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AUTHORS	J.A. Consiglio
ARTICLE INFO	J.A. Consiglio (2007). Financial Services Privatisation in the CEECs - An Overview. *Banks and Bank Systems*, *2*(2)
RELEASED ON	Friday, 22 June 2007
JOURNAL	"Banks and Bank Systems"
FOUNDER	LLC “Consulting Publishing Company “Business Perspectives”

FINANCIAL SERVICES PRIVATISATION IN THE CEECs – AN OVERVIEW

J.A. Consiglio*

Abstract

Financial services privatization in the Central and Eastern European countries (CEECs) is an account of significant differences in strategy processes and implementation, and of strongly asymmetric evolution paces of bank and economic restructuring. The inherited background disorganization factor, different motivating factors, extent and pace of the process, and the lingering argumentative positions on its real need, make this one of the most fascinating contemporary banking history themes.

Key words: privatisation, financial services, CEECs.
JEL classification: D53, E44.

Popular Western media presentation of the post-communist block of countries often suggests their being homogenously placed in the economic transition ladder. The spread of characteristics of the CEECs' banking sectors shows quite sufficiently how differently they must be considered from each other: for example in aspects like the pace of change, privatization infrastructures, legal and social elements.

Just as much as the move from the economics of communism to the economics of democracy required a particularly sequenced methodology, similarly the shift from privatization to market structuring, inclusive i.e. of the element of M&As in the financial services industry (FSI), could not be expected to flourish before privatization too had evolved to status and levels of both mass acceptability and efficient methodology. By the end of the 1980s transition from communism to democracy still had much to suggest a perception there of a big black box. The regimes were "familiar" with both systems in terms of their respective economic implications, but the paths from one economic system to the other very often were not as familiar to them.

Even if some exceptions must be made, a substantial part of the literature on this much-dealt-with ground of privatization in the CEECs has predominantly been characterized by holistic approaches that consider the process as a feature of economic transition that has generally common, and totally undifferentiated, characteristics across the whole spectrum of these countries' economies. This paper will focus on some of the more particular characteristics of a specific sector's, financial institutions' privatisation, in that region. It must be considered as part of a lengthier study that this author has made which includes, inter alia, various country case studies, synthesisation of deduced specific country characteristics of the process into a general model of the process in the whole region, and adoption of the analytical evolution model to the experience of a small Mediterranean island's analogous privatization experience.

Economists and policymakers in the CEECs possessed a lot of information on the transition from democracy to communism, and on its economic parallel i.e. from capitalism to central planning and collective property. But no instance or guide was available for the reverse process. But in this context it is useful to note that Rossini (1998) draws attention to the fact that the process towards a socialist economy had also partially been undertaken by several Western democracies who, in this context, one could say were wrongly described as "market economies"[1].

* University of Malta, Malta.

[1] Rossini G. (1998). Review of *The Economics of Post-Communist Transition* by O. Blanchard – Economic Notes, Banca Monte dei Paschi di Siena, No. 1/1998.

Despite the Cold War, during the 1950s and 1960s there seemed to be an inclination towards a form of convergence of some Western economies towards a system in which the original spirit of capitalism could coexist with a strong presence of the state in the economy. One version of this was touted as "the social market economy". Such convergence attempts, it can be argued, came to a gradual halt in the 1980s when in most Western European countries the state could control almost a half of the flow of wealth produced, with the other half being allocated through market institutions. A classical and influential example of such a situation was Italy with its IRI *(Istituto per la Ricostruzione Industriale).*

By contrast, for several historical reasons such convergence did not proceed on the other side of the Iron Curtain. One could argue that one of the main obstacles against moving towards a systemic organization more akin to the capitalist one was not the large diffusion of state property and state presence in all sectors of the economies there (including in the FSI), but rather the concomitant centralization of all relevant, and less relevant, economic decisions.

The "disorganization" factor

Blanchard (1998), when exposing the characteristics of the economics of post-Communist transition, is prompt to emphasise the effect of the disappearance of central planning in former Communist countries[1]. There was a 'disequilibrium' factor which explains the poor performance of some of those economies in both a total and sectorial sense. Differently said, the restructuring of Eastern Europe was muddled by a lack of that coordination which in capitalist economies is provided partly by markets and partly by the state, even when reacting to unexpected crises.

