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## **INSIGHTS INTO REGIONAL DEVELOPMENT FINANCE INSTITUTIONS - REGULATORY AND INSTITUTIONAL FRAMEWORK<sup>1</sup>**

*Development Finance Institutions are legally independent, state-supported institutions that foster sustainable development through private sector investments in developing and underdeveloped countries. Their role is not only financial and investment, but this type of institution is also focused on achieving sustainable development goals such as job creation, poverty reduction, financing of micro, small and medium enterprises and entrepreneurs, as well as on supporting projects of environmental protection, energy efficiency, renewable energy sources. Giving a brief sketch of the conceptual ground and practical significance of DFIs, the paper provides insights into the regulatory and institutional framework of countries of the region in this field, by using normative and comparative methods. Accordingly, recommendations in terms of tackling the global challenges i.e. sustainable economic growth, social inequalities, and environmental protection ought to be identified based on the analysis of the Slovenian, Croatian and Serbian legislation in the developing finance sector and on the ground of critical consideration of national normative and institutional solutions.*

*Keywords: development finance institutions, sustainable development, regional countries, institutional framework.*

### 1. INTRODUCTION

Development finance institutions (DFIs) significantly contribute to the achievement of sustainable development goals by initiating economic, social, and environmental changes

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in developing and underdeveloped countries around the world. Accordingly, the DFIs are legally independent, state-supported institutions that foster sustainable development through private sector investments. Their role is not only financial and investment, but this type of institutions is also focused on achieving sustainable development goals such as job creation, poverty reduction, financing of micro, small and medium enterprises and entrepreneurs, as well as on supporting projects of environmental protection, energy efficiency, renewable energy sources, i.e. providing climate finance to support actions that should be taken to adapt to climate change and effectively mitigate the negative consequences (Savoy, Carter & Lemma, 2016, p. 5). The significance of DFIs, particularly, was emphasized during and after the COVID-19 pandemic. Response of the creators of international, primarily, EU policy was harmonized, and represented in the “Building Back Better” concept. The notion of “Building Back Better” refers to the policy strategy aimed to reduce future risk of disasters and shocks by creating a resilient economic system - green, and inclusive, which also takes into account the gender aspect, including social care for vulnerable categories (Fernandez & Ahmed, 2019). The transformation of the economic system in terms of sustainability implies the establishment of a new production and business model. In addition to the achievement of economic goals of profit maximization, such a transformation does not exclude the social component of development based on the fair inclusion of different social groups, accompanied by the ecological component of environmental protection and concern for the well-being of future generations.

The DFIs of the leading countries of the European Union (hereinafter: EU) have the role of international strategic mechanism, performed by placing funds in developing countries, even in those outside Europe. Often, these institutions invest through the national development institutions of the regional countries to realize the interests of integration into the EU, including the integration of the economic-social-ecological system. Contrary, the DFIs that are established in the countries of the region are predominantly oriented toward the domestic market and the implementation of the national economic policy goals. Unlike the leading EU member states, as well as the states of the region, the national development bank was not established in the Republic of Serbia. The paper aims to gain insights into comparative models of DFIs in the countries of the region, namely Croatia and Slovenia, as well as to explore the regulatory and institutional framework of the DFIs in the Republic of Serbia.

## 2. OVERVIEW OF THE DEVELOPMENT FINANCE INSTITUTIONS MODELS IN THE COUNTRIES OF THE REGION – A COMPARATIVE PERSPECTIVE

Following the example of the EU leading countries, DFIs conduct business based on the strategic framework determined by the national sustainable development strategies in terms of achieving the goals of the United Nations 2030 Agenda for Sustainable Development (2015) in the countries of the region. The scope of national DFIs activities, as well as ownership structure, will depend on the counties’ economic development level. On the other hand, the territorial expansion of business activities beyond national borders, implies the introduction of innovative mechanisms to support certain sectors in which



investments are associated with higher costs and risks, such as energy efficiency sector and climate change mitigation. The paper deals with two models of DFIs in the countries of the region - the Republic of Croatia and the Republic of Slovenia. Both are EU member states, but with different business orientations. The Croatian Bank for Reconstruction and Development is under significant government influence and directs the activity toward the national market and the national development goals achievement. The Slovenian Export and Development Bank is market-oriented, regulated by the commercial bank's rules and regulations, with territorial action also defined beyond national borders and strong coordination of activities with the strategic goals and policies of the EU. Due to those characteristics, the Slovenian Export and Development Bank differs from the Croatian Bank for Reconstruction and Development.

