7.4% for Montenegro. These volumes are at least comparable to EU funding for infrastructure in the region, and dwarf anything committed by Russia or Turkey.

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\(^{50}\) https://wiiw.ac.at/western-balkans-eu-accession-is-the-2025-target-date-realistic--p-4526.html.
Nevertheless, the Chinese funds come with significant risks for the Western Balkans. Partly, this relates to concerns around political influence, potential corruption, and whether significant positive spill-overs will materialise for the region (it may be the case that largely Chinese materials and labour are used, for example). However, perhaps the most serious issue may be that the money comes only in the form of loans, and may unsustainably increase the debt burdens of some countries in the region. True, much of the lending is concessional, with long maturities and low interest rates. However, the IMF has warned that – especially in the cases of Montenegro and Bosnia and Herzegovina – the scale of the increase in debt (on top of an already quite high debt load for these countries) could create issues. A separate study included Montenegro among eight countries at “high risk” of debt problems associated with BRI loans. In extreme cases, this can lead to asset seizures by China (as in the case of Sri Lanka’s Hambantota port in 2017).

**CONCLUSION: CAN THE EU AND CHINA COOPERATE IN THE REGION?**

Aside from simple investment needs, China’s arrival in the Western Balkans comes at a time when both the US “stick” and EU “carrot” are being wielded somewhat more weakly than in the past. The US remains a formidable global power, including in the Western Balkans, but its attention on the region is reduced (partly owing to a “pivot” towards Asia in general and China in particular), and under the current administration it has taken a more passive role with few new initiatives. Meanwhile, the European Commission’s new strategy for the Western Balkans published in 2018 has not been backed up by decisive actions from all key member states. France published its own Western Balkans strategy in 2019, and did not even mention enlargement. More broadly, there appears to be a hardening of public opinion against further enlargement in some key member states in Western Europe. Among the questions asked by Eurobarometer about common EU policies, only enlargement does not enjoy clear majority support (Figure 3). The start of accession negotiations for Albania and North Macedonia may be delayed. This would be particularly bitter for North Macedonia following its recent name change to placate Greece.

The EU is likely to remain the dominant player in the Western Balkans from a finance and investment perspective. However, if EU accession for the Western Balkans remains some way off, as appears likely, then the EU may need to offer something more than the current situation. Frustration in the region is growing, increasing the appeal of outside actors. While countries such as Russia and Turkey cannot compete with the EU or US (or China) in terms of resources, they both have significant soft power capabilities in at least parts of the Western Balkans. Meanwhile China will become an increasingly important competitor to the EU in the region in the field of investment, and specifically construction projects.

One option for the EU is to try to stimulate much higher regional economic and financial integration before EU accession. Two years ago, a customs union within the Western Balkans was proposed by Serbia, and given a warm reception by the EU Commissioner for Enlargement Johannes Hahn. This could theoretically reduce barriers to trade within the region, leading to an increase in regional integration and higher productivity and growth. However, the need for a common external tariff, and more generally for quite a high degree of political cooperation, makes this quite unlikely.

A second option for the EU would be to include the Western Balkans in more EU funds programmes. Access to EU funds on the scale of, say, Romania, could be quite

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a game changer for the region. However, the likelihood of a smaller post-Brexit bud-
get, and concerns in Western Europe about corruption in EU funds in CESEE more
generally, also make this scenario quite unrealistic.

Finally, the EU may be left with the option of increasing cooperation with Chi-
na in the Western Balkans. The geopolitical and practical aspects of this are certainly
not straightforward. China has very different priorities to the EU in the region, and
it will not be easy for a liberal, highly regulated and rules-based organisation like the
EU to work together with a country like China on investment issues. However, if the
EU in particular and the West in general are not willing to act more decisively in the
Western Balkans (for example by speeding up accession), then this may well be the
path of least resistance. One way would be for the EU to formulate its own inves-
tment programme, a “European Silk Road”, which could complement and link up with
China’s BRI.\textsuperscript{58} However, this will require a different approach from some key mem-
ber states, something that is currently quite difficult to imagine.

\textsuperscript{58} https://wiiw.ac.at/a-european-silk-road--p-4608.html.
Digital’s relevance and the role of technological innovation in Europe.

This topic is relevant because we live now in a flat world, with very limited or at least no boundaries. This can be considered both a risk or an opportunity, in any case investments in digital area must be considered as key “enablers” for companies to reach emerging markets and to exploit new opportunities, such as supporting customer mobility or managing quicker and different asset allocations.

Generali aims to keep pace with this transformation: a valid reason to include digital innovation in the company’s business strategy as one the three main pillars.

Why is digital so important for the insurance industry?

It can be explained through three main drivers.

Digital innovation is addressing customers, agents and distributors needs. Customers and agents are always demanding for quicker digital interaction, often through channels that are enabled by smartphone and other devices, causing the digital demand to continuously grow. Especially in specific market segment like the youngest generation.

Additionally, digital enables process optimization in specific operations, thus reducing costs that are related to traditional or manual processes.

Nonetheless, the most important driver is that digital is the mean through which new players are tackling the market. For example, big tech giants (eg Amazon, Google) are providing new services with potential growth in insurance industry.

Especially in underinsured and developing markets, these three digital drivers are relevant for Generali to invest in, before other players will bring their proposition supported by new technologies.

Which is an example of digital transformation?

An example related to digital adoption, specifically in process automation, is the UiPath case. In 2015, Generali partnering with a venture capital, invested in UiPath, a small Romanian start-up composed by few employees at that time. Generali exploited the opportunity to leverage their software to implement process au-
tomation, in a faster and more reliable way. As said, automation is relevant in speeding up and have more efficient operations.

The startup company was selected for a pilot and after a successful initial implementation, Generali decided to invest in the company: nowadays, UiPath is composed by more than 1500 employees, spread across the globe, and it is one of the most important players in the process automation software industry, counting on a market evaluation that is now $7 billion.

