eabh Papers | No. 14-09 | November 2014

The Balkan and Baltic Experience of Financial Services Privatization

John Consiglio*
The University of Malta

Abstract:

The financial services sectors of Romania and Estonia moved towards privatization in sharply contrasting manners. For a long time Romania's enthusiasm for its 1998 promise to the IMF to privatize its leading banks was only a commitment on paper; few steps were made towards its fulfillment. By contrast, Estonia's experience of privatization was generally a positive one, based on norms and structures often comparable to those in advanced industrial economies.

JEL Classification: G21, G28, N24, P34.

Keywords: privatization, financial services, Romania, Estonia, EBRD, IMF.

* John Consiglio, Department of Banking & Finance, The University of Malta.
Email: john.consiglio@go.net.net

THE BALKAN AND BALTIC EXPERIENCES OF FINANCIAL SERVICES PRIVATIZATION

John Consiglio
The University of Malta

1. Introduction: history and theory revisited

This study presents two sharply contrasting Central and Eastern European Country (CEEC) examples of how financial sectors moved from total state ownership into the private sector. Romania and Estonia, countries close to the bottom and top geographical ends of the continent, were similarly distant in their dispositions and modalities towards effecting change.

For many years, Eastern Europe mirrored several key features of the Soviet command economy. The basic elements of this reflection were: *First*, the state (essentially meaning the Communist Party) owned and directed the economy. *Second,* land, mineral resources, provision of banking and all other financial services, commerce and foreign trade, were all nationalized, and each overseen by state monopoly structures of various forms. Soviet-type 'single channel' banking replaced competitive commercial banks, with each channel/bank undertaking a specific role, such as foreign trade, investment, and saving.

Third, in stark contrast to Western market economies, economic management was such that primary production units, and services, exercised little autonomy. *Fourth,* quantity was emphasized over quality. *Fifth*, whereas money supply, the price mechanism and credit functioned in the West in structures where they could serve as tools to reduce costs and boost productivity, in command economies these were either deprivations, such as would be intolerable in the democratic West, and which also naturally included exceptionally low financial services conceptual quality notions. Ultimately all these elements cumulatively sparked change, often revolutionary in nature, in the CEECs.

The banking systems of practically all the CEECs evolved from the centrally planned monobank systems. When the process of change began, different approaches were taken in these economies in transition (EITs) in the creation of two-tier banking systems, but all involved the hiving off of commercial banking activities from the former state monobanks, leaving independent central banks to pursue monetary policy and exchange rate strategy. State-owned commercial banks (SOCBs) were born as joint-stock entities, with predominant and often exclusive ownership of the shares placed in the hands of a state agency or agencies.

In Hungary the commercial portfolio of the NBH (National Bank of Hungary) was divided along sectorial lines to create three such SOCBs. In the Czech Republic the commercial portfolio was separated from the Czechoslovak State Bank (CSB) in 1990, and three universal state-owned banks (SOBs) were born. In Poland the commercial portfolio of the National Bank of Poland (NBP) was divided on a regional basis to create nine such SOCBs. Existing specialized Polish banks (i.e. the foreign trade (merchant) bank and the state savings bank) were given universal charters, and restructured as joint-stock companies. In Bulgaria the creation of the two-tier banking system started in 1987 when the Bulgarian National Bank (BNB) occurred. In Estonia, as we see hereinafter, it was after the Soviet *perestroika* period that the two-tier banking system started. A 1989 Soviet decree granted the Baltic states the right to organize independent banking systems.[1]

"Bank privatization", in these and other CEECs, actually refers to the divestiture of state ownership in an existing joint-stock bank. As such, bank privatization of SOCBs should be distinguished from the creation of new (from scratch) private banks. The state often retained a core-investor-size stake in privatized SOCBs.[2] By contrast *"banking sector privatization"* must be considered as government policy that encourages the entry of either new private banks, or foreign banks, as greenfield operations into an economy.

So the orchestrated transfer of ownership shares in existing banks, from the state into private hands, fits the concept of bank privatization. Although both types of privatization are related in establishing a market-based banking sector, the two concepts should objectively deserve treatment within separate and distinct conceptual frameworks, an exercise which can be much handicapped if one follows only some of the facts which in themselves would be described as contemporary banking history evolution in these CEECs.

The main privatization policies followed one (or some combination of) from the three methods of:

1. Voucher distribution;
2. Private placement with a strategic foreign financial investor (SFFI); and
3. Initial public offering (IPO).

Hungary, the Czech republic, and Poland provided an interesting laboratory for all EITs as each used a method of bank privatization that was broadly representative of one of these prototypes. Hungary used the SFFI method for two of its three main bank privatizations. The voucher mass-privatization programme was the Czech method. In the case of Poland, after an eclectic approach that combined a search for a SFFI with an IPO, the Polish government settled on the IPO methodology as its preferred strategy for privatizations.

A fully detailed comparative analysis which includes *all* the Central and Eastern European countries and former states of the USSR, which tackles all the key issues of economic transition, and how they made progress in their respective national privatization programmes, is an extensive exercise and has featured in other studies. A seminal 1992 work, by Colin Jones, covered the challenges of privatization in Albania, Bulgaria, the Czech and Slovak Republics, Germany, Hungary, Poland, Romania, Bosnia-Herzegovina, Croatia, Macedonia, Serbia, Montenegro, Slovenia, Estonia, Latvia, Lithuania, Belarus, Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan, Moldova, the Russian Federation, and Ukraine.[3]

Jones's extensive work showed that, for existing and potential investors in this part of the world, the important issues always warranting examination are:

1. What was each region's objectives for privatization of its banking sector;
2. The scale and scope of the priorities involved (e.g. structures, bad loans, cronyism, corporate governance, technology, etc.) which needed to be taken into account; and
3. Actual details of the privatization methods and strategies being employed.[4]

Although they shared the same form of government for over five decades these economies were anything but homogeneous, a fact which needs to be taken into account when individual regimes are analysed for pace, and sequencing, of financial services sector reform. Hungary and Poland were already some way down the reformist road when other countries in the Jones's list had barely started the journey. The typical command economy was dominated by industry and agriculture, with services – *including banking* – only comprising around one-third of the whole, i.e. the reverse of the usual Western pattern.

But inevitably there were variations of these evolutionary patterns. Even as the above can be considered a general structural background, one could also conceivably accept the existence of other considerations (e.g. geography, ethnicity, race, history in pre-communist dominance periods, religion or philosophy,) as having, even in small measures, impacted on how and when countries privatized. Our choice in this paper of two example case study countries – one from the Balkans, and another from the Baltic – for examination of their bank privatization processes, must therefore be seen with the above as the general background.

2. <u>Romania</u>

The former Czechoslovakia was, for example, far more industrial than Romania. But in both cases the incidence of bad and doubtful debts in their banking systems was very high. Between 1988 and September 1990 accumulated losses exceeding Lei 250 bn were written off in Romanian enterprises, with the banks then being baled out from their weight through the issue of government deposits. In 1991 Government Decision No.447 (subsequently Law 7/1992) provided further substantial government refinancing of non-performing enterprise loans (Lei 135 bn).

Romania formally launched its mass privatization programme in 1992, by distributing privatization vouchers to about seventeen million citizens, with the initially expressed objective being that of letting them acquire 30 per cent of the capital of the 6300 companies which government wanted to see privatized. But nothing exciting really followed, least of all any livening up of capital market structures or activity.