### *2.1. Development finance institutions in the Republic of Croatia*

The Croatian Bank for Reconstruction and Development was founded in 1992, by the Law on the Croatian Credit Bank for Reconstruction, and in 1995 it changed its name to Croatian Bank for Reconstruction and Development. The following year, a new law was passed that expanded the scope of business to include less developed regions of Croatia (Vujović, Vukadinović & Ćosović, 2014). At the time of its establishment, the Croatian Bank for Reconstruction and Development was framed on the model of Germany's Promotional and Development Bank (Kreditanstalt für Wiederaufbau-KfW) (Gaćeša, 2010, p. 74). The bank is wholly owned by the government of Croatia, and the funds are allocated from the budget. However, a certain part is provided on the international capital market in the form of loans from foreign international financial institutions, usually the European Investment Bank, as well as the European Bank for Reconstruction and Development, while government guarantees cover the bank's liabilities (Vujović, Vukadinović & Ćosović, 2014). The legal regime of operations of the Croatian Bank for Reconstruction and Development is regulated by the Law on the Croatian Bank for Reconstruction and Development which governs its status, scope, ownership, powers, and organizational structure.<sup>2</sup> The bank's status is determined as a Croatian development and export bank of non-commercial character, and as such it is not liable for bank profit tax, contrary to the Germany's Promotional and Development Bank, whose model was used for its establishment. The Croatian Bank for Reconstruction and Development has the status of a separate legal entity, with the exception that it is not registered in the court register, while bankruptcy or liquidation proceedings are not allowed. The basic capital is determined by the law and is paid directly from the budget without the possibility of division, transfer, or pledging. Furthermore, the Law on the Croatian Bank for Reconstruction and Development provides for the possibility of membership in other international financial organizations, upon the approval of the bank's supervisory board. The activities of the bank are also determined by the said law and in accordance with the general strategic goals of the Republic of Croatia, with the possibility of performing other tasks based on the government's resolution related

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<sup>2</sup> Law on the Croatian Bank for Reconstruction and Development, *Official Gazette Narodne novine*, br. 138/06, 25/13.

to infrastructure financing, financing economic renewal and development, supporting the development of micro, small and medium-sized enterprises, as well as encouraging environmental protection, exports incentives and export risk management. Loans, bank guarantees, insurance and reinsurance contracts, investments in debt and proprietary financial instruments are used for the realization of established activities that are carried out through other banks and legal entities. In addition, the Law on the Croatian Bank for Reconstruction and Development stipulates that the Croatian Bank for Reconstruction and Development does not operate to make a profit, meaning that the objectives are exclusively public, thus, the bank is to be classified as a public institution that does not operate according to market principles.

It appears from the statutory scope of its activities that the role of the Croatian Bank for Reconstruction and Development should be defined as limited. Namely, the determined activities relate to the proclaimed achievement of sustainable development goals, and to the transformation of the economic systems of the EU countries towards a low-carbon, i.e. green economy. Namely, the legal provisions governing the bank's activities do not reflect the challenges of modern society, such as climate changes, geopolitical risk, and disruption or demographic challenges. That further undermines harmonization and/or coordination with multilateral, bilateral, and DFIs of other EU countries. Thus, it should be noted that the recently adopted strategic, public policy document of Croatia named "The 2030 National Development Strategy of the Republic of Croatia" does not identify the National Bank for Reconstruction and Development as an implementing entity, considering the EU practice in this regard.<sup>3</sup> One of the key challenges of not only Croatian but also European economic growth are investments through innovations and new technologies, such as digitalization and the development of artificial intelligence, which requires the allocation of resources towards productive and innovative industries. In the context of Croatia, technological modernization and increased productivity are necessary, along with raised investments in green infrastructure, digitization, healthcare, and educational institutions. The special focus is on the support and development of small, innovative, knowledge-based companies such as start-ups, scale-up, and high-tech companies. In addition, according to the Croatia National Development Strategy 2030, one of the goals also refers to macroeconomic stability and the development of financial markets. The Strategy defines four core objectives:

1. Sustainable economy and society, which implies a competitive and innovative economy, educated staff, efficient judiciary and public administration, global recognition and strengthening of international cooperation;
2. Stronger resistance to the crisis, including a healthy, active and quality life, demographic revitalization, improved position of families, and ensured security in general;
3. Green and digital transition, including ecological and energy transition towards climate neutrality, biodiversity, sustainable mobility, a digital transition of society and economy; and

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<sup>3</sup> National Development Strategy of the Republic of Croatia until 2030 - 2021. Available at: [http://europski-fondovi.eu/sites/default/files/dokumenti/Nacionalna-razvojna-strategija-RH-do-2030.-godine\\_3.pdf](http://europski-fondovi.eu/sites/default/files/dokumenti/Nacionalna-razvojna-strategija-RH-do-2030.-godine_3.pdf) (27. 07. 2022).

