The Privatization of Public Banks: Will it Always Turn Out to Be Satisfactory?

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THE PRIVATIZATION OF PUBLIC BANKS: WILL IT ALWAYS TURN OUT TO BE SATISFACTORY?

Sudi Apak, Ahmet Atakişi, Levent Özkan, Caner Ekizceleroğlu

ПРИВАТИЗАЦИЯ НА ОБЩЕСТВЕНИТЕ БАНКИ: ДАЛИ ВИНАГИ ТОВА СЕ ОКАЗВА ЗАДОВОЛИТЕЛНО?

Abstract

The concept of privatization has been deepened due to the liberalization progress in the world economy since the beginning of 1980's. In order to slip out of the great depression period in 1929, the share of government activity in economy and government intervention has been increased and this variety of thoughts was made popular by several economists in United States. Governments share in the total of economy has been ascended and this became wide spread in the capitalist block after long phase of Keynesian policy implementations in these economies. On the other hand, the experienced facts of stagflation and collapse of world's monetary system caused an enormous debate on Keynesian belief in economy and the neo-liberal rapprochements have began to deploy rapidly in the capitalist block by 1980s.

As a result of the 1917 Revolution and in accordance of the new established socialist order in Russia, alienating the private ownership of production to the state has swiftly broadened throughout the country. However, the state owned properties have commenced to transfer to private ownership by radical resolutions, after the collapsing of socialist regimes in the Eastern Block. Needless to say that, the concept of privatization in transition economies has came on the scene only after the year 1989.

In this study our objective is to determine the global public bank privatization trends by focusing on to the privatization conception. As a final point, the public banks privatization process in transition economies will be questioned and analyzed.

Key Words: privatization, public banks, transition economies,

Introduction: The concept of privatization

The widest definitions of privatization are; (i) by means of discharging the sensual properties or financial assets to private firms and individuals (tangible and legal sales), (ii) giving an initiative to private individuals for production and/or distribution of a good or service, (iii) deregulation and re-regulation of goods/services production and/or distribution rights of empowered public authority to administrative authorities.

In other words privatization stand for transfer of the ownership of companies in full or partially, or transfer of shares of these companies through domestic or international public offerings, block sales to real and/or legal entities, block sales including deferred public offerings, sales to employees, sales on the stock exchanges by standard or special orders, sales to investment funds and/or securities investment partnerships by taking into consideration the prevailing conditions of the companies.

Privatization, with the support derived from political determination which is an important macroeconomic policy instrument tool, shall proceed in collaboration with public institutions and independent regulatory bodies in an accelerating manner.

Liberalization and the transformation of financial markets in the Central and Southern-Eastern

Countries hasted only after the collapsing of Socialist regimes in the last decade of 20^{th} century. Indeed, the privatization movements in these countries had a long planning and coordination period. On the other hand the ongoing system of financial markets of liberal economies had begun to change after the global financial crisis. While contagion used to spread crises among the large financial centers, it now affects developing and transforming countries on regional or worldwide basis (Wyplosz, 2001, 1).

In this context, the Privatization Administration (PA), is main approach is that successful privatization performance will be derived from ensuring the 'well-organized and productive use of sources', which is the basic intention of economics, by way of eradication the load of the state owned enterprises to the country's economy rather than the revenues gained from privatization. Efforts are being made to this end in order to create a flexible privatization approach and tendering conditions that offer choices to the investor, not in spite of the market conditions but rather in accordance with the market conditions

How did Public Banks come on the Scene?

In general, banks are providing a financial background for short term savings relocation to investments and trading activities by providing mid or long term credit manners to the all varieties of entrepreneurs.

Definitely, the private banks have a considerable amount of intermediation and operational expenditures in their activities. In addition to that, the banks are recording financial gains upon credits/loans affords for recovering their costs. Therefore the main objective of a private bank is to formulate a strong profitability. Risk taking orientation can be defined as a bank's assessment of profitability. In some cases. the superior risk taker bank would be more profitable than the minor risk taker one. Thus, the banks are evaluating their reserves by accepting some risks.

As it's broadly acknowledged that the bank's gainful interests are providing an origin for effective and entirely utilizing of the resources in national economy. The banks have significant missions of allocating the financial market functionality and spreading the well operated market to all bases in the economy.

From the beginning of the 1930s, the major trend of the world was the influence of government on the economy as a whole. The Keynesian approach was the main adherent of these tendencies. In accordance with these ideas, government intervention on the economy was completely used by policy makers and market operators. The share of the state had been raised in the economy and this outlook had been come into view on the all capitalist block. The sense of government was transformed into not only the administration authority of the economy but also an originator of the duties for the inhabitants. The distribution of public banks was differing among the countries in the capitalist block as well. The public banks were not wholly under the classification of Anglo - Saxon Banking but these banks frequently existed in the Europe Continent banking system (Uzunoğlu, 1996; 20).