Capital markets actually returned to Romania in 1995 after a fifty-year absence. Whatever the shortcomings of the market, its opening, and the announced mass privatization programme (which aimed to sell off within a year of its launch some 3900 companies), freed a large part of the economy from state control. But, measured against the size of its economy, Romania had Central Europe's smallest stock market in the 1995-1999 period. Daily trading volumes on Romania's stock market in 1997 were a meager $2.8 million, with nearly all of this in about 50 companies. In terms of sheer numbers however both the Bucharest Stock Exchange and Rosdaq (the OTC market) were made to look impressive: a total of 5000 companies with 100 on the Bucharest exchange.[5] In December 1997 the Romanian *Bank for Development (RDB)*, actually one of the best SOBs, and big in trade finance, was clearly indicated as one of the first to be privatized.

Early in 1998 the IMF was promised by Romania that, as part of its economic programme, it would privatize three of its SOBs (*Vide* Table 1). The World Bank was also demanding that at least two SOBs be sold before it would release a final $100mn tranche of a finance sector structural adjustment loan. By most standards the country had one of the region's most ineffective banking systems. Bank lending as a share of GDP was less than 15%, compared e.g. with 60% in the Czech Republic. The only way to improve was to import, via bank sales, foreign capital and knowhow, in short selling controlling stakes in the banks to strategic investors

Table 1

Romania SOBs – Lei bn – end 1996			
	Assets	Deposits	Profits
Bancorex	12,980	4,100	170
RCB	8.700	2,720	610
Banco Agricola	8,120	2,500	170
RDB	3,760	700	460
Bankcoop	2,160	1,180	56
Bankpost	1,240	270	32
Source: PriceWaterhouse (BCE, Mar 1998)			

The "merchandise available for sale" was a mixed bag. *Banc Post* (post office bank) and *RDB* were saleable as they were relatively clean and small. *Banc Post* had 108 branches and outlets in about 2000 post offices, a retail presence making it attractive as a distributor of products, such as insurance. Most of its business was short-term lending, often backed by export guarantees. And its management – by dint of its correspondent banking relationships – also had some international experience.

The third bank earmarked for privatization was *Banco Agricola* whose asset base was almost twice that of the other two together. In the particular context of the Romanian economy[6], with an extremely poor and predominantly agricultural working population ekeing out a bare living on the base of state farming subsidies, this SOB was the traditional vehicle for financing, but was also loaded with bad debts. It was highly unlikely to attract interest without parliament voting a proposal to clear these.

The EBRD, and the World Bank's IFC were prepared to take stakes in three Romanian banks on the basis of loan-for-shares agreements. The EBRD was very active in all the Eastern European banking sectors, and all along leading personalities in the country were confident that it would play a useful role in Romania too.[7] In its 1999 Transition Report (p.256) the EBRD highlighted the fact that *Bancorex* had been put under administration of the National Bank of Romania *(NBR)* at end of February 1999 when more than 70% of the bank's loans were classified as non-performing.

The management of *Bancorex* had resigned in a dispute with the government over the terms of a restructuring plan, leading to a run on the bank, with some $200 mn fleeing out of the country's banking system. The development of a restructuring plan for *Bancorex* too had featured prominently amongst the *"prior actions"* required of the government under the IMF programme under negotiation. The State Ownership Fund owned 62% of the bank, with the rest held privately by financial investment companies (formerly private ownership funds) and some individuals.[8]

Table 2

Romanian banking system as of end-December 1998					
Capital ownership	**Number of banks***	**As a share of**			
		Balance Sheet	**Total Credits**	**Total Deposits**	**Paid-up Capital**
State owned	1	9.56	5.43	13.05	4.38
Majority state-owned	6	68.70	76.11	63.22	55.36
Domestic private capital	4	3.29	3.85	3.96	4.84
Domestic and private capital	6	6.10	5.92	5.79	7.02
Majority (domestic & foreign) private capital with some state-owned capital	1	1.74	2.14	2.22	1.59
Majority domestic private and state-owned capital	1	0.21	0.18	0.16	1.00
Majority (foreign & domestic) private and with some state- owned capital	1	0.69	0.82	0.85	1.46
State-owned and foreign private capital	1	2.13	0.62	2.40	6.88
Domestic and foreign private capital	5	2.64	1.65	2.97	5.41
Foreign private capital	8	4.94	3.28	5.38	12.06
	34	100.00	100.00	100.00	100.00

* Except *Dacia Felix* and *Credit Bank.*
Note: The NBR Quarterly Bulletin 1/1999 features a full list of the 45 banks operating in Romania at 31 March 1999, 36 being shown as Romanian legal entities, and 9 as foreign.
Source: National Bank of Romania, Annual Report, p.75

An Asset Recovery Agency was created to manage *Bancorex*'s non-performing loan portfolio, and to implement recovery action. In July 1999 *Bancorex*'s licence was withdrawn, and by this time the country's overall banking system was defined in terms of the structure in Table 2. Besides the EBRD, interest in *BankPost* was also shown by the Anglo-Dutch joint venture ABN Amro Hoare Govett who were confident that they could meet government's demand for a trade sale and equity placement (domestic and international by end of 1998.

But again, in Romania, as we saw in the case of the Czech Republic, the view of western analysts of the Romanian government's resoluteness on privatization was anything but positive for a long time. Even as a new 1998 programme promised calls for at least 1600 companies to be privatized in that year, including three banks, uncertainty prevailed. [9]

The causes for this uncertainty were varied:

1. Reported plans to sell stakes in *Banc Post* to employees, to the post office, and to the national telephone monopoly Romtel;
2. Expressed intentions to retain 'golden shares' and lack of clarity on the size of these;[10]
3. The little real power held by the investment banks mandated to make the privatizations beyond getting bids on board, and, of course; and
4. The usual problem of bank privatization touching the darker side of nationalism, where politicians were reluctant to put into the hands of foreigners what they considered to be a key part of their power.

For a long time Romania's failure to deliver on promises of economic reform earned for it for a long time a reputation as the laggard of Eastern Europe.[11] The centre-right coalition that ruled from 1996 till the end of 2000 paid scant heed to budget discipline and tolerated inflation that never went below 40 per cent. privatization proceeded so slowly that after a decade 80 per cent of large SOEs remained unsold, and allegations of corruption tainted many that were made. Between 1997 and 2000 GDP fell by 13 per cent. One could hypothetically argue that it was the problem of coordination among institutions in the privatization process which hampered national economic progress for a very long time; and this when there were, from 1997 onwards, several indicators of an increased pace of legislation and marketing measures[12] related to the process.

Certainly Romania's extremely bleak economic situation in 1998 and 1999 had "at the root of the whole mess a state banking sector that could soon come apart at the seams".[13] Similar to, for example, the Ukraine, Russia, and Pakistan, it was hovering on the brink of defaulting on Eurobond loan repayments even as – surprisingly contrary to IMF rules – it kept repaying big chunks of them. This too can in a way be interpreted as the country clinging on to post-communist economic practices, when in fact the country, along with Czechoslovakia but different to most other new post-communist governments, did not inherit large external debts from its predecessor governments.[14]

The EBRD Transition Report for 2000 saw the July 1999 closure of *Bancorex* as helping to improve the financial performance of the banking system. The share of non-performing loans fell by one-half between May and December 1999, but continued government support to weak enterprises added a further US$ 1.3 bn (equivalent to 3.8% of GDP) to the domestic debt. As tighter enforcement of Basle and EU-standard regulation bit in, several private banks started to fail, but still this exit process was slow. The Romanian Religion's Bank was put under special supervision in May 2000 after it was unable to raise capital.

