

Free Movement of Capital in Kosovo – Compliance with EU Criteria in the Light of Non-Contractual Relations

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Since the free movement of capital as one of the fundamental freedoms of the Internal Market of the EU is an important sphere of the financial integration process of Kosovo in the EU, its implementation in Kosovo will be presented in the light of Kosovo's non-contractual relationship with the EU. In this regard, the implementation of European standards in terms of ensuring this freedom by Kosovo will be treated through a brief background, an analysis of the EU Progress Reports related to Kosovo (from 2005 to 2013), through a presentation of peculiarities and similarities of Kosovo's financial system as compared to other countries, and through a presentation of the current legal position of Kosovo in terms of overall financial integration.

Keywords: free movement of capital, financial integration, financial system of Kosovo, non-contractual relation

1. Introduction

The historical aspect of financial integration in the European Union (EU), presents two important developing trends regarding this field: the first one is the establishment of the continuous cooperation of the EU member states with the purpose of expanding the basic freedoms of the internal market; and the second being the continuous effort of the aspiring EU integrated countries to harmonize their respective legislation with that of the EU. In this context free movement of capital in Kosovo belongs in the second trend, although an additional factor which is non-contractual relations needs to be considered as well.

In this paper, the definition and the judicial effect of the free movement of capital in the EU framework will be treated initially, then Kosovo's advance in the legal harmonization process in non-contractual relation conditions with the EU, the understanding of Kosovo's specific non-contractual relationship with the EU, the challenges, similarities, differences, advantages and disadvantages of Kosovo's financial system regarding the free movement of capital, and finally the Kosovo's current legal position in the financial integration field in general.

Based on the fact that there is a lack of specific research in this field, the research methodology can be considered 'imposed', since the reference material for this paper constitutes EU primary legislation (the treaties), European Court of Justice (ECJ) judgments, primary and secondary legislation of the country, and the Progress Reports of the European Commission for Kosovo. Apart from these, second hand sources have been taken into account as well, which in one form or another are related to the free movement of capital field (texts and works published in journals).

2. Definition and Judicial Effect of the Free Movement of Capital

From the perspective of European Union Law (EU Law), free movement of capital is to a large extent established by provisions in primary legislation and by the bylaws of the EU.¹ In particular, when considering the content of primary legislation, we start from the formulation that is defined by the Treaty on the Functioning of the European Union² (TFEU), where the content of free movement of capital has not undergone major changes in character from previous iterations. However, its content has been expanded with secondary legislation.³ In addition to that, ECJ has played and plays quite an important role in the regulation of the issues in this area, especially because of the fact that the decisions of this Court are considered as legal sources of EU law.⁴ It is important to note that the ECJ through a judgment in the case *Skatteverket v. A*, of 18 December 2007,⁵ has determined that the principle of free movement of capital shall have a direct effect.⁶ Since the treaties provide for the free movement of capital in general terms, secondary legislation plays a major role in the specification of the provisions of the treaties, thus becoming necessary legal acts.⁷ In addition to the Treaties and secondary legislation, a large role is played by the ECJ judgments in the application of the right of free movement of capital, because this eliminates all national restrictions regarding this right.⁸

Legal basis for the free movement of capital is determined by what is called the primary legislation and it was envisaged under the Treaty on the European Economic Community, which represented a move towards economic integration.⁹ Moreover, the free movement of capital, with roughly similar and generalized content is currently foreseen under the Lisbon Treaty.

Given the historical aspect, the free movement of capital through the founding treaties and its regulation was treated as an interim or transitional process which over time, would adapt and expand in line with European integration. Thus the concept of free movement of capital that was established with the Treaties was further specified with secondary legislation, namely EU directives and regulations, as they were drafted to enable implementation the respective articles of the EU treaties.

¹ In this case, primary legislation would be treaties such as founding treaties containing provisions on free movement of capital, and the Treaty of Lisbon, whereas secondary acts are regulations and EU directives dealing with treaties provisions on the free movement of capital.

² Treaty on the Functioning of the European Union, Art. 63 para. 1 and 2, (signed in Lisbon on 13 December 2007, and entered into force on 1 December 2009), OJ C 326/47.

³ This group of EU secondary legislation consists of acts that are ranked as follows: Regulations, Directives, and Decisions.

⁴ The EU Court of Justice as one of principal institutions responsible for the interpretation of the EU Law exercises its activity in the area of free movement of capital through decisions which are considered as sources of EU Law. An important example of this is the judgment in Case C-95/12, *Commission v. Germany*, <http://curia.europa.eu/jcms/upload/docs/application/pdf/2013-10/cp130138en.pdf> (20 March 2014).

⁵ Case C-101/05 *Skatteverket v. A*, judgment of 18 December 2007, http://ec.europa.eu/dgs/legal_service/arrets/05c101_en.pdf (21 March 2014).

⁶ Direct effect means that member countries need not introduce legal acts dedicated to this area, but shall directly enforce EU Law provisions.

⁷ The first group of this secondary legal acts includes: Directive 88/361/EEC, especially Ann. I; Council Regulation (EC) No. 332/2002; Council Regulation (EEC) No. 397/1975/EEC; Council Regulation (EEC) No. 682/1981; Council Regulation (EEC) No. 1969/1988; Regulation (EC) No. 1889/2005.