The case of this partnership is useful as an example on how to leverage the entrepreneurial and innovative mindset and how to leverage digital innovation in transforming the insurance industry.
First of all, there are a lot of challenges and opportunities at the same time in the area. The penetration of insurance services and products in most of the CEE economies is still limited, which issue needs to be addressed as there is an over-reliance of mandatory insurance and the little penetration of other forms of coverage thus still requires a high level of attention. There are also different opportunities, such as the themes of sustainability and the possibility of green bond investments that need to be put into a critical perspective. This is an opportunity as most of the CEE countries rank within 30th countries worldwide in terms of environmental and social governance. Countries like Slovenia rank higher compared to Western Europe countries such as Italy and Spain, and it means that there is good foundation that will allow further improvements and developments in the above-mentioned sectors. Some of these instruments, such as green bonds represent opportunities in order to develop sea-capital markets. For example the Polish Government was one of the first governments to issue green-labelled bonds. Nevertheless, there still is the need of a certain degree of attention of attention to follow a sensible and gradual path rather than applying sudden and abrupt rules and changes. For example, it is fundamental not to stop ensuring certain call plans and not to divest abruptly from certain sectors along with calibrating the approach depending on the country. Moreover, a transitional approach adopted by Generali envisages an engagement with the local companies whether they are insurance clients issuers of the bonds.

* Chief Executive Officer and Head of Investments, Generali Insurance
There is an obvious role for well managed local pension funds in providing long term local currency financing for key areas such as mortgage and infrastructure finance—desperately needed to drive development and economic growth. Government remains a key actor in this sector but ultimately no single entity will be able to fund all infrastructure needs and so new financing avenues are needed. Pension funds are logically seen as vehicles to fill the gap as they need to invest long-term to match their contributions under management, particularly during the accumulation stage. Whilst foreign pension funds can provide some of this funding, they are less keen to invest in local currency denominated assets whereas local funds’ contributions are normally denominated in local currency and present no such problem. Meanwhile, local and international banking and insurance groups’ capacities to lend long—regardless of currency denomination—will be compromised by deleveraging as well as new capital adequacy regulations such as Basel III and Solvency II.

If a pension fund industry is seen as a critical systemic issue for OECD countries within the Eurozone, their importance for countries in Emerging Europe is far more significant. The region’s financing needs to develop and update infrastructure are proportionately greater and the sources of long-term capital from non-bank groups such as investment funds are currently much lower (Figure 1).

Introducing a funded Pillar II scheme can also introduce a savings culture into an economy where workers (particularly younger workers) may be myopic about their financial future. It also indirectly encourages a greater array of pension and savings products which in turn leads to a greater level of savings being recycled into projects that benefit the national economy. It is clear that the development of a funded pension scheme needs to be considered in tandem with the development of the domestic capital market to provide the products demanded. Not only do Pillar II pension schemes channel capital towards local capital markets, they also play a critical role in stabilising markets in view of their long-term investment horizon.

* Associate Director Local Currency and Capital Markets Development, EBRD.
59. This article is an expanded version of the original Op Ed article by Pierre Heilbronn VP Policy & Partnerships, EBRD and Jim Turnbull Associate Director Debt Capital Markets LC2, EBRD prepared for the EUROFI event in Bucharest 3-5 April 2019.
However, if a system of funded pensions appears to be the solution, this then begs the question – why do some jurisdictions in Southern and Eastern Europe with existing funded Pillar II arrangements look to nationalise or abandon them altogether?

A major reason for the limited acceptance of funded pensions in the region seems to be that short-term budgetary issues often trump policies that promote retirement saving. Nationalisation or cancellation of pension fund holdings of government debt in exchange for a future promise provides a convenient short-term fix to a debt ceiling or budget deficit issue. But as we have observed, nationalising Pillar II contributions and creating unfunded state pensions only pushes the problem onto the next generation of taxpayers and places a huge burden on the national accounts and government policy.

In a 2016 study, the OECD estimated that the level of unfunded government pension liabilities in 20 of its countries exceeded 78 trillion dollars – mostly in Europe. To some observers it was not entirely clear why this was seen as a major issue by development institutions such as the EBRD. But in terms of scale, USD 78 trillion of unfunded pension liabilities dwarfed the published level of national debt which stood at US48 trillion in 2016. In simple terms, unfunded pension liabilities were almost double the national debt. This should be worrisome for even the most complacent observer.

Unfunded pension liabilities are effectively a pledge against the national accounts that governments will provide a reasonable and secure retirement income for indi-

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viduals in the future. Unfunded pension liabilities are growing rapidly at the government level and will place huge stress on the budgetary process in the future. Pensions promised by the state but left unfunded are seen by some experts as a ticking time bomb that is not adequately recognised in the national accounts and is poorly understood by the public and mainstream media.

One way to reduce the future government obligation is to back away from a commitment to pay state pensions. This is, for obvious reasons, normally politically unpalatable. However, one could argue that the same thing happens surreptitiously where pensions are cut or are inadequately adjusted for inflation, eligibility criteria are tightened, or benefit coverage is shaved. The additional uncertainty of receiving an adequate state pension because of budget cuts is a very real issue and those living on low salaries have little flexibility to top up pensions to cover any reneging on a government promise. Such uncertainty affects the most vulnerable in society whom governments are tasked with protecting. Alternatively, governments have to raise taxes or cut government expenditures elsewhere to pay these obligations, which is equally painful.

In addition to the general policy trade-off between short term and long-term government financing, funded pension arrangements such as Pillar II have also been criticised for several other reasons, including:

- High fees charged by private sector asset managers and advisors that undermine returns.
- Pension risks are borne solely by the individual, who must assess risks, develop a diversified investment and decide how much to contribute and when to take income, without regard to the capacity of the individual to take up these challenging tasks.
- Pension funds’ tendency to overinvest in government securities because it is the most developed market segment is self-defeating because it creates financing circularity – the state allocation to private pensions increases the need to issue debt which is bought by pension funds.
- Onerous investment restrictions by regulators mean that returns are highly unlikely to keep pace with inflation.
- Offshore investments by pension funds as a result of the absence of domestic capital market investment products mean that a country’s long-term infrastructure financing needs are not funded by long term national savings.

However, rather than throwing away the whole notion of a funded pension system and dismantling the industry entirely, viable solutions rest in constructively addressing the identified shortcomings. Additionally, while fully funded government run national pension schemes might be marginally preferable to unfunded pension promises, the risk of directed or “vanity” investment without analysis of commercial viability is also a danger – hence the strong preference for outsourced investment mandates.

One solution to the lack of recognition of the scale of the problem is the prominent publication of unfunded pension liabilities as an integral part of the national accounts, including year on year positional change according to an agreed standardised
methodology. There is a powerful private sector precedent to this – it was a key recommendation of the Meynert report (2001)\textsuperscript{61} in the UK – where disclosure of unfunded pension liabilities in company accounts led to an expansion of defined contribution company schemes in the UK.