4. Balanced regional development, with the development of vulnerable areas and increased regional competition.

The roles of micro, small and medium-sized enterprises in the context of the green economy transition are also recognized. Furthermore, those strategic goals will be achieved through “platforms for financing companies that already exist on the capital market, but are underutilized” (National Development Strategy of the Republic of Croatia until 2030, 2021). In this regard, the said Strategy only recognizes investment funds as instruments with strategic importance for financing companies and as the mechanism of directing financial resources from European funds. Also, the Strategy has highlighted that the Croatian financial market is dominated by banks financing stable economic entities. It explains why an objective is to increase the availability of favourable sources of financing, for which the activation of resources from European funds is foreseen. Therefore, the National Bank for Reconstruction and Development is not fully determined as an institution that participates in the implementation of Croatian strategic development goals, which is the practice in the most developed countries of the EU. Croatia lags far behind other EU countries in recognizing the role of the mixed, i.e. hybrid financial entities and instruments, as well as in the achievement of the goals of national economic policies, according to the determined positive effects of the implementation of the public-private partnership concept. One of the reasons may be the very nature of the Croatian Bank for Reconstruction and Development, i.e. its ownership structure, which is completely state-owned, as well as the structure of management boards. The said bank operates exclusively in public interests, and its actions could be characterized as a form of state interventionism. One of the possible solutions would be to transform the Croatian National Bank for Reconstruction and Development in a direction that implies that its role is not only in directing public (budget) funds into projects, i.e. sectors of public interest but also in mobilizing private capital, in the context of public-private partnership and risk sharing in sectors of strategic importance in order to promote sustainable growth. Given that, German Promotional and Development Bank (KfW) may serve as an example, which was also the model for the establishment of the Croatian National Bank for Reconstruction and Development.

## *2.2. Development Finance Institutions in the Republic of Slovenia*

International development cooperation in terms of achieving sustainable development goals in the Republic of Slovenia is regulated by the Law on International Development Cooperation and Humanitarian Aid, adopted in 2018.<sup>4</sup> The public strategic framework for the implementation of sustainable development goals was previously determined by the Resolution on Development Cooperation and Humanitarian Aid of 2017 (hereinafter: Resolution). The Resolution is a long-term, strategic document of indefinite duration, which defines the territorial and sectoral domains, i.e. the priorities in achieving sustainable development goals of the Republic of Slovenia. Based on this Resolution,

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<sup>4</sup> Law on International Development Cooperation and Humanitarian Aid, *Official Gazette of the Republic of Slovenia*, no. 30/18.

the 2030 Development Cooperation and Humanitarian Aid Strategy was adopted.<sup>5</sup> The said strategy defined goals and established concrete mechanisms for their achievement, including priority areas for the action. Thematically, the areas of strategic action are defined as follows: achieving full and productive employment and decent work, a peaceful and inclusive society, sustainable management of natural resources, and action to combat climate change (Jones, Veron, Czaplicka & Mackie, 2019). Territorially, the domain of the Slovenian national sustainable development policy application is directed towards Western Balkans countries, the neighbouring countries of Europe, and the area of Sub-Saharan Africa, especially the least developed countries of this region. In addition, the 2030 Sustainable Development Strategy, adopted in 2017, with the aim of sustainable development goals implementation, defines 12 development goals and six strategic orientations. The strategic orientations are as follows: inclusive, healthy, safe and responsible society; lifelong learning; a highly productive economy that achieves the goals of all social groups; preserved and healthy environment; high level of cooperation; and efficient and competent governance (Jones, Veron, Czaplicka & Mackie, 2019).