The scenario continued to worsen. In May 2000 the largest Romanian investment fund (FNI) too collapsed after mismanagement and fraudulent practices as well as poor regulatory oversight. The failure of FNI also involved the state-owned *Savings Bank (CEC)* which was a shareholder in FMI's management company, and which had invested in FNI certificates and issued a guarantee for investments in it.

This collapse put pressure on the largely unregulated "popular banks", which were mostly credit cooperatives not having any deposit insurance protection for their depositors. *Banca Popular Romana*, the largest of such cooperatives ceased to operate in June 2000 when it could not meet deposit withdrawal requests.

Even as the central bank stepped in, in July 2000, to take over the authorizing, regulating, and monitoring of funds, suspending the issue of all new such licences, it was the turn of the State Ownership Fund (SOF) itself – the country's main privatization authority – to reach the end of the road in September 2001. It too was in a mess. It still held main shareholdings in 1047 firms that needed to be privatized, or closed. But, worse than that, several of its past divestitures were coming back to haunt it in the shape of controversy and corruption accusations. And these included some of the biggest amongst its past sales.[15] Under attack from all quarters it closed down with the remaining SOEs sinking deeper and deeper into debt, and in early 2001 was replaced by a new body, the Authority for privatization and Management of State Assets (APAPs).

When Adrian Nastase came in as Prime Minister at the end of 2000 he showed no hesitancy in declaring his intentions to jump-start the country's stalled privatization programme. His first big promises were to jointly go for deficit reduction and privatization, hoping to end a decade of dithering over reform. At end-2000 SOBs accounted for 38% of registered capital, and held about half of the domestic market in terms of assets.[16]

In the first nine months of 2001 GDP was up 5 per cent, industrial production grew by 10%, and inflation dropped to below 10%. Besides selling Sidex (a large steel mill on the Danube) to the LNM Group (the Anglo-Indian conglomerate which owned the world's fourth largest steelmaker), he vowed to move ahead with plans to find by early 2002 a strategic investor for *Banca Commerciala Romana*, which was then Romania's largest bank.

In April 2001 *Banca Agricola* was privatized to a consortium which included Raiffeisen Bank and the Romanian American Enterprise Fund. After that privatization only three banks remained state-owned. The *Banca Agricola* privatization brought a situation where overall more than two-thirds of total assets of the banking system were now in private hands and about 55% were foreign owned, (c.f. with a situation of 78% being state-owned at end-December 1998).

Of the three remaining SOBs the most attractive to investors was *Banca Commerciala Romana (BCR)* which held 30 per cent of total banking system assets and total loans to customers. In 2001 the usual appointment of an apposite privatization commission for this bank was made, but, again, government dithered and moved the plan to complete the sale to before the end of 2002. The strategic ownership structure of Romania's banking sector in 2001 then stood as follows (Table 4).

Table 3

Romania – Banking Sector Ownership					
	1989	1994	1999	2000	2001
Number of banks	12	27	41	41	41
100% state owned	5	1	1	1	1
Partially state owned	-	6	3	3	2
100% private	-	20	37	37	38
Source: BCE					

In the case of the former savings bank, *CEC*, dithering continued on whether it would be given pure commercial bank status in the subsequent years, whilst *Eximbank* still needed surgical restructuring before privatization could even start. But even as this hesitation persisted, the branches of foreign banks present in Romania[17] - operating in terms of legislation that now allowed them to enter the market under the same conditions as the domestic banks[18] - these were now very effectively making their presence on the market.

But this factor, 'the market', was now carrying with it a public and political psychological connotation totally different to the past. By 2004 Romania, along with neighbouring Bulgaria, was deeply involved in negotiations for entry into the European Union. The country's accelerating privatization drive was seen, and actively pursued, in terms of the necessity that the country be pronounced by the EU as satisfying one of the three necessary Copenhagen criteria, viz that of the country being a "functioning market economy".[19] Some 70 per cent of Romanian GDP was now being created by the private sector, and that earned it the status of *a market economy.*

Table 4.

Romania – Strategic Ownership of Banks – 2001 (On Adjusted Common Equity (ACE) basis)*					
Bank	Ranking among Top 100 CEEC banks	Total reported assets US$ mn	Main shareholder	%	% of all foreign investors in capital
Banca Commerciale Romana	7	2353	State	-	-
Banca Romana pentru Dezvolatare	25	1355	Societe' Generale (FR)	51	56
Bank Post SA	54	367	EFG (GR), Banco Portuguesde Investimento (PT), GE Capital (US)	53	53
Commercial Bank Ion Tiriac	84	283	Redrum Intnl Ivestments	40	76
Banca Agricola	96	313	State	-	-
FR=France; GR=Germany; PT=Portugal; US=United States - * For banks and bank holding companies. Common Equity adjusted for Loan Loss Reserves and Non-performing Loans. *Source:* Standard & Poor's, Central Bank					

German Chancellor Gerhard Schroeder, with what could be described as perceptible political astuteness, held that it would be considered as *a functioning market economy* "if privatization continues at the pace seen recently".[20] Such urging on was conceivably motivated not solely by any wish to see EU expansion, but also by perceived prospects of more German involvement with an (eventually) totally privatized Romanian economy. Even as Schroeder spoke the German bank *KfW* was active in asserting a financing presence in relation to significant deals worth some 800 million euros for German firms[21] in the Romanian market.

3. *Estonia*

This Baltic economy's bank privatization story was a very different example which evolved with a different conceptual approach.

Eesti Pank (EP), Estonia's central bank[22], claims that Estonia "was the country where the very first privately owned commercial banks in the former Soviet Union (and probably even the very first in the whole of Eastern Europe) were founded in the late eighties. By the time of the 1992 monetary reform most of the country's 40 plus banks were privately owned institutions that were not successors of any former state owned structures".[23] The EBRD places the number of commercial banks which were established between 1989 and 1992 at 42, adding that these were mostly small and undercapitalized.[24]

In some cases various Estonian state institutions had obtained minority holdings of these new commercial banks' shares. *Eesti Pank* statistics then considered bank shares held by government owned enterprises as state owned shares. But what could conceivably be considered as a generally positive sounding scenario actually hides a lot.

The 1992 to 1995 years were "crisis" years for Estonian banking[25]. It was a period when insolvent commercial banks held some 41% of the banking system's assets. The licences of five banks were revoked, two major banks were merged and nationalized, and two large banks were merged and converted to a loan recovery agency. Although in early 1994 it seemed as if problems had been resolved, another two large banks were found to be insolvent, and again merged and converted to the national loan recovery agency.

It was palpably clear that the loss of trade with the Soviet Union which had happened in 1990 had caused a terms of trade shock for the country. Monetary policy was tightened, a currency board instituted, and 1992 and early 1993 was a sharp recession period. Did the recession bring the banking crisis, or did the banking problems exacerbate the downturn? Even as we write the debate is still out amongst the country's banking historians.

The new currency board arrangements protected monetary policy from expansion in sequence to the banking problems. As the economy relied more heavily on cash payments the currency-to-deposit ratio rose, and the money multiplier fell. The exchange rate, pegged to the Deutsche Mark, was not affected.