⁸ Tim Connor, "Market Access" or Bust? *Positioning the Principle within the Jurisprudence of Goods, Persons, Services, and Capital*, Vol. 13, No. 06, 2012, pp. 679-756,

<http://www.germanlawjournal.com/index.php?pageID=11&artID=1437> (5 February 2015).

⁹ Paul Craig & Grainne De Burca, *EU Law, Text, Cases and Materials*, 4th ed., Oxford University Press, Oxford 2008, p. 6.

In terms of formulation, the definition of free movement of capital through the treaties and its materialization via secondary legislation has not undergone any significant changes from the earlier ones; however the transformation lies in the expansion of the content of this freedom.

In addition to the facts mentioned above, it is very important to note that the Accession Agreements have significant impact in terms of regulating the area of free movement of capital. As such, they effected the free movement of capital with their provisions on the constraints, respectively the exemptions from the application of some areas of EU Law in the newly acceded countries, thus causing serious difficulties in the functioning of the EU internal market. It should also be noted that in the cases where the free movement of capital regarding third countries presents difficulties in the operation of the Economic Monetary Union, the European Council, by a proposal from the European Commission, and in consultation with the European Central Bank, may take protective measures against those third countries for a maximum duration of 6 months.¹⁰

Free movement of capital, as one of the fundamental freedoms of the EU internal market, as defined in general terms under the Treaty on the Functioning of the European Union, implies the ban or removal of all restrictions on the free movement of capital, and all restrictions over payments between EU Member States, and between EU Member States and third countries.¹¹ The EU internal market as an agreement between the member states was created for the elimination of restrictions for the purpose of enabling free movement of services, people, goods and capital, including competition.¹²

Based on the above and taking into account the hierarchy of legal acts under the EU framework, it can be concluded that the predictability of the free movement of capital presents a general and direct obligation, both for the Member States and third countries aspiring to be part of the EU.¹³

3. Non-Contractual Relations: Kosovo's Case

The Stabilization Association Process (SAP) as a political framework for the Western Balkans¹⁴ through the European integration process of the countries of this region aims to stabilize regional cooperation and establish a European prospect. This process began in the year 1999 and was addressed specifically to the Western Balkans. It will be considered concluded with the accession of these countries in the EU. The relationship between the EU and these countries, until the legal definition phase between the bilateral agreements with the EU, in a theoretical aspect is considered to be non-contractual. In this context we can say that the non-contractual character of these relations between the EU and the Western Balkan countries is considered as such until the Stabilization and Association Agreement (SAA) is signed. These agreements are signed on a specific stage of development, between the EU and an aspiring EU country thus noting the end of the non-contractual relations. The content of these agreements includes the

¹⁰ Op. cit. (note 2).

¹¹ Ibid., Art. 63, p. 71.

¹² Elspeth Barry & Mathew J. Homewood & Barbara Bogusz, *EU Law: Text, Cases, and Materials*, Oxford University Press, Oxford 2013, p. 339.

¹³ General and direct obligation of provisions dedicated to free movement of capital are a result not only of prescription of this freedom under the Treaties but also the judgment of the EU Court of Justice in the *Case C-101/05 Skatteverket v A*.

¹⁴ This group consists of: Kosovo, Albania, Montenegro, Serbia, FYRO Macedonia and Bosnia and Herzegovina.

commitment of the aspiring countries to fulfill the formal criteria necessary for accession,¹⁵ but in a stricter and time frame defined format.

In Kosovo's context, the non-contractual relations lasted longer than in other countries, because of the specifics that characterized Kosovo in this process, whether they were political, economic or legal. Since the non-contractual relations are neither a legal category even from Kosovo's perspective nor that of the EU; they are treated in this paper in a more theoretical manner, and is done for the following reasons:

- to show the EU's commitment to including Kosovo in the SAP since its launch (albeit in very specific circumstances)
- to show Kosovo's commitment to tackling the challenges of EU integration process,
- to show that the progress of Kosovo in this process is in non-mandatory circumstances, and
- to show the readiness of the EU and Kosovo to sign the SAA, by transforming these relations into taking a contractual character.

Apart from this, the treatment of non-contractual relationship in this case serves, not only a strict separation between the contractual relationship, but also as a way to show the obligations that are given by the EU in the preceding stages up to the SAA and after it as well. Consequently, the obligations that the EU undertakes by signing the SAA, indirectly oblige Kosovo to fulfill the challenges that arise from the integration process, even though the relations are of a non-contractual nature. Whereas the obligations that the EU and Kosovo undertake after signing the SAA are mutual and as such unavoidable to fulfill, and their evaluation of fulfillment is more rigorous.

Based on what was said above, while alluding to the theoretical aspect based on the factual circumstances, the non-contractual character of the relationship between Kosovo and the EU is much more evident when compared with other countries that are part of the SAP. This situation exists for two reasons:

- first, because of the longer time Kosovo has passed before agreeing to the SAA compared to other countries, and
- second, because of the specifics¹⁶ that Kosovo has had in this process.

Finally, the consideration of the non-contractual relations and their transfer into contractual relations serves as a valuable indicator for the progress that Kosovo has shown in the European integration process on one side and the recognition of this progress by the EU.

4. Kosovo's Characteristics Related to Free Movement of Capital

Given the basic meaning of the free movement of capital (as defined by the Treaty on the Functioning of the European Union)¹⁷ and its components,¹⁸ it can be easily established that the financial system of the

¹⁵Accession Criteria (Copenhagen criteria): http://europa.eu/legislation_summaries/glossary/accession_criteria_copenhagen_en.htm (4 April 2014).