High management fees can be partially addressed by initiatives such as the establishment of low-cost default funds – possibly government administered and utilising government accounting. The default funds would outsource the investment function to asset management firms as an institutional mandate attracting lower management fees. Whilst potentially effective in keeping costs and fees down this does, however, limit contributor choice to products such as life cycle pensions. An additional advantage of such a structure is that a large percentage of contributors are likely to favour such funds until they build familiarity with other investment products with different risk profiles.

Pooling of risks in so-called ‘collective defined contribution’ plans in which assets (and risks) are managed on a pooled basis could also ameliorate the risks related to the individual taking on all the investment risk and choices over how much to contribute. Parallel policies to develop the financial literacy of workers (both at government and private sector level) could also assist in this regard.

Over-investment in government bonds by pension funds as well as reductions in the level of offshore investment can be partially addressed by a comprehensive capital market development strategy that leads to an expanded array of investment products including corporate debt. This can also be a desirable outcome for economies with potentially large infrastructure funding needs, particularly in local currency. Regional initiatives such as the Capital Markets Union (CMU) also target the expansion of financial products. Nevertheless, pension funds must have an allocation to safe annuity instruments such as government bonds, although some jurisdictions set maximum investment limits for that asset class to limit herding into the government bond markets by pension funds.

Some jurisdictions subject pension funds to UCIT\textsuperscript{62} style investment guidelines that favour investments that can be valued daily rather than instruments of a longer duration that can mirror a funds contribution profile and may potentially keep pace with inflation. Ideally, there should also be an allocation to long term instruments, high growth potential sectors such as venture capital and even commodities. Additionally, during the accumulation phase the liquidity of long-term investments is not as critical as contributions are growing. Besides the obvious diversification benefits, some balance of safety and return is also advisable – for example a 50% allocation to modern art, although very cultural – may not be an optimum investment strategy.

Lastly, additional soft compulsion incentives, such as automatic contributions to pension plans, salary increases or tax relief for additional investment in long-term

\textsuperscript{61} Meyner’s Review (UK) released 6 March 2001 developed a series of wide ranging reforms to the reporting and fiduciary responsibilities of pension fund managers in the Corporate Sector following several scandals related to underfunded pensions at the company level.

\textsuperscript{62} Undertakings for the Collective Investment in Transferable Securities (UCITS) Framework.
savings products, may provide a powerful incentive for wealthier contributors to boost their retirement savings, leaving room for the public pension system to provide improved coverage to the less well-off retiree.

In conclusion, given the region’s need to develop its’ long-term financing capability to fund critical infrastructure, the role of local pension funds cannot be ignored. The need to reduce the pressure on the national accounts by moving from unfunded pension promises to a funded model only adds more weight to the argument that developing this sector should rank highly as a capital market development priority for the region.
Short Biographies

MASSIMO ALVARO
Vice President Supply Chain Assurance – Lloyd’s Register

Vice President of Inspection Business Unit in Lloyd’s Register Heading Supply Chain Assurance business line. Massimo is also currently leading a Sales-Global Account Management Team, Cranes, Nuclear and Low Carbon Segments.

Massimo joined in Lloyd’s in September 2013 as Area Manager for South Europe covering also UK (Headquarters) and after 4 years, he joined the Inspection Management Team in 2017 (1st Italian covering such position). Prior joining in LR he led the Global Accounts in Ansaldo Sistemi Industriali (now Nidec-ASI). Prior this experience he worked in Wartsila managing Americas and moved his first steps in Manufacturing.

Massimo is a Mechanical Engineer and he is also Regional President of Federmanager Giovani (FVG) and National Board Member. He is Permanent guest in ANIMP Energy commission and member of Electrical Engineering Committee at Trieste University.
DARKO BLAZHEVSKI
PhD, Head of Research and Development Unit, Insurance Supervision Agency (Macedonia)

Darko Blazhevski joined the Insurance Supervision Agency in April 2010 at the position Head of R&D. Previously, he used to work in two commercial banks on different positions, as well as in the Public debt management department in the Ministry of finance as an advisor. In 2017, he was engaged as a short-term consultant in the World Bank, Washington. Also, since September 2017 he has become member of the Council for Advancement and Oversight of the Audit of the Republic of Macedonia. He has earned his bachelor’s degree in financial management and graduated from monetary economics at the state university Sts. Cyril and Methodius, Skopje. In 2014, he completed executive MBA in Finance with focus on ERM in insurance companies at the City College, Thessaloniki, affiliated studies from the University of Sheffield. In 2018, he earned a PhD in insurance with focus on insurance schemes for catastrophe risks at the state university St. Kliment Ohridski, Bitola. He attended numerous training in the field of finance and insurance. In 2006 he attended 6 weeks training for corporate governance and shareholders’ rights, at the Georgetown University, USA. He has ACI Dealing Certificate and possess investor adviser license from the Macedonian SEC.

ALBERTO BRANCHESI
Head of Data and Digital platforms in Assicurazioni Generali

Alberto Branchesi – Appointed Head of Data and Digital Platforms in Assicurazioni Generali in 2016, in charge of defining technology strategies and of delivering to the data scientist and business analysts of the Group the capabilities to explore data insights and develop analytical models. He explores also the convergence of Artificial Intelligence and Robotic Process Automation, as well as other relevant digital platforms such
as Blockchain. Prior to 2016, he worked in Microsoft and in IBM, always leading digital innovation conversations. Graduated in Theoretical Physics from University of Bologna and EMBA from MIP Politecnico di Milano Graduate School of Business.

ALBERTO CASTRONOVO
External Relations, SIMEST SpA

Alberto Castronovo 52 years old is Senior manager at External relations Dept. in SIMEST S.p.a, with the task of promoting activities to support the internationalization of Italian SMEs and EDFI coordinator (European Development Financial Institutions). In 1996 he joined MCC (Medio Credito Centrale) where he worked in the Structured Finance Divison as Business Analyst and from 2009 to 2011 he was appointed Chief of Staff of the Vice Minister for the Economic Development. Since he has been in SIMEST he has worked in the Investment & Advisory Department, then as Head of the Business-Scouting Unit and Head of the Business Development and International Affairs Dept.