At the start of this crisis period Estonia's banking system was a concentrated one. There was no direct foreign competition, and only joint ownership was permitted. With such non-diversification the banks often extended insider loans to owners. Credit-assessment skills were underdeveloped, and weak accounting systems, and inadequate loan classification and bad debt provisioning practices, were prevalent.

Estonian banking had been part of the Soviet monobanking system until the late 1980s, and the country had in fact participated in the bank reforms of the last years of the Soviet Union.[26] In 1992 the Estonian banking system had become independent of the former Soviet system, and the Estonian currency (the kroon, or crown) was established in June 1992. In that year its value to the US$ stood at 12.91, rising to 11.46 by 1995, and dropping to 16.82 (15.66 to the Euro) in December 2000,[27] certainly at least one consequence of the then ongoing crisis, and in which the banking sector was inevitably embroiled.

Eesti Pank (the central bank) placed the start of the crisis in November 1992[28]. The fact that three of the largest banks, *Tartu Kommertspank (TK)* (Tartu Commercial Bank), *Balti Chispank (BC)* (Union Baltic Bank), and *Pohja-Eesti Akstapank (PEP)* (North Estonian Bank), plus eight smaller banks (in 1993), became insolvent, considerably weakened public trust in the Estonian banking community. The government-central bank rescue operation merged *BC* and *PEP* into a new bank *Pohja-Eesti Pank* (North Estonian Bank), and this was a complicated affair, particularly in view of the fact that 63% and 64% of the assets of the two respective banks were frozen accounts with the former *Vneshekonomobank* of the Soviet Union.

The *Savings Bank of the USSR* had had a branch in Estonia for a long time. An EP decision of the 14th April 1992 turned that into *Hoiupank,* the Estonian Savings Bank, with the central bank owning all the shares. At that time 85% of the population's savings were held by this bank and EP took over a debt claim against the former State Bank of the USSR for 3.05 bn roubles. The new bank was fully recapitalized on the basis of the central bank's gold reserves by the time of the monetary reform,

Consonant with its already mentioned policy of direct, but always well thought out, involvement in the region's banking systems, the EBRD became a minority shareholder in the *Estonian Investment Bank* in 1993. EP was the majority owner of this bank whose main role was the provision of currency loans to Estonian firms. In that year the *American Baltic Bank* started operations[29], but several Russian and Ukranian banks' approaches for licenses were being back-peddled as political resistance to Russian influence over the Estonian economy prevailed. Fear against possibility of involvement in money laundering, and fraud, from these sources was also high.

The IMF considered the licensing structures for banks in Estonia between 1992-1995 as having been weak. Capital requirements for new banks were inadequate, and other prudential regulations were lacking. Supervision was inadequate and allowed for fast growth, risky portfolios, and the other mentioned shortcomings[30].

An anti-regulation culture pervaded amongst many bankers and other economic operators, and for a long time during the period of banking problems in the early 1990s' no system of deposit insurance was in place and depositors simply suffered losses when banks failed.[31] But 1993 must be also be considered as having been a year where valuable bases for a later effective regulatory environment were laid down: it was the year when new banking regulations were adopted, a securities market law was enacted, a Securities Commission established, competition law passed and a competition agency established, and some utilities regulation (e.g. a new law on the electricity sector) was enacted.

A few months after the establishment of *Hoiupank* four banks were invited to participate in a competitive tender to subscribe to new shares being issued. That October 1992 call brought in *Hansapank* as a strategic investor. The share capital was gradually increased after that, and by end 1995 EP only held 24.1% of the shares. This savings bank is the only bank in Estonia where one comes across privatization in the restricted sense of privatizing of former socialist structures.

EP is particular in distinguishing *Hoiupank* from the category of privately held problem banks which would first have been acquired by state structures and then sold at a later date.[32] Bonin (1998, p 126) describes *Hansapank*'s presence in Estonia as "a rare successful case of indigenous bank development within the four year old Estonian financial market". Not only did it become the largest domestic bank, but by acquiring 30 per cent of *Hoiupank* it dominated the market. Since Estonia was the most open financial market of the region's EITs (probably mainly because of the mentioned currency board) external competition could still prevent a monopolistic situation.

Special characteristics in fact made Estonia's financial markets (particularly the retail and interbank markets) different from those in other CEECs. In essence these were:

(1) *The openness of the economy and of the financial system:*
Cross-border banking was a real option for retail and corporate bank customers, thus rendering local market structure less important than in other CEECs.

(2) *Small individual household deposits in the banks, and high household wealth held in cash:*
A much smaller share of household deposits than in other former centrally planned economies was in the banking system, and *Hoiupank* was therefore far from "dominant" in the market[33]. This was a salient element of the Hansabank-Hoiupank marriage.

(3) *The very short maturity of financial assets:*
The share of demand deposits was overwhelming: 82% of total deposits in May 1995. The domestic supply of medium to long-term loanable funds was therefore extremely limited, and most such long-term loans were backed by foreign (mostly official) funds. Intermediation between domestic savers and borrowers was for far too long of secondary importance.

(4) *Banking had a high, and rising, predominance in the financial markets:*
The four largest banks (*Hansabank, Union Bank of Estonia, ESB* and *North Estonian Bank*) had a combined overall market share of 68.4% in May 1995. The 1992 bank crisis, the 1994 collapse of *Social Bank,* and increased minimum capital requirements, further increased the degree of market concentration and bias towards the banks.

Estonian official policies placed no specific restrictions on foreigners making approaches for local businesses, but at evaluation stage strong study of an "entire bid" would take employment and investment size into consideration[34]. Between 1993 and 1995 FDI into the country moved up from \$153mn to \$249mn in 1994, and down to \$196 mn, but at that level was still one of the highest per capita inflows in the region.

A useful result from EP and government measures after the November 1992 crisis – (in essence the merging of key banks, the absorption of bad loans by government to cover liquidity shortfalls, and bank behaviour reorientation towards risk analysis and diversification, and away from speculation) - was customer shift patterns and more careful selection of banks. This both strengthened competition, as well as pushed the reformed banks to levels of confidence where external perception of Estonian banks – particularly in the eyes of Latvian and Lithuanian banks – increasingly became that these were “arrogant” banks. But Estonia had implemented the most austere financial reform in the region[35], reformed its banking three to four years ahead of its neighbours, and its banks had emerged as high-tech and hungry for international expansion.

A stock exchange (of sorts, it must be said!) was opened in Tallinn in 1996. It traded only five stocks at inception, but the step did indicate an important development in Estonian financial market reform, increasing transparency and opening equity investment to Western investors. The first year of this exchange was a hard and testing period. Investors were clearly worried about the fast pace of economic growth and a widening current account deficit.

In one week in October 1997 the Tallinn stock exchange plummeted a full 22%, and again a further 60% in November 1998, and speculative pressure against the kroon was only resisted through continued expression by the central bank of its determination to support the currency board regime which had fixed the rate to the D-Mark at 8:1 for the full previous five years.

But even after the Estonian stock market had managed to bounce back late in 1997, it was only several years later that real local interest in the exchange got into its stride. Up to around 1998 the Estonian capital markets remained small, and the only traded securities were central bank (EP) short-term bills. The first Estonian Eurobond issue, by *Eesti Uhispank* in February 1999, appeared to do little to liven up securities market activity, and the EBRD, in its Transition Report for 2001 (p.138), was still expressing the hope that the consolidation of the Tallinn and Helsinki stock exchanges, the introduction of new securities legislation, and the development of domestic pension funds, would spur expansion of such security activity.