Markets in post-communist transition countries did not exist, not at least in the freely functional and operative sense that the Western world knew. The state was neither ready to use macroeconomic instruments, nor to undertake any industrial policy which had to operate without compulsory planning. And yet there were differences amongst some of those former Communist countries, the most noteworthy being that of the timing and speed with which some of them started their economic revolution, regardless in some cases of heavy social distress that was involved.

Poland, for example, was able to adopt certain forms of market legislation and practices well ahead of others. A good example here was that of antitrust law, which it adopted early on (indeed even before certain Western European countries). Hungary too was fairly early off the mark with a variety of legislative changes. Other countries were loath to decisively undertake the same route, and it became ever clearer that different adjustment speeds, and a different politico-economic psychosis, prevailed within this group of vastly different countries. Perhaps the best illustration of this was that, in various ways, they were deeply, awkwardly, and differently dependent on the notion of "nothing succeeds like *what at least popularly <u>appears</u> <u>to</u> <u>be</u> a success*", a scenario that various astute politicians of the old guard for long still continued to play with wisely for their own personal interests.

The study of privatization in the financial services sector in the economics of post-Communist transition must therefore also concern itself with some of the reasons why these Eastern European countries experienced different adjustment speeds in this sector, and why restructuring was so awkward to implement. The response of output to transition policies was, in this sector as in others, often U-shaped, with some countries still trapped in the bottom of the U. Expectations often went wrong, and particularly disappointed were those who though that recovery was just a matter of freeing latent animal spirits of economic agents.

When we touch upon the long-term nature of the whole process, issues relating to various factors, including the historical FSI evolution models applicable, the restructuring context and methodologies applied, some very important human resources factors, and others, are all important and ex-

[1] Blanchard O. (1998) – *The Economics of Post-Communist Transition* – (Clarendon Press, Oxford).

plain why some CEECs stayed long in this position and why, for example, none of the CEECs has – up to our times – so far evolved as a reputable, dynamic, competitive financial centre able to hold its own with the London, New York, Paris, Frankfurt, and Tokyos of the Western world.

Gardner and Molyneux (1990, p. 143 *et seq*.) hold as the traditional explanation for the development of financial centres in the nineteenth and early twentieth centuries "the way in which [these] tended to dominate international trade financing and capital export, and the important role they have played in the world economy"[1]. For the CEECs this was certainly not the case. In their economic environment the privatization process was nothing like what many in the West would imagine it should be. If Russia is taken as only one brief example of this, at a period when official policy was professedly very much in favour of the process, the economy was showing a sharp decline in output which was much larger than the decrease in employment. The simple explanation was that in most cases redundant workers were retained on the books of firms, and adjustment took place in the form of reduced wages rather than dramatic lay-offs. And the FSI was often no exception to this approach.

This sort of softer adjustment carried out in many firms has, as one possible explanation, the fact that many were in fact cases of *insider* privatizations. Insider control, alongside state control, is viewed by Bonin J.P. *et al*. (1998, p. 1 et seq.) as having been continued, and often entrenched, from the fact that privatization, as practiced in many of the economies in transition (EITs), often failed to insure independent governance[2]. But insider privatizations, one must admit, are not the only explanation for reallocation and restructuring not to have produced immediate effects. What we refer to as "disorganization" was often the more conspicuous culprit which, in cumulative terms over national levels, also caused derailment risks of the totality of the economies.

Establishing markets where there are only centrally planned links is anathema to the processes of restructuring and reallocation. In the absence of properly functioning markets, privatization in the CEECs could not be undertaken according to the full methodologies and contexts known in Western Europe. Blanchard (op cit) reaches the conclusion that insiders privatization was not only one of the most common ways (excepting possibly in the Czech Republic) of pushing takeovers, but it may also have been the most efficient, given the actual conditions of financial markets. It avoided dramatic underpinning and made the adjustment more gradual, even if painful over a longer period. This however is not a view generally shared by all Western economists, many of whom would not agree with him on the assumed ground that inefficiency may undermine insiders privatization.