THIERRY CLARKE
CEO of InvestorConnected

Thierry Clarke is a successful and multi-faceted entrepreneur, business developer and consultant. He is the founder and CEO of InvestorConnected, a company that provides technology and consultancy services for the investment industry. With over 15 years’ experience in the Investment Management industry, he has raised billions of dollars of investment in his career. Starting from zero, he built a previous business to assets in excess of $1 billion and has advised start-ups, scale-ups and even international governments on their finances. Thierry has worked as a consultant for the EBRD and European Commission on a number of investment industry projects, in-
including a cross regional study of dormant securities accounts; how to improve the institutional investment environment in Lithuania; two other dormant account projects and a study of fixed income transaction cost across the Western Balkans.

MASSIMO DEANDREIS
General Manager of SRM, Economic Research Centre

Massimo Deandreis, 52 years old, is General Manager of SRM, an Economic Research Centre related to the Intesa Sanpaolo Banking Group, specialized in the Italian economy, energy issues and maritime economy in a European and Mediterranean perspective. He is also currently President of GEI, the Italian Society of Business Economists, and Professor of Business Management at University of Turin. In Intesa Sanpaolo Banking Group, he was previously chief of staff of the President of the Bank from 2008 to 2010. In the past he worked as a researcher at Centro Einaudi in Turin and the European Association of Regional Financial Centres (ACRFRE), collaborating with the OECD. He lived in Brussels for five years working as Head of the Piemonte delegation to the European Union and he has been general director of the Piemonte Regional Chamber of Commerce for eight years.

FRANCO DELNERI
Senior Advisor for International and European Affairs, FeBAF

Franco Delneri is Managing Director of DAMM Management&Marketing d.o.o. Belgrade, a consultancy Company providing consulting, legal and financial services to Italian and Serbian Companies. From 2014 Senior Advisor for International and European Affairs of Italian Banking, Insurance and Finance Federation. Member of the Board of Directors and Internal Auditor of FIndomestic Bank, BNP-Paribas Group from 2014 to
2017. Founding member of Confindustria Serbia. Previously Project Advisor for financial support to the Serbian SMEs at the Italian Ministry of Foreign Affairs. Former EBRD’s Senior Banker from 1996 to 1999 and then Head of the Department for Advisory Services of SIMEST merchant bank Rome. Working experience for international organizations (EBRD, EIB, European Commission, World Bank, IMF, IFC, Regional Funds, etc.) and Governments in Eastern Europe, Central Asia, Africa, and South America.

ANDREA DIAMANTI
*Head of CEE Corporate and Investment Banking and Private Banking, UniCredit*

Andrea started his career in 1998 at Commerzbank AG, Milan Branch, in the Structured Finance department. He joined UniCredit in 2000 as Vice President in the Financial Sponsor Solutions team in Italy. Since then he has strongly contributed to the growth of the Financial Sponsor Solutions franchise. In April 2012 he took over the position of Head of Financial Sponsor Solutions Austria & CEE at UniCredit, where he stayed until March 2015. In April 2015 Andrea was appointed as Head of Financing CEE at UniCredit, responsible for the financing business line in the region. One and a half year later, in September 2016, he took over the position of Head of Corporate and Investment Banking and Private Banking in CEE, with responsibilities for the corporate and private banking businesses in the region. He is also a Member of the Supervisory Board at AO UniCredit Bank, Russia, UniCredit Bank Czech Republic & Slovakia and UniCredit Bank Hungary.

GABRIELE GALATERI DI GENOLA
*Chairman, Generali*

Gabriele Galateri di Genola was appointed Chairman of Assicurazioni Generali on 8 April 2011. He holds a degree in Law and an MBA from Columbia University. He
was appointed CEO of IFIL in 1986 and CEO and General Manager of IFI in 1993; subsequently, in 2002, he was appointed CEO of FIAT. From 2003 to June 2007 he was Chairman of the Board of Directors of Mediobanca. From 2003 to 2010 he was Vice-Chairman and a member of the Board of Directors of Generali. From 2007 to 2011 he was Chairman of Telecom Italia SpA, where he was a member of the Board of Directors until April 2014.

PAOLO GARONNA
Secretary General Italian Banking Insurance and Finance Federation FeBAF

Paolo Garonna is the Secretary General of the Italian Banking, Insurance and Finance Federation since October 2012. Professor of Political Economy at the Luiss Guido Carli University of Rome, he was Director General of the Association of Italian Insurers (ANIA) and Chief Economist of Confindustria. Professor Garonna was Director General of the Italian National Institute of Statistics (ISTAT) from 1992 to 1999, and, from 1989 to 1992, Deputy Director for Labor, Social Affairs and Education at the Organization for Economic Co-operation and Development (OECD) in Paris. From 1999 to 2009 he was Deputy Executive Secretary, and Executive Secretary ad interim, of the United Nations Economic Commission for Europe (UNECE) in Geneva. He carried out research in America as Fulbright scholar, and in Cambridge, Great Britain, and taught in several Universities in Italy and abroad. He has published a considerable number of books and essays in Applied Economics, Statistics and Finance.

RICHARD GRIEVESON
SEE expert

Richard Grieveson is Deputy Director of wiiw and head of Country Analysis. His main area of research is CESEE country analysis and economic forecasting, with a particular
focus on Turkey and the Western Balkans. In addition, he works on migration, sovereign risk, economic history and European integration. He holds a Graduate Diploma in Economics from the University of London, Birkbeck, a master’s in advanced international studies from the University of Vienna and a BA in History from the University of Cambridge. Previously he worked as a Director in the Emerging Europe Sovereigns team at Fitch Ratings, with a focus on the CIS and Balkans. Before that, he was Regional Manager and lead analyst for Germany and Poland in the Europe team at the Economist Intelligence Unit.

GIUSEPPE INSALACO

*Senior Financial Stability Expert and Secretary of the Task Force on Central Counterparties at the ESRB Secretariat*

Giuseppe is currently on a three-year secondment at the European Systemic Risk Board Secretariat, working on macroprudential policy related to non-bank financial intermediation and financial market infrastructure, focusing primarily on CCPs, derivatives, Funds and leverage. Before joining the ESRB Giuseppe was senior policy advisor in the Markets and Policy Division of the Central Bank of Ireland, where he represented the Bank at the ESMA Post Trade, Securities Markets, and Financial Innovation Standing Committees, and at the IOSCO Committee on Regulation of Secondary Markets (Committee 2). He had a first-hand involvement in the drafting of Regulatory Technical Standards for EMIR and CSDR and was advising the Irish Department of Finance during and after the Irish Presidency of the European Council on MiFID II, CSRD, and EMIR-related dossiers.