¹⁶ Specifically, because of the undefined status until 2008 (being under the UN interim administration) and the lack of recognition of Kosovo's independence by 5 EU member states.

¹⁷ Treaty on the Functioning of the European Union, Part III, Title IV, Chapter 4: Capital and Payments –Art. 63 (e.g. Art. 56 TEC), OJ C 326/47.

¹⁸ As a component of free movement of capital is the nomenclature prescribed in Ann. 1 of EU Directive 88/361/EEC.

Republic of Kosovo¹⁹ has some unique characteristics which differentiate it from the other countries in the region,²⁰ but they are not very significant. As a new financial system that was established from scratch, it includes similarities and differences in comparison to others, and at the same time highlights some advantages and disadvantages compared to others as well. Some of the specificities which need to be emphasized regarding the financial system of Kosovo are: a) the establishment of the system from scratch 15 years ago (because of the war/conflict between Kosovo and Serbia that concluded in 1999 and left Kosovo to rebuild its financial system); b) the functioning of this system on basic-traditional financial services; c) a system which encompasses all licensed financial institutions which are regulated and supervised by a single authority;²¹ d) the changes to the primary and secondary legal framework during this period, i.e. since establishment in 1999 to date; e) the structure of capital which is dominated by foreign capital; f) the payment system and a credit registry²² which is managed and maintained by the Central Bank of the Republic of Kosovo (CBK); and g) the small financial system with limited international exposure.

Besides these specifics, the financial system of the Republic of Kosovo also has similarities with other financial systems, compared to the others in the region, which can be summarized in terms of general features concerning: a) the level of development, which means that the challenges that Kosovo's financial system faces are roughly the same, with some exceptions (the efficient functioning of the system, the expanding span of financial services, capacity development, etc.); b) harmonization of financial legislation with EU respective acts presents one of the important similarities of Kosovo's financial system with those of other countries in the region for two reasons: the first, after these countries are faced with the process of incorporating EU legislation into their own national legislation, and the second after EU legislation undergoes changes, especially after the financial crisis of 2008, challenges these countries with harmonization of same financial legislation at the same time, and c) the role of supervisory and regulatory authorities related to free movement of capital also presents a similarity since the regulatory authorities of the financial system of these countries are responsible for fulfilling the challenges of a regulatory and supervisory character regarding the free movement of capital that arise from the EU integration process.

Specifics and similarities of the financial system of Kosovo mentioned above, if compared with those of member countries of the EU, do not necessarily imply that they can be treated as distinct or similar, as can be done in addressing specifics or similarities with those of the region. Therefore, similarities of the financial system of the Republic of Kosovo with those of any EU member country may be difficult to find or are not present at all, especially in terms of development and legislation, whereas similarities can be found in a comparison of the financial system of Kosovo with the countries in the region.

¹⁹ Kosovo, since 1999, until 2008 when it declared its independence was under UN Interim Administration based on the UN Security Council Resolution 1244. The Republic of Kosovo currently is recognized by over 100 UN member countries, 23 of which are EU member states. Apart from that, the International Court of Justice has confirmed Kosovo's unilateral declaration of independence by the Advisory Opinion of 22 July 2010 that it is not in opposition to International Law. For the purposes of this paper, the term Kosovo will be used for the period preceding 2008, while the term Republic of Kosovo will be used when referring to the period after the declaration of independence (i.e. after 17 February 2008).

²⁰ Albania, Serbia, Montenegro, Former Yugoslav Republic of Macedonia (Candidate countries) and Bosnia and Herzegovina (Potential candidate countries together with Kosovo).

²¹ All financial institutions in the Republic of Kosovo are licensed/registered, regulated and supervised by the Central Bank of Kosovo.

²² The purpose of the Credit Registry is collection and dissemination of positive and negative information on physical and legal persons, for the purpose of improving the evaluation process for client creditors and enforcing the supervisory function of the Central Bank.

5. Advantages and Disadvantages Compared to the Region and the EU

Based on specifics and similarities of the financial system of the Republic of Kosovo in comparison to the countries in the region and the EU countries, several advantages and disadvantages may be identified:

- As a system built from scratch, during the drafting of legislation in this area standards and international best practices were used, adapting them to the needs of establishing the system and then in the development of this system, without being influenced by the earlier system (tradition)²³ and the non-existence of publicly owned financial institutions (such as Bosnia and Herzegovina, Albania, Serbia, Montenegro, etc.);
- As a system which is regulated and overseen by a single authority, it implies a lower cost to the country, by avoiding the establishment of separate supervisory authorities for different sectors of the system (banking, insurance, pensions, etc.) something that differentiates the Republic of Kosovo from Albania, Bosnia and Herzegovina, Montenegro, Macedonia which have established separate supervisory authorities for their separate financial system sectors;
- As a small system in terms of volume of products and institutions, and with minimum international exposure, it highlights two principal facets: a) on one hand, it has been proved as positive phenomenon especially during times of crisis and financial turbulence, such as the recent international financial crisis, b) on the other hand, lack of international exposure reflects the level of development of the system.
- As a system dominated by foreign capital, it demonstrates continuous stability and sustainability;²⁴
- With a unique system of payments and a unique credit registry, the country's financial system represents a quality of economies respectively small financial systems, under ongoing development;
- As a system faced with frequent changes and transformations of primary legislation and secondary legislation respectively, it reflects in itself the development character of the system over the years since its establishment, and at the same time presents difficulties both from the regulatory aspect for the CBK, and also difficulties with which constituent institutions of the system were faced.