Objectives

The raising of public efficiency was of course one of the stated objectives of privatization programmes in many countries, including in the CEECs group. But it is not the only one. Others include:

- A concomitant improvement of the quality and range of services to citizens.
- The redeployment of national resources in a more efficient manner.
- Allowing governments to concentrate on what are – according to a particular political stance – considered as being their sole or core activities in their economic role, and in the process encouraging an independent "enterprise culture", and
- The turnaround or consolidation of public finances.

From a more restrictedly FSI viewpoint, privatizations are often viewed as the way forward for:

- The introduction, enhancement, and development of local capital markets.
- Encouraging competition and modernization in the sector.

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[1] Gardener E.P.M., Molyneux P. (1990). *Financial Centres* in Changes in Western European Banking – (Routledge, London).
[2] Bonin J.P. *et al*. (1998). *Banking in Transition Economies* – (Edward Elgar, Cheltenham).

- Attracting foreign and domestic private investment in infrastructure which enhances technology through strategic partnerships.
- Labour market restructuring, i.e. away from state-owned enterprises (SOEs).

Achieving all or several of these objectives is easily traceable as a *leitmotiv* of many prominent CEEC politicians' (sincerely, or otherwise, motivated!) speeches and writings during the first decade after 1989. But that analysis quickly brings up the timing factor as often raising the issue of whether the process should in fact have been done when it was. Or, indeed, when it was not. The fact however remains that with the breakup of the Soviet Union, and the start of market-oriented reforms in many former socialist of Central and Eastern Europe, that was a period where the prospect of privatizing inefficient state-owned companies started to figure not only, on the one hand in academic writings, but also in the new popular *mens,* the new general mindset, which started to create and form mass and popular perceptions.

As one of the headline events symbolizing change from central planning to capitalism, privatization seemed to promise an end to the inefficiencies of the former, and in mass perception became the key to freezing the resources and talents of people everywhere, but more so in the CEECs, where the ideal of lifting living standards to those of the industrial countries of Western Europe became a holy grail.

When did it start?

Havrylshyn and McGettigan (1999), who were prominent in the International Monetary Fund's (IMF) Europe II, and Policy Development & Review, departments, summed up some analysts' views holding that when the CEECs embarked on the privatization route in the way of severally apparently nationally embraced formal programmes, there existed no formally theoretical base to guide the practical process of economic transition. For many analysts there only existed generic – or even sometimes insistently specific – theories on capitalism and socialism.

This is perhaps a somewhat surprising position if one considers the fact that the IMF argues in its own favour a claim for historical antecedent in this area – [its 1977 strict pressurizing of the British Labour government that it effects a sale of its then held shares in British Petroleum (BP)] – prior, that is, to the introduction by the Thatcher government in the UK in 1979 of a formal lengthy programme of divestitures. That was one year after Prime Minister Harold Wilson – who had made much of his intention to modernize Britain with a much touted "white hot technological revolution" – had resigned.

In the UK several Tory politicians have claimed credit for that country's privatization process, but later former Chancellor Sir Nigel Lawson held that the paucity of references to privatization in the Conservative Party's 1979 general election manifesto was in actual fact, according to him, a reflection of *"Lady Thatcher's lack of enthusiasm"* for privatization[1].

But Megginson, Nash, and Van Randeburgh (1994), and again Jones, Megginson, Nash and Netter (1999)[2], also argue that "the first large-scale, ideologically-motivated denationalization programme

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[1] *"The Financial Times Guide to Privatisation"* – Jan 8th, 1996. *Vide* also FT, Oct 15th, 1999 where Robert Peston significantly reports thus, under *"Thatcher's flagship finally runs aground":*
"The death sentence has been posted. The 20-year campaign to privatize public services is over. No less a figure than the Prime Minister (Tony Blair) read the last rites over the archetypical Thatcherite policy this week. "Today the issue is not ruling back government, hammering trade unions, or more and more and more privatization of public services", Tony Blair wrote in a little-noticed article in Monday's issue of London's "Times" newspaper. "It is investment in public services, allied to their reform and modernisation…………….".