Giuseppe comes from a career in the private sector with primary Italian asset managers as treasurer, head of trading desks and investment control, and COO. He also has an experience in the Fintech space as founder of a crowdfunding MTF. He holds a degree in political economics from Università Bocconi and a MBA from UCD Michael Smurfit Graduate Business School.
ALEKSANDAR KOVACEVIĆ
Energy economist

Aleksandar Kovacevic is the energy economist and author of the energy – poverty analyses (UNDP, 2004) and South East Europe gas market analyses with the Oxford Institute for Energy Studies, co-author of the Western Balkans energy policy survey (IEA/UNDP, 2008) and the World Bank analyses (2003, 2010) and a number of papers and lectures. Over 30 years he provides strategic advice, due diligence, policy innovation, complex energy solutions and emergency situation assistance to major institutional, financial and private clients including to UN OCHA to coordinate rapid reconstruction of Serbia energy infrastructure after 1999 war. Chairman of annual Western Balkans Energy Finance Conference, Member of Advisory Board to the Russian Power Conference from 2002-2016 and contributor to Oil and Gas Economy and Law (OGEL) network. He won the Innovation Award at the Power Gen Europe Conference at 2002. Aleksandar combines policy work, research and hands-on consultancy. He is active participant in the Energy Community Treaty process from its inception in 2003 till now and contributor to the SEE 2020 economic development strategy with the Regional Cooperation Council RCC.

SAFET KOZAREVIĆ
PhD Professor at Faculty of Economics, University of Tuzla

Safet Kozarević holds the rank of Full Professor at the Faculty of Economics, University of Tuzla, and in period 2010-2016 he was the Dean of the Faculty. His teaching and research fields are focused to Risk Management, Insurance and Quantitative Economics. In academic 2007-2008, Dr. Kozarević was a Fulbright Scholar at the Department of Risk, Insurance and Healthcare Management at the Fox School of Business, Temple University, Philadelphia. As visiting professor, he gave lectures at sev-
JAKUB KRÁTKÝ
Financial analyst

Jakub Kratky is a Financial Analyst in macroeconomic research, political analysis, municipal credit at Generali Investments CEE based in Prague since 2011. His work is focused on SEE region. He holds a master’s degree in Political Science and Contemporary history at Charles University in Prague. models for core government rates and for sovereign and corporate spreads for USD and EUR-denominated assets. He has been a CFA charterholder since 2013.

FRANCESCO MARTORANA
Chief Executive Officer and Head of Investments, Generali Insurance Asset Management S.p.A. Società di gestione del risparmio

Francesco Martorana is the CEO of Generali Insurance Asset Management S.p.A. Società di gestione del risparmio since April 2019, while also maintaining the Head of Investments role which he covers since October 2017. He joined the Generali Group in November 2013, as the Head of Group Asset Liability Management & Strategic Asset Allocation; in this capacity, he was also instrumental in outlining the new asset management strategy for the Generali Group, which was announced in May 2017. Prior to that, Francesco spent eight years at Allianz Group, holding several management positions in the investment department, and previously worked for Deutsche Bank and JPMorgan Chase. A CFA and CAIA Charterholder, he holds a master’s degree in finance from Università Commerciale Bocconi in Milan.
**EDOARDO MARULLO REEDTZ**

*Research department of Italian Insurers Associations (ANIA)*

Edoardo focuses on topics related to investments and financial markets, coordinating the Investment Working Group within ANIA’s Eco-Fin Committee and participating in roundtables and policy advisory sessions of FEBAF; he is among the editors of “ANIA trends”, a monthly newsletter on financial and insurance market developments and of parts of the ANIA's Annual Report on the Italian insurance industry. Moreover, he analyses investment trends and related prudential regulation and participates to working groups and roundtables in Insurance Europe (Solvency II WG and EcoFin). He is also responsible for contents and documentation for financial and prudential seminars and workshops directed to ANIA members and takes part in seminars and workshops on risk and insurance economics. Directly reporting to the General Manager, he provides support in drafting texts for official hearings and speeches before national and international institutions. Previously he has worked for a year as a structured finance risk analyst for Banca IMI and has served, from 2006 to 2009, first as an intern in the Securitisation division and then as an analyst in the Corporate Banking division of Citi.

**MICHELE MORGANTI**

*Senior Equity Strategist and Head of the Insurance and Asset Management Research, Generali Insurance Asset Management S.p.A. Società di gestione del risparmio*

Michele Morganti is Senior Equity Strategist and Head of the Insurance and Asset Management Research at Generali Insurance Asset Management S.p.A. Società di gestione del risparmio. From 2008 to 2013 he was Equity Strategist and Fund Manager of 7 equity funds (third Party institutional clients – pension funds with different benchmarks and geographical allocation). He was in charge of the tactical asset allocation and stock selection of the funds and coordinator of the stock model portfolio of the equity team.
Michele is regularly invited as a speaker at several international events and internal conferences in his capacity as Market Strategist. Until mid-2015 he was a member of the Investment Committee at BSI (Banca Svizzera Italiana of Lugano). From 1991 to 2000 he was Head of Bottom-up Research and Equity Strategy, as well as Internal Consultant for M&A deals at INA (Istituto Nazionale delle Assicurazioni) based in Rome. Michele holds a Degree cum laude in Economics and Finance from the University “La Sapienza” of Rome.

DAN MUTADICH
Partner, KV Capital Partners

Dan has 20 years of experience in Strategy, Business Development and Entrepreneurship. Dan has for the last 10 years been the founder and Managing Director at Kvantum Capital Partners, an M&A boutique based in Belgrade and prior to that was Vice President at Citadel Financial Advisory. Dan led a number of successful transactions in all of the countries of the SEE (South Eastern Europe) region across Telecom, Healthcare, Retail, FMCG and IT sectors, having worked with local clients, multinationals and PE funds. Having started his career in product R&D for Philips Consumer Communications (France) and Nokia (UK), Dan held a number of sales and business development positions previously with Microgen, Britannic Technologies and Trading Partners in the UK. Dan holds an MEng in Electrical and Electronic Engineering from Imperial College, London and an MBA from INSEAD.