6. Challenges and Progress in Complying with EU Criteria

In order to give a clear picture of the financial system of the Republic of Kosovo in relation to the free movement of capital, we need to adopt a generalized analytical overview of the EU Progress Reports for Kosovo,²⁵ with focus on the economic criteria part, and especially the free movement of capital.

²³ This fact is mentioned since in several cases (countries), "legal tradition" is claimed as one factor slowing down the process of harmonizing the legislation. This as a result that certain legislation creates a certain related system, where legislative changes imply changes in a respective system, where the latter is manifested as a resistance factor against the harmonization of legislation.

²⁴ Banka Qendrore e Republikës së Kosovës, *Raporti i Stabilitetit Financiar*, Nr. 06, dhjetor 2014, pp. 26, 29, 75, 77, 81; http://www.bqk-kos.org/repository/docs/2015/BQK%202014_FSR%206_shqip.pdf (5 February 2015).

²⁵ Progress Reports for Kosovo are assessment reports prepared by the European Commission which measure the annual progress achieved in Kosovo. Progress assessment is done against fulfillment of Copenhagen criteria, as formal criteria for membership in the European Union. This assessment document for Kosovo is published since 2005.

Below are some of the most important challenges that have accompanied the financial system of Kosovo, as identified by the EU Progress Reports for Kosovo throughout the years, from the early years up to 2013):

- In 2005, Kosovo Progress Report highlights that Kosovo currently has no specific legislation covering the area of free movement of capital, and that free movement of capital in and out of Kosovo is completely unregulated.²⁶
- Progress Report for 2006 highlights that the free movement of financial capital into and out of Kosovo remains unregulated, and that the use of Serbian dinar as a currency more than Euros in making payments in Serbian enclaves in northern Kosovo, represents a serious obstacle to the free movement of capital and hinders the BPK²⁷ role in these areas²⁸.
- 2007 Progress Report for Kosovo highlights that overall there is very little progress that can be reported in this area²⁹.
- Progress Report for 2008 highlights that in general progress has been made in the area of free movement of capital, being partially harmonized with European standards, also there has been some progress in building the necessary administrative capacities, however substantial actions need to be taken with respect to legislation and capacity building for implementation, and that no meaningful progress has been made in the payments system³⁰.
- 2009 Progress Report for Kosovo concluded that limited progress had been made in terms of free movement of capital, but Kosovo currently did not differ in the treatment of foreign financial actors in relation to domestic ones. In general, the regime for the free movement of capital was very liberal; however, EU compliant financial legislation needed to be drafted.³¹
- In 2010, Progress Report noted that the system of free movement of capital is very liberal, but it is necessary to continue with the gradual harmonization with requirements of Basel II³² standards, and harmonization of legislation with the EU framework with respect to the area of movement of capital³³.
- In terms of free movement of capital, 2011 Progress Report noted that the system for free movement of capital is quite liberal; however, reforms are needed in order to implement the Basel standards and draft legislation also consistent with EU standards; it also notes that the capacity of the CBK to supervise the financial system is adequate³⁴.

²⁶ European Commission, *Kosovo (under UNSCR 1244/99) 2005 Progress Report [COM 2005]*, (Part 3, 3.1. Internal Market; 3.1.3 Free movement of Capital), p. 40.

²⁷ BPK-Banking and Payment Authority of Kosovo, means the supervisory and regulatory authority of the financial system in Kosovo at that time, respectively the predecessor institution of the Central Bank of Republic of Kosovo.

²⁸ *Kosovo (under UNSCR 1244/99) 2006 Progress Report [SEC 2006]*, (Part 4 European Standards, 4.1.3 Free movement of Capital), p. 25

²⁹ *Kosovo (under UNSCR 1244/99) 2007 Progress Report [SEC 2007]*, (Part 4 European Standards, 4.1. Internal Market, 4.1.3 Free movement of Capital), p. 31.

³⁰ *Kosovo (under UNSCR 1244/99) 2008 Progress Report [SEC 2008]*, (Part 3 European Standards, 3.1. Internal Market, 3.1.3 Free movement of Capital), p. 40.

³¹ *Kosovo (under UNSCR 1244/99) 2009 Progress Report [SEC 2009]*, (Part 4 European Standards, 4.1. Internal Market, 4.1.3 Free movement of Capital), pp. 28-29.

³² Basel II means a framework of international standards for efficient bank supervision, as developed by the Basel Committee on banking supervision of the Bank on International Settlement (BIS).

³³ *Kosovo 2010 Progress Report [SEC 2010]*, (Part 3 European Standards, 3.1. Internal Market, 3.1.3 Free movement of Capital), p. 30.

³⁴ *Kosovo 2011 Progress Report [SEC 2011]*, (Part 4 European Standards, 4.1. Internal Market, 4.1.3 Free movement of Capital), pp. 34-35.

- In 2012, it was recorded that Kosovo has a financial system dominated by a liberal regime on the free movement of capital, including foreign direct investment, whereas efforts to obtain access to the SWIFT³⁵ system have not yielded results; it has an embryonic system of capital market and to fulfill its requirements arising from the SAA (i.e. for the future) it needs to harmonize its legislation with EU standards as regards free movement of capital and payments system.³⁶
- 2013 Progress Report for Kosovo notes the following: that Kosovo uses the Euro as its official currency, however the CBK has limited instruments of monetary policy, albeit important steps have been taken to preserve the financial stability but there is ample space for improvements, secondary legislation should be reviewed, and faster progress has to be made towards risk-based approach.³⁷

Based on these progress reports of the European Commission, it has been noted that until 2005 when the first progress report was published for Kosovo, there was no progress. That does not mean that this area was completely unregulated, as mentioned in the progress report for 2005.