[2] Megginson W.L., Nash R.C., & Van Randeburgh M. (1994). "The Financial and Operating Performance of Newly Privatised Firms: International Empirical Analysis", The Journal of Finance Vol. XLIX, No. 2, June.
Jones S.L., Megginson W.L., Nash R.C., & Netter J.M. (1999). "Share issue privatizations as financial means to political and economic ends", Journal of Financial Economics, No. 53, pp. 4-5 and 217-253. Other discussions of the purely historical aspects of the development of privatization are to be found in, *inter alia*, Jenkinson & Meyer (1988), Van Der Walle (1989), Shirley & Nells (1991), Brada (1996), Bennell (1997), Yergin & Stanislaw (1998), and The World Bank (1995).

of the post-war era was launched by the government of Konrad Adenaur (one of the so-called "founding fathers" of the European Union) in the FDR. In 1961 (i.e. four years after the EU's birth) the German government sold a majority stake in Volkswagen[1] in a public share offering heavily weighted in favour of small investors. Four years later the German government launched an even larger offering of shares in VEBA, the mining and heavy industry giant. Both offerings were initially very favourably received, increasing the number of private shareholders in Germany from around 500,000 to some 3 millions, but the appeal of share ownership did not survive the first cyclical downturn in stock prices, and the government was actually forced to bail out many small shareholders.

The Adenauer government's 1960's privatization programme had officially announced objectives which read identical to those of the two decades' later Thatcherite plans. When one then pursues the historical iter of privatizations even in other European countries (Denmark, Italy, France, and from the mid-1990s in the EU generally), in Asia (Malaysia, Singapore, Japan), and South America (Chile[2]), one sees that, regardless of ideological basis, the objectives are nearly always similar, viz:

- Raising revenue for the state
- Promoting increase efficiency
- Reducing government interference in the economy
- Promoting wiser share ownership
- Providing opportunity to introduce competition
- Exposing SOEs to market conditions
- Developing national capital markets.

After Germany and the UK, the next major Western European nation to pursue privatization as a core element of its politico-economic policy was France. Jacques Chirac's conservative government which came to power in March 1986 was declaredly committed to selling off not only the financial and industrial groups which had been nationalized during 1981 and 1982, but also the large banks nationalized even further back by General Charles De Gaulle in 1945.

With the benefit of hindsight it can be said, for the period between 1965 and 1979, that the number of non-European governments who implemented deeply well enough thought out scientific policies of privatization was fairly small. Later, after 1987, privatisation programmes spread rapidly round the globe, and the 1989/1990 events in the former USSR and Eastern Europe thereafter shifted the "movement" to that part of the world.

Shirley and Nells (1991) motivate the imperative for privatization in these countries as being that "to create a market economy as quickly as possible, using all available methods, and almost regardless of the social cost entailed"[3]. However, irrespective of when, and to where, an exact chronological start of this widely discussed economic policy innovation is to be accredited, it can be argued that from the decade between 1989 and 1999 – which was the first whole and continuous period of the transition economies' experience with privatization – some elements for the cobbling together of a workable "model" of transition or transformation which, it can be imaginatively said, should be 'grateful' or 'owe a lot to' privatization, can be individualized.

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[1] There is a touch of irony in the fact that the German term *"Volkswagen"* actually means *"People's Car"*.

[2] Possibly the one which attracted most media interest was the case of Chile, where the Pinochet government, which gained power after the ouster of Salvador Allende in 1973, attempted to privatize companies that the Allende regime had nationalized during its short but eventful reign. However the process was poorly executed, and required very little equity investment from purchasers of assets being divested. Thus, many of these same firms were renationalized once Chile entered its debt and payments crisis in the early 1980s. Chile's *second* privatization programme, which was launched in the mid-1980s, and relied more on public share offerings, than direct asset sales (where the government acted as both creditor and seller) was much more successful. These Chilean vicissitudes are assessed in more detail in Yotopoulos (1989).