MARIO NAVA
DG for Financial Stability, Financial Services and Capital Markets Union

Mario Nava holds an undergraduate degree in Economics from Bocconi University (1989), an MA from the Université Catholique de Louvain, Belgium (1992) and a
PhD in Public Finance from the London School of Economics (1996). Mario joined the European Commission in 1994 and held various senior positions. Since October 2018, he is the Director for “horizontal policies” in the Financial Stability, Financial Services and Capital Markets Union Directorate General. Prior to that, from 2016 to April 2018, he was Director of the “Financial system surveillance and crisis management” Directorate and, from 2011 to 2016, Director of the “Regulation and prudential supervision of financial institutions”. Previously, he was Head of the “Banking and Financial Conglomerates” Unit, of the Financial Markets Infrastructure Unit, a member of the Group of Policy Advisers of the EU Commission President, Prof. Romano Prodi, and a member of the Cabinet of the Competition Commissioner, Prof. Mario Monti.

FERDINANDO NELLI FEROCI
President of the IAI

Ferdinando Nelli Feroci is president of the IAI. A diplomat from 1972 to 2013, he was Permanent Representative of Italy to the European Union in Brussels (2008-13), Chief of Staff (2006-08) and Director General for European Integration (2004-06) at the Italian Ministry of Foreign Affairs. Previously, he served in New York at the United Nations, in Algiers, Paris and Beijing. He also served as Diplomatic Counsellor of the Vice President of the Italian Council of Ministers (1998). In June 2014 he was appointed to the post of European Commissioner in the Commission chaired by Manuel Barroso to replace Antonio Tajani, a position he held until the end of the mandate of the Commission on 1 November 2014. Formerly a Fellow at the Center for International Affairs, Harvard University (1985-86), and Visiting Professor at the Istituto Universitario Orientale of Naples (1989), he is currently a professor at the School of Government of Luiss, Rome. He is the author of many articles and essays on international relations, European affairs and political affairs.
ANTAL NIKOLETTI
Alternate Secretary General of Central European Initiative

Mr. Nikoletti is 54 years old, graduated at Corvinus University of Economics in 1989, with specialization in International Economic Relations (thesis in Risk based decision making). 23 years’ experience in banking sector in various banks, including Creditanstalt (now part of Unicredit), Rabobank, GE Capital with focus in risk management, corporate and retail lending, project management and senior-executive level leadership. Also was CFO and Deputy CEO of Budapest Airport, chair of Supervisory Board of the Duty-Free Business line. Former Deputy State Secretary for International Economic Affairs at Ministry of Economy (and Finance) of Hungary, head of Economic diplomacy, EBRD Board member for Hungary, Czech, Slovakia, Croatia and Georgia. EU SME Envoy for Hungary, country representative and member of Rules Committee in BIE, Eximbank board member. Ambassador by diplomatic rank. Currently Alternate Secretary General of Central European Initiative in Trieste, beyond general leadership tasks and the core function of intergovernmental relations, also responsible for the Business (Economic) dimension of CEI.

ROZÁLIA PÁL
Economist, European Investment Bank

Rozália Pál, Ph.D. joined the European Investment Bank in 2017, as an economist at Country and Financial Sector Analysis Division, Economics Department. She is responsible for economic and financial analysis in particular for Romania, Croatia and Non–EU Western Balkan Countries. She is contributing to the EIB publications, such as the EIB Investment Report, Bank Lending Survey, EIB Investment Survey. Her research focus is on financing constraints and investment barriers of SMEs. Rozália has
more than ten-years’ work experience in banking sector, working previously as chief economist in UniCredit Bank Romania and Garanti Bank Romania. She conducted several research projects at the European Central Bank and at the Postgraduate Research Programme “Capital Markets and Finance in the Enlarged Europe” at the European University Viadrina, Frankfurt (Oder). Rozália has a doctoral degree in Economics obtained from Westfälischen Wilhelms-University Münster, Germany.

CHRISTOPH PLEIN  
*AIM-CIO-FGE, Allianz Investment Management SE*

Dr. Christoph Plein is the Regional Chief Investment Officer for the so called “Fast Growing Entities” of Allianz Group. In his role he is responsible for the investment result of the insurance and pension fund companies of Allianz Group in the Anglo-Saxon countries, CEE, South-East Europe, Middle East/Africa and Latin America. He is member of the Supervisory Board of Allianz Bank Bulgaria, Allianz Hellas and Allianz pension fund companies in Croatia and Romania. Prior to assuming his current role in 2011, he was for seven years member of the Board of Allianz in the Czech Republic, serving initially as CFO and later on as COO. He joined Allianz Group in 1998 after being an auditor with Deloitte, Munich. He holds a doctoral degree in economics from the University of Regensburg and has authored publications in various economic journals.

MONICA POLIDORI  
*Head of the Strategic Market Analysis at Fincantieri*

Monica Polidori holds the role of Head of the Strategic Market Analysis within the Corporate Business Development function. Her main field of activity consists in the analysis of competitors and forecast and scenario planning for the main markets of
ENZO QUATTROCIOCCHI
Secretary General, European Bank for Reconstruction and Development

Enzo Quattrociocchi is the EBRD’s Secretary General. He is a member of the Bank’s Executive Committee – together with the President, Vice Presidents, and other senior management representatives. The Secretary General reports to the President and works with the Board of Governors and the Board of Directors. The Secretary General engages in policy dialogue with the Bank’s shareholders, deals with requests for membership, and represents the Bank in international fora as appropriate. Enzo Quattrociocchi worked for 12 years as Director for Italy on the Bank’s Board of Directors before resigning in August 2008. After a brief period in Italy, during which he worked on a project for the Italian Ministry of Economy and Finance, he took up his role as Secretary General in February 2009. During his period as Board Director, Mr Quattrociocchi served as Chairman of three of the four Board Committees: The Budget and Administrative Affairs Committee; the Financial and Operations Policies Committee; the Board Steering Group (which coordinates the work of the two named committees and the Audit Committee). Beyond his years as a Board Director at the Bank, Mr Quattrociocchi has held management positions at the Italian Ministry of Economy and Finance – as Division Chief for IFIs and as Director General – and has worked as an official in the Executive Board of the IMF. In 2015, Enzo Quattrociocchi was awarded the highly esteemed honour of the Italian Decoration of “Grande Ufficiale, Order of the Stella d’ Italia” bestowed on him by the President of the Italian Republic for his services to the Italian Government over the past 20 years.
GAVIN RALSTON
*Head of Official Institutions and Thought Leadership Schroders*

Gavin’s role involves managing Schroders’ relationships with government institutions, including central banks, sovereign wealth funds and national pension funds. Gavin is also responsible for the production, coordination and distribution of the firm’s thought leadership material. He joined Schroders in 1980 and is based in London. Gavin was Head of Product at Schroders from 2008 to 2012, which involved responsibility for the overall Schroders Product Strategy. He was Head of Continental Europe and Middle East at Schroders from 2003 to 2008, a role which involved responsibility for sales teams in nine offices across Europe; setting strategy and priorities, managing the teams, and interacting with a large number of clients. Qualifications and memberships: MA in Classics from Oxford University; Associate Member of the UK Society of Investment Professionals.