An analytical overview of the progress reports on Kosovo from 2005 to 2013 suggests that in the beginning challenges highlighted in these reports resembled more to findings of an assessment or audit report than challenges per se. Since initially it became evident that there was a lack of both the legislation and administrative capacities dedicated to free movement of capital. Over time, the relevant legislation for the financial system of the country was gradually introduced, and in that legislation a specific part is devoted to the free movement of capital. This is evidenced by the findings of Progress Reports starting from 2008 onwards, when challenges related directly to the free movement of capital were being identified, and at the same time measuring of the progress in addressing those challenges was initiated.

Based on the Progress Reports, we found that many of them are phrased generally and not specifically, therefore leading to room for interpretation regarding whether or not Kosovo's challenges were met.

An important aspect that needs to be noted is the instances in the progress reports that identified challenges which have been directly linked to supranational political aspects. Typical examples include the efforts to join the Green Card System and SWIFT, where these processes require being a member of United Nations, however it should be mentioned that these instances were not very significant.

From the above, it can be concluded as follows:

- The financial system of Kosovo has addressed the issue of free movement of capital from the beginning, but the institutional and legislative aspects were introduced from 2005,³⁸ because as mentioned earlier, this system was built from scratch;
- Since 2005, the progress in this area, both in terms of institutional capacity building and legislative capacity building is a subject of assessment by the Progress Reports of the European Commission for Kosovo;

³⁵ Society for Worldwide Interbank Financial Telecommunication (SWIFT), to which the Central Bank of Republic of Kosovo has obtained access in December of 2013.

³⁶ *Communication from the Commission to the European Parliament and the Council on a Feasibility Study for Stabilization and Association Agreement between European Union and Kosovo [SEC 2012]*, (part 3 Ability to assume the obligation from an SSA, 3.4 Movement of workers, establishment of services and capital), p. 24.

³⁷ *Kosovo 2013 Progress Report on Kosovo [SWD 2013]*, part 3 Economic Criteria, pp. 21-26, and part 4 European Standards, 4.1 Internal Market, pp. 27-30.

³⁸ The first Progress Report for Kosovo was published in 2005, which marks the key moment when free movement of capital is addressed institutionally and is regulated with legal acts, expressively or indirectly.

- In the first years of operation of the country's financial system, the priority was given to basic legislation in order to set the foundations, namely the framework for building a stable and sustainable system, to be followed later by secondary legislation in order to make it a more dynamic and efficient system;
- After the installation of the legal infrastructure and administrative capacity building related to the country's financial system, there is a further need for the advancement and development of this system both in terms of legal coverage, as well as the expansion of services and financial products to the country;
- The above-mentioned need resulted in a dynamic process of transformation and enrichment of legislation, and its harmonization with EU standards, especially after the Declaration of Independence on 17 February 2008;
- The process of developing this system and the development of legal infrastructure was followed by dynamic efforts to harmonize the legislation and a more focused assessment by the EU for the purpose of meeting the challenges arising in connection with the free movement of capital and payment system.
- Currently, the financial system of the Republic of Kosovo lies in a stage of development where it has completed its legal infrastructure to a large extent, although for certain areas there are ongoing efforts for the review, drafting, and amendments to both primary and secondary legislation, always harmonized with the EU legislation.
- Currently, no provision in the applicable domestic legislation related to the financial system provides any hindrance or restriction regarding the free movement of capital and payments.³⁹
- Finally, it is worth mentioning that last year,⁴⁰ the Republic of Kosovo initiated the process of negotiations for the SAA with the EU, where titles IV, V, VIII, and IX of the draft of this Agreement are dedicated to free movement of capital and payments. In January 2014, negotiations were concluded on the above-mentioned chapters between Kosovo⁴¹ and the EU, and the SAA was initialed in Summer 2014⁴².

All the foregoing conclusions represent a statewide activity, which viewed from the standpoint of relations between Kosovo and the EU, represents the harmonization of Kosovo with the terms and conditions of the EU under the spirit of non-contractual relations as the SAA between Kosovo and the EU has not yet been signed. It is this Agreement which will determine the contractual relations between Kosovo and the EU⁴³. In addition, it means that Kosovo's approach to integration processes indicates the

³⁹ Following are the legal acts that directly or indirectly regulate matters related to the area of free movement of capital: Constitution of the Republic of Kosovo, which promotes the market economy as a value (section 7) and determines that the free market economy and competitiveness shall be a foundation for the economic regulation in Kosovo (section 10), Legislation on banks, insurance, pensions, financial institutions and non-banking financial institutions, including regulations and instructions issued by the Central Bank of the Republic of Kosovo.

⁴⁰ In December 2013.

⁴¹ This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

⁴² Source: Kosovo Ministry of European Integration, <http://www.mei-ks.net/?page=2,5,1011>, (2 February 2015).