In Estonia, (unlike for example in Hungary), the central bank had strong statutory discretion over bank insolvency. But what is also often cited in international policy debate is that its 1992 handling of the earlier mentioned bank failures was effectively a hands-off approach that paid off spectacularly.

One reason which is today quoted by Estonian bankers as a possible explanation for this is that, as some of the country's large commercial banks were inherited from the Soviet era as Estonian branches of the Soviet specialized banks, and as some of these had become partly owned by private Russian structures as their own parent banks went through an ownership transformation, for these reasons treating them severely would have had a strong political dimension, and a more laissez-faire attitude was "easier" to implement by the Estonian authorities.

privatization policy was therefore very substantially different in Estonia when compared to other CEECs. The predominant approach can be described as having been that of state structures only intervening to acquire privately held problem banks, to then sell them later. The central bank became a holder of various small problem banks' assets over the years until these were all acquired by *Eesti Uhispank* (Union Bank) in early 1997.

In late 1998 the central bank (which had held no significant blocks of bank shares for the previous year) had to take over the majority (58%) of the shares of *Optiva Bank* which then held an approximate 6.5% market share. Plans were already in hand to sell them off by late 1999 or early 2000. Table 5 below shows that at end of 1998 the government only owned 14.3% of total ownership of Estonian credit institutions.

Table 5

Estonia – Owners of credit institutions as of 31st December 1998

		Estonian legal persons				Non-resident legal persons				
	Public sector	Credit institutions	Investment funds	Other legal persons	Estonian natural persons	Credit institutions	Investment funds	Other legal persons	Foreign natural persons	Other
Eesti Krediidipank				2,9%	52,7%		9,1%	27,0%	0,0%	8,3%
Eesti Ühispank	0,9%	0,4%	1,0%	13,0%	8,9%	68,4%	5,0%	2,0%	0,4%	
Hansapank	1,9%	0,2%	1,0%	12,1%	6,3%	64,9%	0,5%	12,7%	0,6%	
Optiva Pank	57,9%	5,8%	0,4%	24,7%	2,6%	7,1%	0,1%	1,2%	0,2%	
Tallinna Äripank	0,0%			78,9%	4,7%			16,3%		
Total	**14,3%**	**1,6%**	**0,8%**	**17,4%**	**7,8%**	**48,5%**	**2,3%**	**6,6%**	**0,4%**	**0,3%**

Source: Eesti Pank, Annual Report, 1998

Hansabank (Estonia's largest commercial bank), *Estonia Savings Bank* (third largest, and largest as retail bank), *Tallinna Pank* (fifth largest commercial bank)[36], *Forekspank* (another large commercial bank), and *Uhisbank*, all of these institutions had by 1998 become very ambitious institutions in the region. By international standards they were still small (and in certain aspects backwards) but the benefits of early reform had placed them in a situation where they were even being looked upon with some hope[37] that their discipline and propensity towards international expansion would possibly help sort out some of the chaos in the region's banking.

The evolution of ownership of Estonian banking between 1993 and 1998 emerges very clearly from the following Table 6.

Table 6

Estonian Bank Ownership 1993-1998						
	1993	1994	1995	1996	1997	1998
Total no. of banks	21	22	18	15	12	6
No. of banks with state ownership exceeding 50%	3	3	1	1	0	1
No. of banks with foreign ownership exceeding 50%	1	1	4	3	3	2
Source: Eesti Pank, 1999						

1997 was an extraordinarily good year for Estonian banks. These were now institutions which had embraced cutting-edge technology in their desire to become effective and profitable western style institutions. Paper cheques were never really introduced in Estonia; the PC, internet, telephone banking, and bank cards[38], were the generally used fund flow systems; and when the banks in 1997 borrowed abroad at favourable rates costs for domestic consumers fell. Bank assets and credit grew rapidly in that year, and record profits were made from securities trading. But the expansion of domestic credit financed by foreign borrowing raised concerns of economic overheating.

In 1999 the Estonian finance ministry granted the country's first-ever pension fund licence to *Hansa Asset Management*, a subsidiary of *Hanspank.* Inflation boosting tax incentives to industrial investors and corporates attracted counter central bank intervention on the banks to raise CA ratios.[39] From 12 in 1997 the number of licensed banks dropped to five.

Over the 1998-99 years a number of banks merged. *Hanspank* joined with *Hoiupank*, *Unispank* joined with *Tallinna Pank*, and *Swedbanken* acquired an influential stake in *Hansabank* (just under 50%). *Skandinaviska Enskilda Banken* (also Swedish) acquired a significant minority stake in *Ohispank* (36%), and a number of banks also closed. In late 1998 the central bank had recapitalized *Forkesbank* which had been going through a troubled patch, and then merged it with the *Estonian Investment Bank.* Early in 1999, in the aftermath of the Russian crisis, *Evea Pank* and *ERA Pank* (which actually owned 35% of *EVEA Pank*) were declared bankrupt.

In June 2000 the central bank agreed with the Finnish *Sampo Finance* for the sale of its 58% stake in *Optiva Pank*, then the third largest Estonian bank. Under this privatization deal *Sampo Finance* paid a total of Ek 214 mn (approx. Euro 14 mn), but also wrested a partial indemnity from EP to cover the quality of *Optiva*'s assets. *Sampo* also offered to purchase the rest of the *Optiva* shares owned by minority shareholders – including the 19% stake of *Eesti Uhispank*, then the country's second largest bank – for a price of Ek 7.8 per share.

With the sale of *Optiva Pank* the Estonian government and central bank reached the stage where – excepting some small residual holdings of less than 1 per cent – the state had no more shares in the banking sector. A decade of single-minded reforms had not only brought its banks to age on the domestic front, but also in the region. *Hansabank Latvia,* the name given to *Deutsche Lettische Bank* after Estonian *Hansapank* had bought it out in mid-1996, by 1999 became Latvia's sixth largest bank. And it was now planning a subsidiary also in Lithuania. *Hoiupank* also bought the small Moscow-based bank *FABA* in September 1997.

Table 7

Estonian Banking 1989-2001					
	1989	1994	1999	2000	2001
Total No. of banks	10	22	7	7	7
100% SOBs	5	-	-	-	-
Partly SOBs	0	1	1	0	0
100% privately owned	5	21	6	7	7
Commercial banks	5	20	6	7	7
Investment banks	0	1	0	0	0
Bank branches	n/a	n/a	296	205	211
*Total deposits	n/a	443.7	1681.4	2217.0	2719.7
*Total lending	n/a	279.7	1704.3	2189.2	2602.2
*Share Capital	n/a	34.1	134.2	123.7	130.5
Return on Equity (%)	n/a	4.4	9.6	8.3	20.9
Loans overdue for 60 days, (%)	n/a	n/a	3.4	2.2	2.7
* mn of Euro (1 Euro = 15.6466 EEK)					
Source: Eesti Pank, 2002					

The last act in the Estonian state's total withdrawal from ownership of financial market structures was the May 2001 sale of its majority shareholding in the Talinn Stock Exchange to the owners of the Helsinki Stock Exchange. The EBRD described this as "consolidation" of the two exchanges, and expressed the view that, together with new securities legislation and the development of pension funds, this measure "should spur the expansion of securities activities"[40].