CIRO RAPACCIUOLO
*Research Department, Confindustria (CSC)*

He is senior economist at the Confindustria Research Department, where he is responsible for the short-term analysis and economic forecasts area since 2018. His main topics are prices and margins; raw materials; monetary policy; government bonds and households’ wealth; banking system; credit, finance and interest rates. He participated in the construction of a quarterly forecast model of the Italian economy. He was a teaching assistant at the Luiss University of Rome, Federico II University of Naples, Pompeu Fabra University of Barcelona. He coordinates the chapter on forecasts in the reports of the CSC and the monthly publication Congiuntura Flash. He is the author of various scientific publications. He edited monographic chapters in the CSC reports and numerous Note dal CSC. He is the author of articles on Repubblica
and Corriere della Sera. He presented scientific papers at various Universities and research institutions. He is the author of numerous presentations at seminars of associations of Confindustria and other institutions. He received his PhD in Economics from the University Parthenope of Naples and a M.Phil from the Universitat Pompeu Fabra of Barcelona. He obtained a master's degree in Economics from the UPF and from the University Federico II of Naples, where he graduated.

BORIS SABAN
National Bureau of Montenegro Insurer

Boris Saban, 48 years old, is Executive Manager of National Bureau of Montenegro Insurers. He actively participated in the development of Montenegro insurance market and new Montenegro Insurance Law as a member of working groups. He is a member of the Management Committee of the Council of Bureaux in Brussels (international motor third party liability insurance organization) and participates in improvement of MTPL insurance system for better protection of traffic accident victims across Europe. He is experienced in and familiar with Montenegro insurance markets, current trends and estimated future developments. He previously worked in Lovcen Insurance Company Ltd in Podgorica and also in Lovcen-RE Ltd Podgorica at reinsurance of Transport and Aviation, from February 1996 to April 2007. He lived in London, from 1998 to 2001 where he worked and attended trainings of Insurance broker Company Kininmonth Lambert – Lambert Fenchurch, which later became Heath Lambert upon emerging of two companies. He graduated from the Faculty of Economics in Podgorica in December 1995 and obtained his Master degree at the University of North London, London UK in April 2002, Master of Business Administration (MBA). He is married and has two children.
GIANLUCA SALSECCI
Head of International Research Network Intesa Sanpaolo S.p.A.

Married with two children, Gianluca Salsecci graduated at the University of Florence in 1984 and got the Master’s in Economics and Political Science at the London School of Economics in 1986. He started his career in the Research Department of Istituto Mobiliare Italiano (IMI), now Intesa Sanpaolo (ISP) after the merge of Sanpaolo IMI with Banca Intesa. In 1992, he spent one year leave at the London Business School as Ph. D. Visiting Student in Finance. In Intesa Sanpaolo, he is currently in charge of the International Research Network within the Group’s Research Department. He is interested in topics of international economics and, in his areas of research, is speaker at events, occasionally lecturer, and author or co-author of publications. Among the most recent speeches, Gianluca Salsecci (2016), Deflationary risks and low/negative interest rates in the Euro Area. What are the drivers and the possible implications for banking? Speech at the Slovenian Banking Association, and among the most recent papers, Gianluca Salsecci et al. (2016), One Belt One Road Initiative: An Opportunity for the Western Balkans, International Research Network, ISP Research Department and Gianluca Salsecci et al. (2017) Eurasian Economic Union – European Union Relations: geo-political Developments and Trade Dynamics, Occasional Studies, ISP Research Department.

JULIO SUAREZ
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Boris Saban, 48 years old, is Executive Manager of National Bureau of Montenegro Insurers. He actively participated in the development of Montenegro insurance market and new Montenegro Insurance Law as a member of working groups. He is a member of the Management Committee of the Council of Bureaux in Brussels (international...
Federica Seganti is Programme Director of the master’s in insurance & Risk Management – MIRM – at the MIB Trieste School of Management. Her main teaching and research areas are Corporate Finance, Project Financing, Pensions and Risk Management. She is Lecturer of Banking & Insurance Techniques at University of Udine and member of Scientific Advisory Board of ANRA, Italian Association of Risk Manager, and Assiteca Award. Her main non-academic roles include independent non-executive director of Hera SpA, independent non-executive director and member of Internal Audit Board of Eurizon Capital Sgr SpA. She was commissioner of COVIP – the Italian pension funds supervisory authority and member of OPSG – Occupational Pensions Stakeholder Group of the European Insurance and Occupational Pensions Authority (EIOPA).
GORAN SVILANOVIĆ
Expert on SEE

Goran Svilanović is an expert on economic and political developments in South East Europe, working with different consultancies. He served as Secretary General of the Regional Cooperation Council (2013-2018). Between 2008 and 2012 he was Co-ordinator of the OSCE Economic and Environmental Activities (2008-2012). In November 2004, he became Chairman of Working Table I (democratization and human rights) of the Stability Pact for South Eastern Europe, where he served until the end of 2007. From 2000 to 2004, Mr Svilanović was Minister of Foreign Affairs of the Federal Republic of Yugoslavia/State Union of Serbia and Montenegro. Between 2000 and 2007, he was a Member of Parliament. With Ph.D. in Law, from the Union University in Belgrade, Masters and undergraduate law degrees from the University of Belgrade, Mr Svilanović has also studied at the Institute for Human Rights in Strasbourg, France, the University of Saarland in Germany, and the European University Center for Peace Studies in Staatschllaining, Austria.