[3] Shirley M. & Nells J. (1991). "Public Enterprise Experience" – World Bank, Washington DC, Publication No. 9800; (1991) – "Public Enterprise Reform – The Lessons of Experience" – World Bank, Washington DC.

In considering some of these elements it is easy to see that all are – at least theoretically – such as can be hypothesized in a general manner for the financial services sector. Consider, *inter alia*,

- The forcing through of *moves from a sellers' to a buyers' market* – through price liberalisation this is also possible in the market for financial services.
- The *enforcing of a hard budget restraint* – through privatization itself and the elimination of various government support mechanisms the FSI is, again, a possible contributor[1].
- The *reallocating of resources from old to new activities* – closures and bankruptcies, combined with the establishing of new enterprises, within the FSI is again theoretically relevant.
- The *restructuring within surviving firms* – even in the FSI labour rationalization, product line changes, and new investment, are relevant factors to be considered.

Extent and pace

Any hypothesized model of the evolution of the CEECs' FSI privatization perhaps carries too much to resist analogy with Schumpeterian creative destruction. And yet, again naturally *a posteriori*, it can now be said that this became the generally accepted road down which developing countries chose to travel. Between 1988 and 1992 the pace of privatization in these countries decreased dramatically. From 6% of total world privatization sales income in 1988, the developing countries' share rose to 42% in 1992. In 1995 an ILO report stated that proceeds from the sale of public enterprises in developing countries rose from just over US$2 bn in 1988 to almost US$ 20 bn in 1992[2]. And indication of to what extent privatization proceeds became for these countries the more important source element for their financing needs, when compared to their previous heavy dependence on external financing, is suggested by the following World Bank figure covering just the beginning of these countries' experiences with privatization.

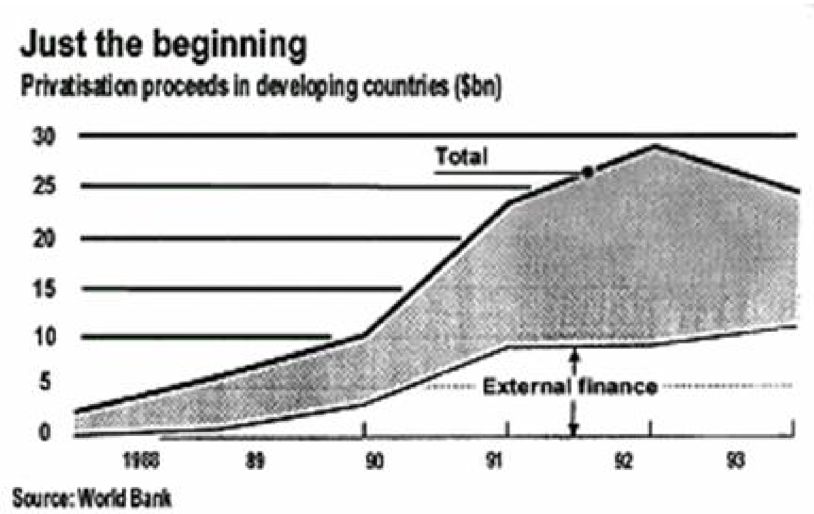

Fig. 1. Provatisation proceeds in developing countries ($bn)

By the first half of 1995 worldwide privatization was progressing at a much slower pace compared to the same period in 1994. During that period total proceeds from the sale of SOEs stood at US$ 18.4 bn, down from the peak reached in the comparable previous year period of almost US$ 37

[1] There is of course a 'flipside' *soft budget constraint* position that can also be made, with concomitant issues.
[2] *"Privatisation surge in developing countries"* – Financial Times, April 26th, 1995.

bn. Privatisation International (1995) – published in the US – however maintained that a large number of deals were already in the pipeline for the second half of 1995, or for early in 1996, and so, "barring an adverse turn in markets, the value of privatization worldwide could still reach US$ 45 bn or more for 1995"[1].