⁴³ This reality could be considered because of "political" circumstances since at the time when European prospect for the Western Balkans was opened in 1999, and later on confirmed in the Thessaloniki Summit in 2003 and until 2008, Kosovo was still under interim international administration under the Organization of the United Nations. UNMIK. This has enabled Kosovo to gain access to the Stabilization and Association Process through a specific EU mechanism known as STM, in force until 2010. As of 2010, the STM is advanced to the Stabilization and Association Process Dialogue, also as a specific mechanism of the EU for Kosovo, as a result of some other different political circumstances such as the non-recognition of Kosovo by the five EU member countries (Greece, Spain, Cyprus, Slovakia, and Romania). Both these mechanisms represent a dialogue framework between Kosovo and the EU in order to meet the challenges in the European integration process, however, this is

seriousness and the only alternative, therefore even in the non-contractual relations with the EU, a similar approach is adopted as in other countries of the Western Balkans (Albania, Bosnia and Herzegovina, Macedonia, Kosovo, Serbia). With a special focus, such progress achieved in the area of financial integration is evidenced by the presence of foreign financial actors in the financial system of the country, as well as the level of foreign capital, mainly from EU countries.⁴⁴

7. Current Judicial/Real Position of Kosovo in Area of Overall Financial Integration

Based on the facts and circumstances presented so far, in this section we will attempt to present a comprehensive overview, with the purpose of presenting the current legal status of Kosovo in relation to the overall process of financial integration.

Considering the fact that the EU membership prospect of Kosovo began immediately after the war in Kosovo, namely in 2003, when such a possibility has generally become available for all countries in the region known as the Western Balkans, the Kosovo case is marked by a distinctive set of features compared to others. Those distinctive features of Kosovo in this process were of a political character, as described below:

- Starting with the Interim International Administration of Kosovo for approximately 9 years, where the EU's solutions for the inclusion of Kosovo in the process of European integration were characterized by the installation of mechanisms specific to Kosovo, such as the Stabilization and Association Process Tracking Mechanism (STM), followed by the Stabilization and Association Process Dialogue (SAPD).⁴⁵
- Declaration of Independence has changed Kosovo's approach to this process. However, in legal terms with respect to the relationship with the EU, not much progress has been made. This is because of the five EU Member Countries⁴⁶ that have not yet recognized Kosovo. As a result, until 2010, *i.e.* even after the declaration of independence, the representation of the country in the integration processes was made possible through the STM, a body that is separate and established since the time when Kosovo was under interim international administration.
- SAPD marks a very important moment in the process of European integration for Kosovo, as this mechanism represents an advanced transformation of the prior mechanism (STM) of the EU for Kosovo. Therefore, the SAPD comes as a result of meeting the challenges by Kosovo in the

not a contractual relationship in the legal aspect. In 2012, the Feasibility Study on the SAA between Kosovo and the EU was conducted, which was positive, thus resulting in the initiation of negotiations in December 2013 between Kosovo and the EU on SAA. Currently, negotiations on the SAA are concluded and the Agreement was initialed in Sumer 2014. Source: Kosovo Ministry of European Integration <http://www.mei-ks.net/?page=2,5,1011>, (5 February 2015).

⁴⁴ Source: Periodic and annual reports of the Central Bank of Kosovo, especially from 2008 to 2014, available at www.bqk-kos.org.

⁴⁵ These specific mechanisms for Kosovo represent a dialogue framework between the latter and EU. The Stabilization and Association Process Tracking Mechanism was established to enable Kosovo access to the Stabilization and Association Process as a framework for dialogue for the Western Balkans, since until 2008 Kosovo was still under UN interim administration. Even following the declaration of independence of Kosovo (17 February 2008), the same mechanism (STM) was in force until 2010, and at that time it was replaced by the more advanced follow on mechanism, the Stabilization and Association Process Dialogue (SAPD). Source: Kosovo Ministry of European Integration, <http://www.mei-ks.net/?page=2,78>, (5 February 2015).

⁴⁶ As of April 2014, EU member countries that have not recognized the Republic of Kosovo are: Greece, Spain, Cyprus, Slovakia and Romania.

process of European integration. However, in no way it can be concluded that this specific mechanism specially established for Kosovo was not a reflection of the acknowledgment and recognition of the reality created in Kosovo after the declaration of independence, or may be otherwise defined as a typical “political response” of the EU in relation to Kosovo.⁴⁷ In one form or another, it was formally confirmed that the STM should be transformed into a SAPD since Kosovo has made the necessary progress in the European integration process, and it was now necessary to move to a more advanced stage of relations between Kosovo and the EU, albeit still not on a contractual basis. Viewed from the standpoint of the content of these mechanisms, the transition from STM to SAPD has to do more with legitimizing the recognition of Kosovo's progress by the EU rather than a substantial change in terms of its functioning and content. Further it implies a significant reaction of the EU, which certainly provides a stronger legal position to the whole process of integration, and paves the way for further advancement of our country towards EU. Regardless of the advancement of the Republic of Kosovo in the process, such relationship did not take a contractual character even under the new mechanism, respectively the SAPD.

- The negotiation of the SAA marks the most important phase for the Republic of Kosovo in the process of European integration, since entering into such an arrangement with the EU is legally based on the provisions of the Lisbon Treaty.⁴⁸ This is because the country enters into a more dynamic and detailed phase in the realization of its aspiration to join the EU. The initiation of this process is based on the progress made by Kosovo in the process and is made possible under the umbrella of a “tacit consensus” of all EU member countries in light of the fact that Kosovo is not recognized by five of twenty-eight member countries of the EU.