When it comes to the implementation of bilateral cooperation strategies in the field of sustainable development, the most important legal entities, established by the Government of Slovenia, are the Slovenian Export and Development Bank, and the Centre for International Cooperation and Development. The Centre is established as an independent, non-profit organization of the Slovenian Export and Development Bank, whose main activity is the implementation of cooperation infrastructure projects to improve the economic, social, and ecological infrastructure (Jones, Veron, Czaplicka & Mackie, 2019). Unquestionably, the most important development finance institution of Slovenia is the Slovenian Development and Export Bank, founded in 1992 as the Slovenian Export Corporation, with the main goal of financing Slovenian export companies, but in 1996 it was transformed into a specialized bank for export and development. Since 2008, the said bank has been wholly owned by the government of Slovenia (Gnjatović, 2012). The role, ownership, and organizational structure, status, and activities of the Slovenian Export and Development Bank, as a specialized financial institution in the field of promoting development, international trade, economic cooperation, entrepreneurship development and innovation, encouragement of research and educational activities, development of ecological, energy and construction infrastructure of interest to the Republic of Slovenia, are regulated by a special law - the Law on the Slovenian Export and Development Bank.<sup>6</sup> The said law stipulates that the Slovenian Export and Development Bank conducts business according to the objectives set by the public policy documents of the Republic of Slovenia and the EU, while all activities, i.e. transactions, projects, investments, as well as other forms of financial operations, shall be subject to economic, environmental and social quality

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<sup>5</sup> 2030 Development Cooperation and Humanitarian Aid Strategy – 2018. Available at: <https://www.gov.si/assets/ministrstva/MZZ/Dokumenti/multilateral/razvojno-sodelovanje/Development-Cooperation-and-Humanitarian-Aid-Strategy-of-the-Republic-of-Slovenia.pdf> (28. 07. 2022).

<sup>6</sup> Law on the Slovenian Export and Development Bank, *Official Gazette of Republic of Slovenia*, no. 56/08, 20/09, 25/15, 61/20.

assessment based on international standards.<sup>7</sup> The given law further establishes the basic principles of the bank's operations, i.e. non-competition in relation to other financial institutions on the market, the principle of non-discrimination, i.e. equal access to financial services for all potential users, and the principle of transparency of operations.<sup>8</sup> The principle of non-competition in relation to other financial institutions on the market is relevant since the status of the Slovenian Export and Development Bank corresponds to a public financial institution, instead of corresponding to a traditional commercial bank. The bank's activity is regulated by Article 11 of the Law on the Slovenian Export and Development Bank, with a focus on support in the implementation of economic, social, and other structural policies, on provision of financial services in sectors where challenges of the self-regulating market are most noticeable and require additional support. These are, among others, micro, small and medium-sized enterprises, entrepreneurs, the innovation sector, the education sector with a special focus on the development of management skills, the area of additional qualification and adoption of specific knowledge. It also includes employment promotion, especially of vulnerable categories of workers such as persons with disabilities and their inclusion in the labour market, development of green infrastructure, support for balanced regional and local development, all following the principle of public-private partnership, while international development cooperation is also enhanced at the international level through established project activities. The Slovenian Export and Development Bank provides financial services according to the procedures established by the said law but also follows the regulation of commercial banks and the company regulations, under the supervision of the Central Bank of Slovenia and the Ministry of Finance. An annual report is submitted to the National Assembly of the Republic of Slovenia.<sup>9</sup>

### 3. REGULATORY AND INSTITUTIONAL FRAMEWORK OF THE DEVELOPMENT FINANCE INSTITUTIONS IN THE REPUBLIC OF SERBIA

Unlike the regional countries (Croatia and Slovenia), a specialized development bank has not been founded in the Republic of Serbia, although there was an initiative since the proposal for a special law on a development bank was drafted in 2012. However, the development financial activities of public national interest in the Republic of Serbia are carried out through the Development Agency of Serbia (hereinafter: DAS), the Development Fund of the Republic of Serbia, and the Green Fund of the Republic of Serbia. The status of the DAS is regulated by the Law on Investments which was adopted to improve the investment potential and encourage direct investments by domestic and foreign investors, and to ensure economic development and employment growth.<sup>10</sup> Unlike the adopted models of DFIs of the EU leading countries and the countries of the

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<sup>7</sup> Law on the Slovenian Export and Development Bank, Official Gazette of Republic of Slovenia, no. 56/08, 20/09, 25/15, 61/20.