World Bank calculations show that privatization raised US$ 270 bn worldwide in the period between 1988 and 1993. As the above figure suggests, developing countries received a large share of those revenues. State sell-offs, in Latin America, in Asia, and in other developing countries elsewhere raised a total of US$ 96 bn during the period in that group of countries, with more than a third of it coming from foreign investors. That size of activity was large in itself, but both in its factually completed component as well as in what was being programmed down the road, was in fact to an extent that at one stage loomed dangerous in the eyes of the OECD.

In 1995 the OECD warned that the current privatisation programmes in its member countries were so large that their implementation would have a powerful impact on the countries' financial systems. It estimated that these programmes could result in equity offerings totaling US$ 200 bn during the successive five years, creating the crucial issue of whether the financial markets would be able to absorb this. The OECD's report included warnings referring, *inter alia,* to "fatigue among retail investors", and to the possibility that "future privatizations would have either to reduce the tranches specifically directed to retail investors or to enhance the attractiveness of the offering to these investors"[2].

The digression here towards OECD experience, and away from CEECs specifically, is explained by the intention of underlining the substantial differences in both the economic and political environments, and timings, within which privatizations occurred in these different scenarios of the world. Whilst the developed world presented issues like

- equity prices of offerings needing to remain strong to support investor appetite for new issues,
- downturns in equity markets leading to shifts away from equity and thus potentially undermining privatization plans,
- some large-scale privatizations having *negative* effects on share prices (e.g. in 1994), and having to compete in a rising interest rates market,
- meanwhile when some governments carried out privatization programmes in the transition economies a key question constantly bothering investors and analysts was "Is the country, or that sector in that country, ready?"

Even when the whole concept has long been accepted as an ideal or methodology along the road of economic transition, the banking sector in Central Europe was factually not yet totally ready for privatization, and forcing the issue was likely to hurt rather than help banking development.

A non-proven case?

For a long time many observers' first look at the progress made by the CEECs towards transition was summed up in the question about what is the extent of the private sector's share of an economy. But whilst this was a legitimate way of measuring a country's progress away from central planning, it did not, on its own, necessarily follow that bank privatization was always essential or, when effected if needed, that it was well timed. The simple, key, standard question would need to be: what was privatization trying to achieve in that particular country, and how would it increase banking efficiency? Answers from different CEECs are less simple, and specific case-studies[3]

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[1] *"First-half slowdown in worldwide privatisations"* – Financial Times, July 18th, 1995.

[2] *"Privatisation and Capital Markets in OECD Countries"* in "Financial Market Trends (OECD), Feb 1995. See also *"OECD warns on scale of privatization programmes",* FT, March 6th 1995. Specific case studies of countries where such scenarios effectively came very close to reality feature in the Ph.D. thesis of which this paper is a component.

[3] The financial services privatization experiences of Hungary, the Czech Republic, the Slovak Republic, Romania, Estonia, and Russia, are extensively analysed in my 2006 Ph.D. thesis on the subject, as referred to on Page 1.

highlight issues like the extent to which Central Europe's economic and industrial vicissitudes in post-privatisation years showed much progress away from state planning, whether and at what stage had the state really arrived in total readiness to give up control of the banking sector, and again indeed whether arguably it should have at all.

Michael Kapoor, who in 1996 was making a strong case against "forced quasi-privatisation" distracting the CEEC banks from acting more commercially, assessing risks better, and generally offering better service, maintained that at its simplest privatisation is a bottom-line question: the commercial orientation of private companies means that they should operate more profitably than state dinosaurs[1]. For corporates needing fundamental refocusing to survive, the argument is compelling, and in many cases privatization was indeed an essential step to commercialization. But the bottom-line argument was at times of limited relevance to Central European banks, some of which – according to certain yardsticks – were actually amongst the most profitable in the world. The excessive caution they were charged with stemmed as much as anything from a determination to keep profits up. Indeed, problems did as often as not come from naïve commercialization (e.g. chasing new business when distinctly unqualified to gauge risks) as from complacency.