IVAN TAKEV
CEO, Bulgarian Stock Exchange

Ivan Takev is CEO of the Bulgarian Stock Exchange. He joined its team in 2001 and was appointed as CEO in 2008. His entire experience is in the finance industry. Prior to joining Bulgarian Stock Exchange Ivan Takev held an expert position at the Bulgarian Financial Supervision Commission. In May 2012 he was appointed as a member of the management board of CD AD, the Central Securities Depository of Bulgaria. Since Jan 2016 he has been serving as Chair of the National Corporate Governance Commission of Bulgaria.
Dejan Tesic
Associate Partner, Western Balkans, BAC IP EAD (BAC Securities)

Dejan has over 25 years of experience in banking, ICT and international business. He held C-level executive positions in leading Serbian banks including Komercijalna Banka, Banca Intesa, AIK Banka and Piraeus Bank. Throughout his professional career, Dejan had led numerous projects aimed at implementation of state-of-the-art technologies in financial services industry. He had personally contributed to introduction of latest technologies in the area of online payments using International payment organizations such as Visa, MasterCard, American Express, many of those being first pioneer implementations in Balkans and CEE region. He used to serve as a MasterCard Central and Eastern Europe Board Member and High Growth Markets Customer Advisory Forum Member. Dejan also has extensive experience in banking sector restructuring in the region, being involved in several acquisitions and post-acquisition transformation processes. Moreover, he had been involved in numerous corporate and project finance transactions, led investor relations office in AIK Banka and was active in local capital market being a member of the governance bodies of Intesa Eurizon and Kombank Invest funds. Dejan holds PhD degree in business and managerial economics from Faculty for Business Studies and MSc degree in ICT Management from Faculty of Electrical Engineering in Belgrade. He had improved his knowledge through Executive Education at London Business School, Visa Bank Card Business School in Cambridge and postgraduate projects at Hong Kong University of Science and Technology.
MARCELLO TOPA  
**Director, Market Policy and Strategy at Citi – Markets and Securities Services**

Marcello Topa is responsible for Market Policy and Strategy within Citi’s EMEA Securities Services team. He covers Citi’s external representation in various European trade associations and regulatory fora in the securities post-trading industry (primarily as member of AFME’s “Post Trade Executive Committee” and as Chairman of EBF’s “Post Trade Working Group”). Marcello’s expertise at Citi spans over 25 years in multiple roles within Direct Custody and Clearing (sales, product management and risk management). He is member of the ECB’s “Advisory Group on Market Infrastructures for Securities and Collateral” (AMI-SeCo), member of the T2S “Harmonization Steering Group” (HSG) and of the Collateral Management Harmonization Task Force (CMH-TF), and chairman of the T2S “DCP Group” (DCPG). In March 2016 he was appointed by the European Commission as member of the “European Post-Trade Forum” (EPTF) and was among the four co-editors of the EPTF Report on post-trade barriers to efficient capital markets in Europe.

JIM TURNBULL  
**Associate Director Local Currency and Capital Markets Development (LC2), EBRD**

Jim Turnbull joined EBRD in 2011 and is the Senior Debt Capital Markets Advisor for the Local Currency and Capital Markets (LC2) Initiative. He co-ordinates team activities in Romania, Bulgaria, Greece, Cyprus, Turkey and the Balkans. Jim has over 30 years’ experience in investment banking, pensions and funds management covering debt and equity portfolios, foreign exchange, fixed income, derivatives and treasury management in both emerging and developed markets. He currently sits on the Board of the Depozitarul Central in Romania.
FRANCESCO VOCE
*Cyber Security Expert, Deloitte Risk Advisory Srl*

Francesca Voce is part of Deloitte Risk Advisory’s Security Services. Her main field of activity is the Public Sector and she is involved mainly on projects with Governments, Governmental Agencies and International Organizations. She has expertise in National Cyber Strategy, CIRT, Cyber Exercises and Cyber Legal Framework. Francesca graduated from the Sant’Anna School of Advanced Studies in Pisa and the University of Trento and is the author of a book and several publications related to...
cyber security. Before joining Deloitte, she worked in the staff of the Ambassador Giulio Terzi di Sant’Agata and at the Italian Permanent Mission to the OSCE in the first period of the Chairmanship.

RICK WATSON

Rick Watson is Managing Director and Head of Capital Markets, Events and Membership at AFME, the Association for Financial Markets in Europe. In his Capital Markets role, he leads staff whose member committees include all the main fixed income and equities-related cash products across Europe, AFME’s growth-related initiatives, as well as co-leads AFME’s investor and corporate relationships. In Events and Membership, he focuses on member outreach including AFME’s broad range of over 35 events which assists members and others with capital markets education, networking and support for advocacy. He is on AFME’s Senior Management Team. Previously, Mr. Watson was Managing Director, Structured Finance, for FGIC UK Limited. Prior to joining FGIC, Rick held positions as head of securitization origination at HSBC Bank plc and Bear Stearns in London, and before then worked at UBS Limited, Morgan Stanley and Freddie Mac. Mr Watson received an MBA from the Fuqua School of Business at Duke University. In September 2013 he was appointed to the EIOPA Insurance and Reinsurance Stakeholder Group and reappointed in 2016. In January 2006, he co-edited the Euromoney Books’ publication “Asset Securitization and Synthetic Structures: Innovation in the European Credit Markets”.

FABRIZIO ZERBINI
Chairman/President at Trieste Marine Terminal

Born in Lucca on March 20th, 1951. He is married, with one child. In the previous 50 years of work activity (still proceeding) he acted as: Master Mariner (navigational experience on various types of ships including container ships and passenger vessels); Operations Manager for Italian and Mediterranean Ports for major Shipping Lines; Terminal Manager of Voltri Terminal Europa and General Manager of Pra Distripark Europa (Sinport and PSA Group); formerly President and Managing Director of Trieste Marine Terminal, the container terminal of the Port of Trieste, and, currently, President; Managing Director of TO Delta Group (currently); President of The Propeller Club Port of Trieste and Vice President National Propeller Clubs (currently). Furthermore, he has solid experience in planning and construction of maritime ports and terminals; planning and managing of maritime Ports and Terminals, logistics, port and terminal equipment, warehouses and Distripark, intermodal/multimodal transports.
We would like to express our gratitude to Alessandra Szoldatics, Program Manager EMIF at MIB Trieste for her efforts and support throughout the organization of the Workshop. Thanks also to Radisav Puric and Caterina Crudeli, who strongly supported the organization of the Workshop from the FeBAF office in Rome and Brussels, Augusto Sisani, Giacomo Miele, Gerardo Coviello, Caterina De Giorgi, Giulio Sindaco e Sivia Darretta for their help in editing the final report from the FeBAF office in Brussels. Special greetings to Prof. Safet Kozarević for his strong motivation and assistance, in relation with the entire process of organization of the different contributions to the Trieste Conference and this volume.