<sup>8</sup> *Ibid.*

<sup>9</sup> *Ibid.*

<sup>10</sup> Law on Investments, *Official Gazette of the Republic of Serbia*, no. 89/2015, 95/2018.

region, particularly the Republic of Slovenia, the DAS is an exclusively public institution that does not operate according to market principles, and has the status of a government agency, under the control of the competent public authority. The DAS has the status of a legal entity and operates according to the public agency's rules, while not according to the commercial bank's rules and regulations (Article 28). The DAS was founded to foster direct investment, promote and increase export, by improving the competitiveness of economic entities, as well as to promote development and improve the reputation of the Republic of Serbia (Article 27). The Development Fund of the Republic of Serbia was formed by a special Law on the Development Fund of the Republic of Serbia.<sup>11</sup> The Development Fund of the Republic of Serbia has the status of a legal entity registered in the court register, and it appears from the said law that it can be organized as a joint stock company. The DAS and the Development Fund of the Republic of Serbia share the same founding objectives. These are the promotion of balanced regional development, increase in the business productivity and competitiveness of legal entities and entrepreneurs in Serbia, and export and employment promotion (Article 2). The same objectives indicate unjustified overlapping of these two development organizations. To address the strategic interest of the Republic of Serbia which refers to EU integration in terms of environmental protection, a special Green Fund was established by the Decision of the Government of the Republic of Serbia in 2016.<sup>12</sup> The Green Fund is established within the Ministry of Environmental Protection, with the aim of determining special funds for financing the preparation, implementation, and development of programs, projects, and other activities in the field of energy conservation, sustainable use, and environmental protection. Projects in the field of climate change mitigation and application of adaptation measures, as well as disposal, and waste management are particularly addressed.

However, in the literature, far too little attention has been paid to the national development banks' role in achieving sustainable development goals. The dominant argument against the national development bank's establishment is the prevention of state interventionism, particularly having in mind the period of privatization of the state-owned banks in Serbia after 2000, which represented a reform process and the path to the introduction of a market economy. In addition, it is pointed out that the establishment of a national development bank "increases the risk of political influence on the criteria for resource allocation, endangers the banking sector efficiency and creates financial system instability" (Marinković & Golubović, 2011, p. 183). The argument in favour of development banks is the "correction of allocative distortion of the credit market", noticed in the domestic financial system (Marinković & Golubović, 2011, p. 185). Some studies have shown that the establishment of a national development bank would also have a positive effect on the rise of the employment rate of vulnerable categories, e.g. persons with disabilities, older workers, migrant workers, and women, as well as on the promotion, finance, and development of social enterprises (Stojković Zlatanović, 2019). Moreover, it is also worth noting that the Council of the EU defined

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<sup>11</sup> Law on the Development Fund, *Official Gazette of the Republic of Serbia*, no. 36/2009, 88/2010, 119/2012, 5/2015.

<sup>12</sup> Decision on the establishment of the Green Fund of the Republic of Serbia, *Official Gazette of Republic of Serbia*, no. 91/16, 78/17.

the social economy as a key factor in achieving the goals of sustainable development, due to the United Nations 2030 Agenda on Sustainable Development, which Serbia has also joined. Moreover, the Council of the EU in its document entitled 'Initiative to start your own business' pointed out the importance of improving and introducing new forms of financing, with the aim of ensuring access to the market and creating conditions for the visibility of economic and social economic entities.

#### 4. CONCLUSION

Two different approaches of public policymakers were determined in terms of the place and role of DFIs in the implementation of the strategic goals of national and consequently EU economic policies in the Republic of Croatia and the Republic of Slovenia. Namely, the Croatian Bank for Reconstruction and Development differs from a commercial bank because it does not operate in line with market principles and has the status of a public government institution following the concept of state interventionism. On the other hand, the Slovenian Export and Development Bank operates according to market principles and regulations of commercial banks, performing financial activities in line with the concept of public-private partnership having the role of "mobilizer" of private sector activities in cases of high economic risk where national interest is determined. Finally, the DAS and the Development Fund, as the only national development institutions in the Republic of Serbia, are not able to adequately respond to the demands of the market and economic transition process towards a green and inclusive society. They have a role similar to the DFIs of the countries of the region, but at the same time, they are characterized by the dominant influence made by the public authorities. Therefore, the establishment of a national development bank in the Republic of Serbia could be an option to consider and the possible path to provide a green economic transition, particularly following the Slovenia model of a DFI. The Inclusive Green Economy model supports the establishment of a national development bank modelled on the public-private partnership concept, combining the protection of both, public and private interests to deal better with inequity and environmental issues while aiming to reach sustainable economic growth. Investing in private sector projects of public interest, national development banks as a dominant form of DFIs significantly contribute to green transition and broader social inclusion where the "hidden state interventionism" could be properly overcome by ensuring transparency in their operations i.e. by providing publicly available basic information about project investments, financial terms, development impacts, as well as a possible negative impact on affected communities.

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