Moreover, many would indeed argue that the banking system in any of these countries was run on commercial, rather than political, lines. Along the way, whilst state influence certainly remained there, direct control had long gone. Nor could privatization be seen as the guaranteed key to bank restructuring, for there was actually no evidence that privatization per se would speed up the process. At times, even the IMF seemed to be maintaining an arm's length approach to the issues of privatisation's worth as an essential component of bank restructuring methodology within the much wider sphere of appropriate macroeconomic policy in transition economies[2]. Indeed the presence of competition seems to be a far more effective catalyst to development than mere transfer of ownership. Most observers for example agreed that Hungary's *OTP Bank* restructured more effectively than the Czech Republic's *Sporitelna*, even though the Czech savings bank was privatized significantly earlier.

Up to early in 1996 the case for bank privatization in the CEECs was, at best, unproven, and at that point in time, when the difficulties of selling what were effectively large institutions in some of these economies were factored in, the conclusion was that it was better to concentrate on increasing their efficiency – if necessary even under state ownership – than on privatizing them. The situations in Hungary, the Czech Republic, and Slovakia are specific examples of that particular conjuncture.

Most of the literature originating from non-CEEC sources suggests that the perception around the beginning of 1996 was that Central European banks were not yet ready for privatization, and that forcing the issue was likely to hurt rather than help banking development. The general popular approach was that of looking at the progress made towards transition, and posing as a first quote the private sector's share of the economy. But whilst this was a legitimate way of measuring these countries' progress away from central planning, it did not necessarily follow that bank privatization was essential. The simple question which had to be posed was: what was privatization trying to achieve, and how would it increase banking efficiency? The answer was always less simple, and highlighted the extent to which Central Europe's economic and industrial future at that stage still remained unplanned. The state was not yet ready to give up control of the banking sector, nor, arguably, should it have done so.

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[1] Kapoor M. (1996). *"Are banks ready?"*, Business Central Europe, February, pp. 7-11.

[2] It is significant, for example, that privatization is totally absent in all the papers published in the IMF's 1997 publication *"Systemic Bank Restructuring and Macroeconomic Policy"* – (Alexander W.E., Davis J.M., Ebrill L.P., Lindgren C.J. (eds) – which was the joint product of the IMF's Fiscal Affairs and Monetary & Exchange Affairs Departments arising "from the need to advise countries on how to deal with banking system problems, and on how to consistently incorporate the macroeconomic aspects of systemic bank restructuring into IMF policy advice and IMF-supported adjustment programmes".

At its simplest, privatization is a bottom-line question: its defenders will consistently hold that the commercial orientation of private companies means that they should operate more profitably than state-owned dinosaurs. For companies needing fundamental refocusing to survive, the argument is compelling and in many cases is an essential step to commercialization. But the bottom-line argument was of limited relevance to Central European banks, which were arguably amongst the most "profitable" in the world. The excessive caution they were rightly charged with stemmed as much as anything from a determination to keep profits up. Indeed, problems did as often as not come from naïve commercialism (e.g. chasing new business when unqualified to gauge risk) as from complacency.

By early 1996 few would deny that the banking system in any of these countries was run on commercial, rather than political, lines – while state influence was certainly there, direct control had long been gone. Nor could privatization be seen as the key to bank restructuring, for there was no evidence that privatization *per se* was speeding up the process. The presence of competition was a far more effective catalyst to development than mere transfer of ownership. For example, Hungary's *OTP* Bank restructured more effectively than the Czech Republic's *Sporitelna*, even though the Czech savings bank had been privatized significantly earlier.

At that stage it therefore appeared that the case for bank privatization in the CEECs remained at best unproven, and when difficulties of selling such large institutions were factored in the obvious conclusion was that it would be better to concentrate on increasing their efficiency, if necessary still under state ownership, than on privatizing them. The most obvious example of this debate was Poland, where international creditor pressure was forcing the authorities to take drastic steps to privatize the long-stagnant banking industry. But, because it was impossible to sell the banks on what were effectively shallow domestic capital markets, privatization was likely to be a sham by any meaningful criteria. If banks could be sold to private investors working through aggressively managed funds, then the debate would have been different, because there would be an emphatic distancing from the state, and corporate governance could be imposed by the market. But with 40% of Polish stock market capitalization already dominated by the banks, significant further issues were impossible, meaning that the shares would, one way or other, be given away (unless the banks were to be sold to foreigners, which was then politically unlikely), and market control, as opposed to legal ownership, would still be lacking.

