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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
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Statement by the Hon. **LJUBE TRPESKI**,
Governor of the Fund for the **FORMER YUGOSLAV REPUBLIC OF MACEDONIA**,
at the Joint Annual Discussion

Statement by the Hon. Ljube Trpeski,
Governor of the Fund for the former Yugoslav Republic of Macedonia,
at the Joint Annual Discussion

Please allow me to extend my best regards to all of you in the new millennium, here in Prague, the host city of this year's millennium meeting of the International Monetary Fund and the World Bank. I hope that the beauty of Prague will be an additional motive for even more successful work at the Annual Meetings.

Since its independence, the Republic of Macedonia has implemented complex programs for macroeconomic stabilization, structural reforms and institutional reforms in order to create a stable, modern, efficient and market oriented economy. The reforms of the financial system, on which the level of development of the Macedonian economy depends to a large extent, are also an integral part of the overall reforms.

A sound, competitive banking system and effective institutional and regulatory frameworks are preconditions for mobilization of financial resources and efficient allocation of credits, for increased level of saving and investments, for creating optimum structure of interest rates, for efficient transmission of monetary signals and for low fiscal costs. All these have a positive influence on macroeconomic stability and the level of economic growth. Simultaneously, this is especially important for countries in transition and developing countries, in which the capital markets and financial markets in general, are insufficiently developed and do not provide for alternative financial instruments.

Basic preconditions for a sound and modern banking system are the existence of a sound macroeconomic framework, high quality internal corporate governance and appropriate economic infrastructure. With respect to the infrastructure, there are two important elements: an institutional framework that includes legal, administrative and political structures for managing economic and financial transactions and; financial markets structure, as an operative framework in which the banking institutions operate. The efficient banking is based on a legal system, which will facilitate the execution of the financial contracts, collection of credits and collection of the collateral. Banks must be in position to collect their due claims, which requires quality of bankruptcy procedures and adequate protection of ownership rights. On the other hand, it is also necessary to have an administrative structure, which will be able to apply the laws and provide correct and prompt court procedure when solving financial disputes.

Macedonian banking system has evolved from the banking system of former Yugoslavia. At the moment of gaining the monetary independence, the structure of the banking system of the Republic of Macedonia was classically oligopolistic, being dominated by two banks with a market share of 80 percent. The main function of banks' operations was set in a reversed manner - instead of having profit making as their main objective – their function was to support their main shareholders, which were simultaneously the largest debtors, i.e. borrowers. The derogation of the banks' main function and development of a "habit of non-settlement of liabilities", provoked deterioration in the banks' performances, reflected in large concentrations of non-performing loans in their credit portfolio (over 70 percent), overstaffing, high costs, poor geographic dispersion, dominance of debtors in the managing bodies, absence of credit policies and internal procedures, etc. The externally imposed problem of "freezing" the old foreign currency deposits, which remained with the Central Bank of Yugoslavia, diminished the confidence in the banking system, resulting in lower levels of saving and financial intermediation. Attempts of monetary authorities to break up the oligopolistic structure of the banking system through setting a very low minimum capital requirement in the first years after monetary independence, resulted only in the establishment of so-called "dwarf banks", which were not capable of challenging the dominance of the two largest Macedonian banks.

Developments in this area significantly improved this year. Namely, the sale of the largest and the only state-owned bank in the Republic of Macedonia - Stopanska Banka a.d. Skopje, to foreign investors, the sale of Kreditna Banka a.d. Skopje, also to a foreign investor, and the announcement of the sale of the third largest bank – Tutunska Banka a.d. Skopje, to investors from Germany and Slovenia, are undoubtedly large steps towards creating sound competition, as an integral part of the process of the banking system restructuring.

From the aspect of the system, the base for the so-called "second generation" reforms in the banking system is the new Banking Law, passed in July 2000. In the preparation of the new regulation, main intention was to achieve optimum balance between strict regulation of supervisory aspects and allowing a high degree of liberalization, which would enable competitiveness, capability and creativity of individual banking institutions to be fully shown. Passing this modern legal text summarizes the joint one-year efforts of the expert teams from the National Bank of the Republic of Macedonia and the Ministry of Finance, but also the experience and suggestions of distinguished foreign experts from the World Bank.

The new Banking Law has been prepared on the basis of the European Union Directives on Banking and insurance from the so-called "White Book" and the "Twenty-five Basle Principles for Effective Banking Supervision". Keeping in mind that the long-term objective of the Government of the Republic of Macedonia is to join the European Union, adjustments to regulations in the banking sector is a good beginning to this process. Preparing our new Law, we considered the Laws of the developed European countries, as well as the solutions in this area from several advanced economies in transition.

The main principles and changes imposed by the new Banking Law focus on several aspects, such as: more liberal procedure for bank licensing and acquisition of voting shares; higher degree of liberalization in numerous aspects of the law; strengthening of supervisory standards, which regulate current operations of banks; strengthening of corporate governance in banks and introduction of the so-called "four-eye principle"; strengthening of the operating procedures for banks' operations; defining more strict and more detailed corrective measures which the Central Bank is obliged to undertake against banks that do not act in compliance with the regulations; strengthening of the role and responsibilities of the Managing Board in the banks, etc.

Passing the new Banking Law, the sale of Stopanska Banka a.d. Skopje, the amendments in the regulations aimed at improving the financial discipline, as well as passing a new Law on Securities, which enable banks to operate in the capital market, are only part of the activities agreed to under the arrangement with the World Bank (FESAL II). aimed at restructuring of the financial sector and the enterprise sector. However, these massive projects do not suggest an end of the reforms. From an institutional aspect, the FESAL II arrangement assumes a major organizational change – in the National Bank of the Republic of Macedonia, and as an integral part of the Supervision Department, a separate Problem Bank Unit has been established. The task of this Unit is to monitor the operations of banks. In cases where the liquidity or solvency of a bank are jeopardized, and the bank meets the criteria which give it the status of a "problem bank", it will immediately become a subject of special monitoring and corrective measures will be taken against it.

Among other reform activities aimed toward improvement of the situation in the banking system, is the new Law on Foreign Exchange operations, which is expected to be passed by the end of 2000. This law will introduce a higher degree of liberalization in this area, while maintaining the necessary precaution. The last major reform project in the financial sphere, which will be implemented during this year and in the first half of 2001, are the reforms in the payment system. These reforms include the introduction of the "Real Time Gross Settlement System" (RTGS), where the commercial banks will play major role in the execution of payments. This will give the banks a better insight in the liquidity of their clients, which will improve the process of cash-flow management and will incur a sounder and more liquid banking system.