At the end of 2000 the Talinn exchange market's capitalization stood at Euros 1.9 billion, compared to Euro 318 billion and Euro 32.87 billions of, respectively, the Helsinki and Warsaw exchanges. And at the end of 2001, in terms of CEEC strategic ownership status, Estonia's banks ranked, and were owned, as follows:

Table 8

Estonia – Strategic ownership of banks – 2001 (On Adjusted Common Equity (ACE*) basis)					
Bank	Rating among top 100 CEEC banks	Total reported assets US$ mn	Main shareholders	Holding %	% of all foreign investors in capital
Hansabank	14	313	Smedbank (SE)	58	100
Eesti Huisbank	15	925	SEB (SE)	>96	-
Sampo Leonia Bank	over 100	262	Sampo Leonis (FI)	100	100
SE = Sweden; FI = Finland * For banks and holding companies; Common Equity adjusted for Loan Loss Reserves and Non-performing Loans.					
Source: Standard & Poor's, Central Bank					

The pragmatic measures and structures which small Estonia had followed in its bank privatization setups, and these as a vital element of its economic transition, have been described as Thatcherite in approach.[41] It had been an approach which brought the country to a stage where totally new concerns were occupying its authorities from 2001 onwards. These were all essentially related to the declared objective of getting the country into the EU.[42]

The country's new priorities in the financial sector now included, *inter alia*, the building of a well-functioning securities market, where company visibility and market liquidity would be regular features, and the bringing into effective operation an integrated financial supervisory structure, covering not only banking but also securities activities and insurance.[43]

4. *Post-reform evolution and conclusions*

The two different trajectories of Romania's and Estonia's financial sectors moved from under total state ownership into the private sector inevitably brought in their wake sharp contrasts in EBRD economic classifications in 2001 for the two countries' progress on large-scale enterprise privatization, on banking reform, on interest rate liberalization, on securities markets, and on non-bank financial institution reform. These classifications are shown in Table 9 and further interpreted below.

Table 9

Transitional Progress – 2001		
	Romania	Estonia
Large scale enterprise privatization	3 +	4
Financial Institutions:		
Banking reform and interest rate liberalisation	3 –	4 –
Securities markets and non-bank Financial institutions	2	3
Source: EBRD Transition Report, 2001		

The 3+ grading which Romania earned in respect of the privatization process of its larger enterprises meant that a level of *over 25 per cent of the assets* of these enterprises had moved into private hands, or was in the process of being privatized. The process in the latter case was considered as having reached a stage where the state had effectively ceded its ownership rights, but major issues regarding corporate governance remained.

For the same process the 4 grading earned by Estonia reflected the fact that the percentage of such privatized assets was *over 50 per cent*, and that significant corporate governance progress had taken place in these enterprises.

By 2001 Romania was considered by the EBRD as having made "substantial" progress in establishing bank solvency, and in the creation of a framework for prudential supervision and regulation. The country now had full interest rate liberalization, with only restricted situations of preferential access to cheap refinancing. The 3- grading also reflected the EBRD's view that the levels of lending to private enterprises, and of the presence of private banks, were significant.

On the other hand, Estonia's now higher gradings meant that the standards and performance norms in that country's banking system were those equivalent to advanced industrial economies, with full convergence of banking laws and regulations towards the standards of the Bank of International Settlements (BIS). In the eyes of the EBRD Estonia now had a banking system where banking competition functioned well and was prudently supervised. Significant term lending to private enterprise, and substantial financial deepening had also become welcome aspects of the privatized Estonian banking sector.

Romanian and Estonian securities markets, and the role and levels of activity of non-financial institutions, showed a number of areas where in both countries progress was slow. The formation and development of securities exchanges, and similarly so that of market-makers and brokers, was a long uphill struggle in Romania. Trading in government paper and in other securities was at low levels, and public perception of such business was no doubt effected by the existing rudimentary legal and regulatory framework for issuance and trading in securities.

In Estonia the issuing of securities by private enterprises was more substantial. The market was better protected through the existence of formal share registries, secure clearance and settlement procedures, and an acceptable level of protection of minority shareholders' rights. Estonia also earned a positive grading from the EBRD for an acceptable associated regulatory framework covering emerging non-bank financial institutions, such as investment funds, private insurance and pension funds, and leasing companies.

These differing pictures of the manner of SOB privatization in these two countries could possibly suggest as a general conclusion that in both countries FSI privatization was at a certain point accepted with the necessary positive and correct culture. They had however substantially different starting off bases and evolutionary patterns, and the main elements of their respective privatizing experiences are synthesized in the two tables below.

KEY BANK PRIVATISATION THEMES		THE EXPERIENCE IN ROMANIA
Category	**Indicators and Issues**	
Attitudinal approaches to banking	- Downplaying financial services sector's role for economic growth - Banking not considered as a public good - Low appreciation level why systemic banking problems need to be addressed urgently - The socialist concept of "public enterprise" - The pain-credibility-of-bankruptcy nexus - High/low information economies	- Persistent large SOE losses baled out by government deposits - Bank privatisation vs nationalistic feelings - Leading personalities expected EBRD to play role in sector's transition - W.e.f. 2001: increased decisiveness to privatise - Low information economy up to 1998
Economic scenario	- Big country or small - The disorganization factor - Budget limitations, and the soft budget constraint - Human resource & managerial competence - Legal traditions & infrastructures - Extent and role of FDI	- 13th in size in Europe; 10th in population; 1999 per capita GDP: $1520 - Poor predominantly agricultural working population - Institutional non-cooperation hampering economic progress - No large external debts inherited initially post-communism - Foreign capital and knowhow badly needed in banking system - Capital markets returned in 195 after 50-year absence - Status of 'market economy' only earned by 2004
Political scenario	- Weak governments & institutions - State immobilism towards change - Conflicts of interest - Interference	- Scant need given by government to budget discipline - Politician vs management clashes over *Bancorex* restructuring - Failure to deliver on promises of economic reform - Corruption slowing SOE sales - Institutional non-coordination - Post-2000: PM Nastase eager to jump-start privatisation
Privatisation generally	- Inadequate frameworks for the process - Inadequately developed capital markets and stock exchanges. - Pre and post privatization action.	- Long strongly negative perception of government's privatisation resolve - 1995-1999 Smallest Eastern European stock market - Sep 2001: State privatisation fund collapse - Regular *ad hoc* legislating re reorganisation & regularisation for bank sales
Systemic banking sector problems	- Capital inadequacy - Weak/ unperforming assets (e.g. loans) - Co-relation between poor bank lending & SOEs - Government (under) capitalisation - Timing of bank bailout recapitalisation - Expensive bank credit, especially SMEs - Poor or absent corporate governance	- One of the region's most ineffective systems - Banks' dependent on government deposits for survival - High incidence of B & D debts - Very low bank lending/GDP ration - Enforcement of Basle and EU standards pushed to failure private banks, but later also stimulated FDI into the sector
FSI privatization	- Strategy choice - Undertaking financial restructuring without supporting reform - Inadequate regulatory & supervision infrastructure - Speed or pace - Inability to collect, collate, publish bank data - Method (stock market sale, employee buyout, private sale, mass voucher)	- Long period of dithering about measures to be taken - W.e.f. 1992: i.e. initially privatisation vouchers - Small, ' clean' banks made available early for sale - Branches of foreign banks increased market presence post-2002 - Very slow initial progress; improving rate after 1998 - A low information economy - After failure of coupon system sales to foreign and domestic buyers