1996 – WHAT THE POLISH GOVERNMENT WANTED

The structure of Polish banking was too dispersed, and the Government intended to rationalize the industry around existing regional and specialized banks.

In early 1996 the structure was:

- *Five state-owned commercial banks*
- *Three state-owned socialized banks*
- *Agricultural and cooperative banks (BGZ SA Holding)*
- *Private banks*
- *Foreign banks.*

Post-reform it wanted it to be:

- *Two or three banking groups with some foreign capital and remaining state minority share (formed around Handlowy Bank and Pekao Bank)*
- *PKO BO state-owned savings bank*
- *BGZ SA (food economy bank) and cooperative banks*
- *Two or three private banking groups formed out of the regional banks, probably with a remaining state shareholding*
- *Socialised banks (e.g. mortgage).*

Source: Business Central Europe, Feb. 1996, p. 7.

Ironically, this very lack of domestic capital appeared to be as the only thing which, in an inverse sort of manner, motivated the banks themselves towards privatization. Up to around 1994 Poland's largest bank, *Bank Handlowy*, showed absolutely no eagerness to privatize: ownership, to it, was irrelevant. Two years down the road it became desperate to do so, not out of conversion to Thatcherite idealism, but because it had become seriously scared by its inability to compete with larger banks. It needed growth capital; there was none available in Poland; that meant going to international markets; and that in turn required the transparency of a listed – and therefore private – company. Looking prophetically ahead the then deputy director of the bank put it very wisely: "If we don't have access to international markets, then in ten years' time we'll be the 20th biggest bank [in Poland], not the biggest".

Conclusions

It is easy to see how the debate on financial services privatization in the CEECs can become entangled in conflicting positions between issues related to systemic banking sector problems on the one hand, and those associated with individual banks in the region on the other.

A well-functioning banking infrastructure should be considered as a public good everywhere. The different CEECs' perception of the various elements discussed here is one important explanation of why the different governments there addressed banking sector problems with heterogeneous (sometimes outrightly inconsistent and often questionable) levels of urgency. And this must be seen alongside the fact that systemic banking *problems* often turn into full scale banking *crises* with related negative effects for macroeconomic growth.

Those CEECs which did consider the banking sector positively (e.g. Estonia) did so because there was realization of the fact that the size and impact of a systemic banking crisis on economic output and growth are dependent on the stage of development of the financial sector, and of course its linkages with the real sector. Actually however there are two views to be considered here.

On one hand is the argument that in a big country, say, the US, if a significant portion of such a country's banking system would collapse, the relative adverse consequences would be larger than if a similar event occurred in a smaller country. Matousek (1997) on the other hand does not think that this is quite so where big developed economies are concerned[1]. His view is that it is 'in many transition countries [that] bank credits still represent the only financial channel for the real sector, and that, moreover, a small number of commercial banks tend to have dominant positions as key lenders to the biggest companies". Therefore a collapse of such key institutions in the CEECs could be very harmful indeed for the real sector as well as for the emerging financial sector, something which, he holds, is not the case elsewhere.

This paper has not looked at the actual transformation and restructuring process of the banking sector in Central and Eastern Europe, a process which can generally be said to have commenced around 1989-1990, and which can justifiably be held as yet another consequence of known political events. Systemic national bank system restructuring during the 1990s developed into a discipline of its own, had a dynamic of its own, and comprised comprehensive programmes to rehabilitate significant parts of countries' banking systems, with the ultimate objective being that of providing vital bank services on a sustainable basis. Close study of policy assessments and strategic steps relevant to the different situations in each CEEC invariably reveals many issues that make this possibly one of the most fascinating areas of study in contemporary banking history.

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[1] Matousek R. (1997). Comments to paper by Hans Bloomestein in *"The New Banking Landscape in Central and Eastern Europe"* – (OECD, Paris).