The paper will now present the current legal position of Kosovo in light of financial integration, where one of the key factors is the primary and secondary legislation for the financial sector, the above mentioned EU mechanisms for Kosovo and the process of negotiating the SAA, and the draft SAA itself. The process of European integration can also be divided into integral parts, principally for study or evaluation purposes. Related to this, the process of financial integration shall be assessed in light of Kosovo's path in this process and the assessment will come as a result of a separation of financial integration part from the European integration as a whole. Financial integration is primarily a market-driven process,⁴⁹ which means that its establishment is impossible to realize in one country or one single country in isolation, simultaneously its development enables the development of other financial actors of other countries that are an indirect indicator of the degree of financial integration. For the importance of financial integration in particular for the national legal harmonization that is linked to the internal market of the EU, Ralph H. Folsom considers it critical for the advancement of the EU integration.⁵⁰ Financial integration should also be distinguished from economic integration which, according to Encyclopedia Britannica is defined as: “The process in which two or more states define a specific geographic area in

⁴⁷ It is considered a typical political reaction since the new reality created in Kosovo following the declaration of independence necessitated actions of such character by the EU for the following reasons: acknowledgment of Kosovo's progress in the integration process and acknowledgement of the new reality in Kosovo. These two main reasons are followed by interesting purposes by the EU by creating a political balance for member countries not recognizing Kosovo and creating the necessary conditions for the much needed consensus for contractual relations between EU and Kosovo.

⁴⁸ Treaty on the Functioning of the European Union, Art. 217, OJ C 326/47.

⁴⁹ Klaus Liebscher, Josef Christl, Peter Mooslechner & Doris Ritzberger-Grünwald, eds., *Financial Development, Integration and Stability: Evidence from Central and South-Eastern Europe*, Edward Elgar Publishing: Cheltenham U.K. 2006, p. 48.

⁵⁰ Ralph H. Folsom, *Principles of the European Union Law*, 2nd ed., St. Paul, MN: Thomson/West 2009, p. 67.

order to limit trade barriers to protect certain economic purposes.”⁵¹ Looking at the process of European integration for Kosovo since the beginning, without repeating the circumstances of political character, we can draw some conclusions which are relevant for the current position of Kosovo in view of financial integration. These findings are:

- The process of financial integration of the country is initiated by the opening of the European prospect for Kosovo in 2003, but its formalization in fact is done by the publication of first Progress Report for Kosovo in 2005.⁵² Through this report, which as we said earlier assesses progress in Kosovo on the basis of meeting the criteria for EU accession known as Copenhagen criteria,⁵³ where among others a part of this report assesses the progress towards financial integration;
- Progress of the Republic of Kosovo in the process is assessed based on incorporation of European standards into national legislation and on the basis of the overall development of the country's financial system. As a result of meeting the challenges in the process of financial integration, it is interesting to note the findings of Progress Report for Kosovo for 2005, quote “Currently there is no provision dedicated to free movement of capital, and free movement of capital in and outside Kosovo is completely unregulated”, whereas subsequent progress reports in general terms note, quote “progress has been made but there is still room for improvement.” What does this comparison imply? Nothing more or less than a very meaningful overview which demonstrates the willingness of Kosovo despite non-contractual relations with the EU, to take all the necessary steps to harmonize legislation and meet the financial challenges as identified in evaluation reports of the EU.
- Starting from a general principle that economic processes precede legal ones, we can say that the advancement and progress of Kosovo in economic integration and in particular financial integration have indirectly facilitated progress in other areas that are subject to achievement and evaluation based on meeting the Copenhagen criteria. This means that progress in meeting the challenges of the financial sphere in particular has contributed to improving the current legal position of the Republic of Kosovo in the integration processes in general.
- Harmonization of financial legislation of the Republic of Kosovo with that of the EU did not develop spontaneously and unilaterally but only on the willingness and actions of Kosovo. This is best illustrated by the installation of a special mechanism only for Kosovo (STM and SAPD) and evaluation reports of the EU for Kosovo, through which the harmonization of legislation is measured and supported.
- Feasibility Study for the Stabilization and Association Agreement between Kosovo and the EU,⁵⁴ directly led to the change in the legal position of the Republic of Kosovo in the integration

⁵¹Encyclopedia Britannica, *Economic Integration*,

<http://www.britannica.com/EBchecked/topic/178433/economic-integration>, (5 March 2015).

⁵² European Commission, *Kosovo (under UNSCR 1244/99) 2005 Progress Report [COM 2005]*, http://ec.europa.eu/enlargement/archives/pdf/key_documents/2005/package/sec_1423_final_progress_report_ks_en.pdf, (3 March 2014).

⁵³ The Copenhagen criteria are formal criteria for EU accession, as determined by the European Council in Copenhagen in 1993. These criteria include the economic, political and legal criteria.

⁵⁴ *Communication from the Commission to the European Parliament and the Council on a Feasibility Study for Stabilization and Association Agreement between European Union and Kosovo [SEC 2012]*.

This study assesses whether Kosovo is ready to negotiate and subsequently can implement a Stabilization and Association Agreement and identifies priority issues to be addressed before negotiations can start and priority areas that Kosovo would need to address to be able to meet its obligations under a Stabilization and Association Agreement.

processes in general, and in financial integration in particular. This is because the Republic of Kosovo has now entered into a new phase of relations with the EU resembling relations that the EU has with other countries as part of the SAP. Therefore, it has entered a stage when the attribute of being in “special relations” due to political circumstances, is gradually transformed into “contractual relations” between Kosovo⁵⁵ and the EU, which will eventually happen with entry into force of the SAA.