KEY BANK PRIVATISATION THEMES		THE EXPERIENCE IN ESTONIA
Category	**Indicators and Issues**	
Attitudinal approaches to banking	- Downplaying financial services sector's role for economic growth - Banking not considered as a public good - Low appreciation level why systemic banking problems need to be addressed urgently - The socialist concept of "public enterprise" - The pain-credibility-of-bankruptcy nexus - High/low information economies	- Early 1990s: anti-regulation culture present - First private commercial banks in former Soviet Union and Western Europe - System initially only favouring financial assets of short maturity - Strong central bank statutory discretion over bank solvency - Weak accounting skills - Post-1995: high and rising predominance of banks in financial markets
Economic scenario	- Big country or small - The disorganization factor - Budget limitations, and the soft budget constraint - Human resource & managerial competence - Legal traditions & infrastructures - Extent and role of FDI	- Population: 1.2 m; 44% of land mass forested - Open economy and financial system - Shock from 1990 loss of trade with Soviet Union - 1992-93 sharp recession; cash payments economy; high cash household wealth - Underdeveloped credit assessment skills
Political scenario	- Weak governments & institutions - State immobilism towards change - Conflicts of interest - Interference	- Official policies not restrictive to foreigners…..but - Employment and investment size considerations deemed paramount - 1993-94: highest per capita FDI in the region
Privatisation generally	- Inadequate frameworks for the process - Inadequately developed capital markets and stock exchanges. - Pre and post privatization action.	- State structures only intervened to acquire private problem banks, to then sell off later - State's approach only that of intervening in problem banks - 1996 opening of stock exchange signalled transparency and opening up to Western investors - Limited supply of medium and long term loanable funds
Systemic banking sector problems	- Capital inadequacy - Weak/ unperforming assets (e.g. loans) - Co-relation between poor bank lending & SOEs - Government (under) capitalisation - Timing of bank bailout recapitalisation - Expensive bank credit, especially SMEs - Poor or absent corporate governance	- 1992-95: inadequate satisfaction of CA standards - 1992-95: weak licensing system - Inadequate loan classification and bad debt provisioning practices - 1992-95: insolvent banks held 41% of banking system assets - 1992-95: revocations of licences, mergers, creation of loan recovery agency, and some insolvencies.
FSI privatization	- Strategy choice - Undertaking financial restructuring without supporting reform - Inadequate regulatory & supervision infrastructure - Speed or pace - Inability to collect, collate, publish bank data - Method (stock market sale, employee buyout, private sale, mass voucher)	- Merging of banks led to reduction in numbers, and absorption of bad loans - Key banking infrastructural introductions - Inadequate supervision up to 1993: fast growth, risky portfolios - Minority shareholdings by SOEs in new commercial banks - Small number of banks involved: suitable collated data availability levels - Reform completed by June 2000: years ahead of country's close neighbours.

APPENDIX A

ROMANIA: KEY FINANCIAL SECTOR PRIVATIZATION LEGAL MEASURES (1990-1998)

1. *Law No.15/1990*
   On the reorganization of state-owned commercial companies.

2. *Law No. 33/1991*
   On banking business.

3. *Law No. 58/1991*
   On privatization of commercial companies (amended by Government Emergency Ordnance No. 15/1997 dated 13th May 1997).

4. *Law No. 52/1994*
   On securities and stock exchanges.

5. *Law No. 55/1995*
   On speeding up of the privatization process and the social capital quotas allocated to the Private Ownership Funds.

6. *Law No. 66/1996*
   On the reorganization of *Casa de Economii si Consummatjume* into a joint stock bank.

7. *Law No. 83/1997*
   For privatization of commercial banks in which the state is shareholder.

8. *Government Decision No. 660/1997*
   On establishment of the privatization commission for the commercial company *Banc Post S.A.*

9. *Government Decision No. 670/1997*
On setting up the privatization commission of *Banca Romana pentru Dezvoltare S.A.*

10. *Government Decision No. 428 (27/7/1998)*
Approval of the privatization strategy for *Banca Romana pentru Dezvoltare S.A.* (M.O. 279/28.07.1998).

11. *Government Decision No. 435 (28/7/1998)*
Approval of the privatization strategy for *Banc Post S.A.* (M.O. 284/31.07.1998).

12. *Government Ordinance No. 127 (29/8/1998)*
For halting under-capitalisation (M.O. 328/29.08.1998).

13. *Government Ordnance No. 130 (29/8/1998)*
On regularization of registered capital quotas of banks undergoing privatization (M.O. 328/29.08.1998).

14. *Government Decision No. 598 (15/9/1998)*
Modifying Government Decision No. 670/1997 on *Banca Romana pentru Dezvoltare S.A.* (M.O. 360/23.09.1998).

15. *Government Decision No. 776 (29/10/1998)*
On amendment of Methodological Norms for enforcement of Law No. 83/1997 on privatization of SOBs (M.O. No. 426/11.11.1998).

16. *Government Emergency Ordnance No.51 (15/12/1998)*
Regarding several actions to be taken prior to privatization of banks (M.O. 482/15.12.1998).

17. *Government Emergency Ordnance No. 67 (29/12/1998)*
Relative to financial restructuring of *Banca Romana de Comert Exterior – (Bancorex S.A.)* as a prerequisite for privatization (M.O.515/30.12.1998).

18. *Law No. 250*

Modifying and supplementing Law No. 66/1996 *(vide No.6 above)* (M.O. 516/30.12.1998).

19. *Government Decision No. 995 (30/12/1998)*

Modifying Government Decision No. 660/1997 *(vide No.8 above)* (M.O. 526/31.12.1998).

ENDNOTES

[1] For full treatment of development of the Latvian banking system *vide* Chapter IV by Helmuts Ancans in *"Latvia Entering the XXIst Century"* by Roberts Zile (*et al)* (2000) – (Nacionalais Medicinas Apgads Ltd., Riga).

[2] A "core-investor-size" stake is defined as one which is larger than 25% of total equity in a bank.

[3] *Vide* Jones C. (1992) – *" privatization in East Europe and the former Soviet Union"* – (Financial Times Business Enterprises, London).

[4] In evaluating these elements one has to make allowance that, as stated in an earlier chapter, we are now (2003) well down a path where the reality is that only very few SOBs remain available in the CEECs for privatization, or even for M & As.

[5] *"Romania's stock market: quantity not quality"* – Business Central Europe (BCE), June 1998.

[6] Ceausescu's legacy was an economy plagued by an inefficient industrial structure and an almost totally obsolete capital stock, a completely disorganised system of production and distribution, a *collectivised agricultural sector*, a decaying infrastructure, and a population whose living standards had been forced steadily down to a level where bare necessities – food, heating, electricity, and medical attention – were hard to come by. There is little doubt that the initial obstacles to reform in Romania were far worse than those forced by the other reforming East European countries – (Denekas and Khan, 1991, p.30).

[7] *Vide e.g.* Lieven A. (1998) – *"Romania banks on EBRD to smooth the privatization process"* – (FT, April 3), and COOK J. (1998) – *"Romanian bank privatization: forced sale"* – (BCE, Vol 6, No.49, pp 59-60.

[8] *Vide* also *"Bank, or Wreck?"* - BCE, Vol 6, No. 60, April 1999, p 12.

[9] Final sale negotiations were actually the preserve of the State Ownership Fund, the government agency charged with privatising state assets.