Given the above findings, it is very important to note that Kosovo is currently a member of major international financial institutions / organizations such as International Monetary Fund, the World Bank Group (WB), and the European Bank for Reconstruction and Development (EBRD). This form of international financial integration implies an important part of the undeniable progress in financial integration of the Republic of Kosovo in the EU.

Another interesting argument that demonstrates the commitment of the Republic of Kosovo to financial integration is the publication of monetary statistics in the publication of International Financial Statistics of the IMF (IFS)⁵⁶ just weeks after joining the IMF.

The overall conclusion of the current legal position of the Republic of Kosovo in the field of financial integration may be summarized as follows: the Republic of Kosovo as a full member of the IMF, the WB and EBRD, may be considered integrated into the international financial system. In addition to that, as a country with clear a European Union prospect, it is now in one of the most important development stages to date, in setting and meeting the challenges of the (regional) financial integration in the EU, which is of a different size and format⁵⁷ from international financial integration. Financial legislation of the Republic of Kosovo as stated in other parts of this paper is extremely advanced and is being harmonized with international principles and standards, and EU directives. This legislation does not contain restrictive or discriminatory provisions in the treatment of foreign capital against domestic capital. Financial institutions in the country have reached such a level of development that enables them to cope without any difficulties with any legislative changes as a result of the incorporation of EU directives and international standards. Finally, the CBK as a supervisory and regulatory authority has achieved the necessary capabilities that enable it to introduce secondary legislation to harmonize and promote, supervise and regulate the financial system efficiently and to meet all the challenges arising from the international financial integration and the EU accession.

8. Conclusion

In the preceding parts some conclusions have been summarized that are very specific for each of them. Evaluating the free movement of capital from an EU perspective and that of Kosovo is impossible

⁵⁵ This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

⁵⁶ International Financial Statistics (IFS) is an annual IMF publication on countries' financial statistics for IMF member countries. Source: Central Bank of Kosovo, available at www.bqk-kos.org.

⁵⁷ It has been stated previously that the European financial integration is of a different size and format from that of international integration, in order to explain two circumstances. Firstly, to explain an element which at first glance resembles a disruption in the traditional logical sequence of regional and international integration, which in Kosovo's case is in the opposite order. Second, European financial integration is a system built by EU member countries which does not affect or oppose the principles of international financial integration, as a system which sets conditions and criteria to be fulfilled by countries aspiring membership in the system, and which is not built in terms of subordination or domination in relation to international financial order.

without referring to its legal treatment. The specifics of Kosovo's case in the implementation of the free movement of capital process, in particular the circumstances of the non-contractual relations, highlights the characteristics, advantages and disadvantages, the challenges and the harmonization process with the EU criteria as well as the actual legal position of Kosovo in the financial integration field and the EU in general.

In this context we come to some very concise and material conclusions closely related to the object of analysis in this paper. The conclusions are:

The financial system of Kosovo is new in terms of its operation (after it separated as a result of the disintegration of the previous system and it had to be rebuilt from zero), which faced many basic challenges with an organizational and functional character.

Is not affected by the so called "legal tradition" since its development had a detachment (1990-1999), which led to the construction of a completely new system.

The financial system of the country was not faced with existing publically owned financial institutions that present significant challenges in Albania, Serbia, Bosnia and Herzegovina, etc.

Development of a financial system followed many quick changes to legislation that was a result of two circumstances, that of the transformation after the independence of Kosovo, and that of the EU legal harmonization.

Although national legislation in the first years of operation did not contain specific provisions regarding the free movement of capital, it also did not contain provisions that restricted it. A more important argument for this is the fact of the domination of foreign capital (mainly from EU member states) in the system.

As an advantage of the financial system of Kosovo, we can count the existence of a single regulatory, licensing and supervisory authority of the whole financial system, the existence of a unique payment system (characterized by small economies) and the presence of foreign capital, something that establishes sustainability of a system in an adequate manner supported by a legal infrastructure.

The flaws as well as challenges are considered to be the limited exposure to the global system (during the times of crisis this may have seemed to be an advantage, but in current circumstances it is an indicator of the level of development), the frequent changes to legislation that had implications on financial system actors, the expansion of the financial products and services range.

The harmonization of the financial legislation in general and the one that is linked with the free movement of capital specifically, is presented as a main challenge, thus the dynamic in this direction is from Kosovo's side needs to be intensified since financial legislation undergoes frequent changes even within the EU.

The characteristics of Kosovo's financial system in implementing free movement of capital is an illustration of the will on the part of Kosovo even in the circumstances of non-contractual relations to make progress in harmonization of the relevant legislation with that of the EU;

Financial legislation in Kosovo does not contain any provision that limits the free movement of capital and no provision that presents preferential treatment to national capital with regard to foreign capital.

The involvement of Kosovo in the SAP, the establishment of EU mechanisms specially for Kosovo (STM and SAPD) and its progress in the process of European integration as well as new circumstances after the

declaration of independence distinctly improved its legal position regarding financial integration in the EU and in general (membership in the IMF, WB, EBRD, access to SWIFT, etc.).

Kosovo in the legal aspect as well as its factual aspect now enters a new phase of the relationship with the EU, one where non-contractual relations will be transformed into contractual ones after the entry in to force of the SAA (currently initialed).