[10] *Vide* Cook J. (1998) – *"The big test"* – BCE, Vol 6, No. 52, p.27.

[11] *"Eastern Europe"* as a political term belongs firmly to the postwar period – pre-war geographers had placed Eastern Germany, Poland, Czechoslovakia, and Hungary in *Central Europe.* Romania, Bulgaria, and Yugoslavia were clustered in *South Eastern Europe* (or the Balkans). Above all Eastern Europe represented a geopolitical bloc centred on Moscow. The Soviet superglue began to be applied to all states bar Yugoslavia when these were referred to by Soviet spokesmen as the "people's democracies" of Eastern Europe.

[12] Costly advertising by the Romanian State Ownership Fund, for "share sales *by negotiation*", for sales of shares "*by direct negotiation*", for sales "*through negotiation with final offers*", sales "*through negotiation*", and for "*management and financing*" of state entities contracts, appeared with assiduity in the Financial Times, The Economist, and other specialist readership media in 1999 and 2000.

[13] BCE, Vol 6, No. 61, May 1999 p 47.

[14] *Vide* Aldcroft & Morewood (1995) *op cit,* p.221.

[15] *E.g* a parliamentary commission claimed that in 1998 a 35% stake in national phone firm RomTelecom to Greece's OTE was sold below market value. Officials also claimed that the sale violated the law by including a 10% commission fee to unnamed parties.

[16] ECB (2001) – *"Financial Sector Developments and Convergence in Accession Countries: An Overview"* – Background paper for the Eurosystem Seminar with Accession Countries' Central Banks, Berlin, Dec 6-7, p 15.

[17] *E.g.* Chemical Bank (US), Societe' Generale (France), Franco Romanian Bank, Frankfurt Bucharest Bank, Egypt-Romania Bank.

[18] NBR, Quarterly Bulletin, N.3/1992, p.11.

[19] At the June 1993 Copenhagen meeting of the European Council four conditions were stipulated for future applicant countries to be accepted as EU members. These were (1) stability of institutions, guaranteeing democracy, rule of law, human rights, and respect for an protection of minorities, (2) the existence of *a functioning market economy,* (3) capacity to cope with competitive pressures and market forces within the EU, and (4) the ability to take on the obligations of membership, including adherence to the aims of political, economic, and monetary union, with this implying full acceptance of the *acquis communautaire.*

[20] *"Schroeder sees Romania as closing EU talks this year"* – Reuters, The Times, Aug 14th, 2004, p 19.

[21] The list of firms German firms which benefited from those deals included EADS Defence & Communications Systems (a Euros 650 m contract for implementing an integrated homeland state border security system), Siemens A.G., and the ABB-AREVA joint Swedish-German consortium.

[22] The Bank of Estonia was established as a central bank in 1990, but the local branch of the Soviet Gosbank continued to carry out most central bank functions until January 1992. The Estonian central bank was granted independence in 1993.

[23] Kaja Kell, Eesti Pank Head of Information, to author on 7th July 1999.

[24] EBRD, Transition Report, October 1994, p.23.

[25] The term is here used in the IMF context which distinguishes between "crisis" and "significant". The IMF (*vide* Sandararajan and Balino 1991) methodology refers to cases where there were runs or other substantial portfolio shifts collapses of financial firms, or massive government interventions, as "crises". On the other hand extensive unsoundness short of a crisis is termed "significant" (Lindgren *et al*, 1996 "Bank Soundness & Macroeconomic Policy", IMF).

[26] These had included the establishment of specialised state banks and some new commercial banks, including some private ones.

[27] The Economist, "Europe in Figures", 2001, p. 81.

[28] Eesti Pank, Annual Report 1993, p.18.

[29] At the end of the year it was the smallest commercial bank in Estonia with 0.4% of all bank assets.

[30] Lindgren C.J. (*et al*) 1996, *op cit.*

[31] It was events in neighbouring Latvia that accelerated plans for a new deposit insurance structure. From July 1996 deposits of up to $10,000 started being insured; in October 1998 compensation of up to 90% of deposits or to a maximum of Ek20,000 was introduced; and protection for limited deposits of legal entities came in in 2000.

[32] As stated by Kaja Kell (1999), *op cit.*

[33] The share of deposits held by individuals among total deposits in commercial banks was 24.9% at end May 1995. (Hungary: 55.1%, Dec 1994). Based on balance sheet total the market share of ESB was 16.3% at end May 1995. The increase in ESB's balance sheet total over 12 months to March 1995 was 89.5%, slightly above the average increase for the four large banks. (Hungary: OTP bank market share at end of 1994 +/-31%). The market share of ESB in individuals' deposit market was 43.2% in May 1995. The combined share of the other four large players was 36.4%. The ratio between cash, and non-government domestic currency deposits in banks was roughly 1:2 in May 1995. (Hungary: 1:3.5 in Jun 1995 and probably even higher if foreign currency deposits and foreign cash are taken into account).

[34] EBRD, Transition Report 1994, p.127.

[35] Including balanced budgeting, pegging the kroon to the Deutsche Mark, and a flat rate of tax.

[36] Based on market shares in the 1995-1997 period.

[37] *Vide e.g.* Schultz T. (1996) in *"Baltic banking – Estonian disciples"* – BCE, Vol 6, No.32, pp 54-55.

[38] More than 800,000 (in a total population of 1.5 mn) were on issue in 1998.

[39] *Vide* BCE, Vol 6 No. 63, July/Aug 1999, p.37.

[40] EBRD, *Transition Report 2001,* p.138.

[41] Vijai Maheshwari (2001) describes Thatcherism as a fashionable past Estonian characteristic, before going on to add that "[But] now looming EU accession is nudging the government to reconsider its social agenda long ignored in the drive for reform and privatization" – BCE, Vol.8, No.82, pp 45-46.

[42] Estonia, along with the Czech Republic, Malta, and Cyprus, was in August 2003 described as being the best prepared from amongst the ten countries scheduled to become EU members with effect from 1st May 2004. This assessment was made by EU Commissioner for Regional Policy Michael Barner.

[43] Similar to Malta's own Malta Financial Services Authority (MFSA), Estonia introduced such a structure in 2002.

The European Association for Banking and Financial History (EABH) e.V.

www.eabh.info

info@eabh.info

The ***EABH*** **Working Papers Series** (***eabh Papers***), launched in 2014, gives scholars in banking, financial, business, and economic history and related fields the opportunity to distribute their research-in-progress. Making these findings available to a wider audience, even at an early stage, supports authors' search for qualified feedback, makes their work visible to international audiences, and increases their research's impact. These are important steps towards publication in a top-ranking scientific journal.

EABH offers

- 'Light-touch editing': ensuring that basic scholarly standards are met. Papers may be sent to outside experts for advice.
- Language editing (papers must be submitted in English): ensuring that a basic English language level is met.
- Copyediting in line with the RePEc standards.
- Promotion through our international network and listing of papers in relevant on-line databases.

Submission

Submissions should go to Ms Carmen Hofmann: c.hofmann@bankinghistory.de

Series Co-Editors

Dr Chris Colvin, *Queen's University Belfast*: c.colvin@bankinghistory.de

Dr Nathan Marcus, *National Research University – Higher School of Economics*: n.marcus@bankinghistory.de

Further information

Submission guidelines and a full list of *eabh Papers* are available at the *EABH* website:

http://www.eabh.info/publications/eabh-papers/