In this period, several new banks had begun to operate in the financial system. While the new progresses were shaping the financial functioning of capitalist block. on the other hand alienating the private ownership of production to the state deployed among the whole communist block and all of the banks in socialist regimes were transferred to the state ownerships. However. the liberalization trends have been deepened in the capitalist block since the year 1970. This progress had become visible in the socialist block only after the 1989. After the dissolution of the socialist block, the sate ownership enterprises have transferred to private ownership by radical resolutions such as performing legal arrangements and building new regulatory bodies. The privatization concept naturally occurred in transition economies after the 1989.

In 1996, seven years after the fall of the Socialist regime. the Bulgarian government still controlled more than 90% of the assets in the economy. The government was under profound political pressure to privatize these assets and to accomplish the transition to a market economy. Following the example of the Czech Republic, the Bulgarian authorities concluded that mass privatization not only would be a way to privatize assets quickly. but would also allocate these assets to a large number of individual investors, which would feasibly result in a more liquid stock market. A liquid stock market would be the best commercial for the success of the transition and would attract foreign direct and portfolio investors.

Above all, the transfer of ownership from state to private initiatives would improve the governance of the enterprises and make them more profit-oriented and thereby more efficient, as claimed generally by economists around the world. The government concluded that distributing assets essentially for free would be a small price to pay relative to the political and economic merits of mass privatization, and commenced the process in mid-1996 (Atanasov, 2005; 195).

In the period 1996 - 1997 the Mass Privatization Center privatized state-owned enterprises through investment vouchers. Share packages of 1,050 enterprises were offered for sale, which resulted in the privatization of assets to the amount of 14.58 % of the total state-owned enterprises assets or 22.08 % of all state-owned assets subject to privatization.

By the end of 2002 a new Privatization and Post-Privatization Control Act (PPCA) was adopted under which the whole activity as regards the sale of state interest in the enterprises was centralized in the Privatization Agency, even as the privatization of municipal property was done by the municipal councils or bodies specified by them. The line ministries preserved their role of principals and representatives of the state, as owner of the state interest in the corporation capital.

With the adoption in 2002 of the new Privatization and Post-Privatization Control Act the key privatization four principles have been regulated:

1. clear and transparent rules and procedures for all participants in the privatization process;
2. equal treatment;
3. fast privatization process;
4. economically effective privatization as a prerequisite for sustainable economic development and competitiveness of the privatized companies.

Under these circumstances, the publicly advertised tender and public auction has become the main methods for sale of share and interest packages of the enterprises. The method "negotiations with potential buyer" was abolished. In the period after PPCA has come into force (31.03.2002) till nowadays - 2,065 packages of shares/interests of enterprises and detached parts were sold, or 22.52% of the sales in the period 1993 – 2006. The sales of minority packages of shares/interests of enterprises have been speeded up with the changes in the legal base. 1,655 sales of companies with less than 50% state interest have been made, which represents 41.95% compared to the total number of minority packages sales since the beginning of the privatization process (www.priv.government.bg, 15.05.2006).

The reason why the public banks are privatized?

On the basis of public bank privatization approach is as follows (Uzunoğlu, 1996: 19-24);

a- Reducing the government intervention and straightening the state ownerships in the entire economy,

b- Public sector deficit reduction by providing alternative financial gains from privatization,

c- Enhancing the competition in the banking sector and more effective utilizing of resources for stabilizing a sustainable development and economic growth,

d- Abrogation of the beneficial relations between banking sector and politics,

e- Developing the money and capital markets on the nationwide basis,

f- Providing modern and dynamic structure to the public banks.

The general conclusion that emerges from the studies in this convention is that bank privatization improves profitability, portfolio quality, and operating efficiency when it is done currently (Clark et all., 2005: 1919). The economists suggest three main reasons for privatization of public banks that work under government support.

First, state managers will have weaker willing than privately owned firm managers about the issue of maximizing the revenues and minimizing the costs (Megginson, 2005; 1936). State managers will be subject to less intense observing by firm owners. Besides, the managers of the state-owned enterprises are not highly responsible on the profit maximization of their firms. The whole of banking sector has effected damagingly because of these managerial facts. On the other hand, in the private sector the managers are under the pressure of regulatory auditing risks.

Second; The main reason is collective action problems. Public bank managers have less managerial performance than private bank colleagues. Administrative performance of the public bank managers is relatively lower than the private bank managers as well.

Last of all, state-owned enterprises in some cases might perform worse than private ones is that they would face less competition than private companies. As it's mentioned above that self-interested politicians are willing to use state-owned enterprises to provide patronage jobs or subsidies to favored individuals. When they imply this behavior, sate-owned enterprises will be incapable to compete in liberated markets and will therefore need financial assistance or government guaranteed debt to cover up their losses. To diminish the need for subsidies, politicians, state officers and bureaucrats might then protect the state-owned enterprises form competition, in order to make entry more difficult and limiting trade, with a negative impact on efficiency (Clarke, Cull, Shirley, 2005; 1908).

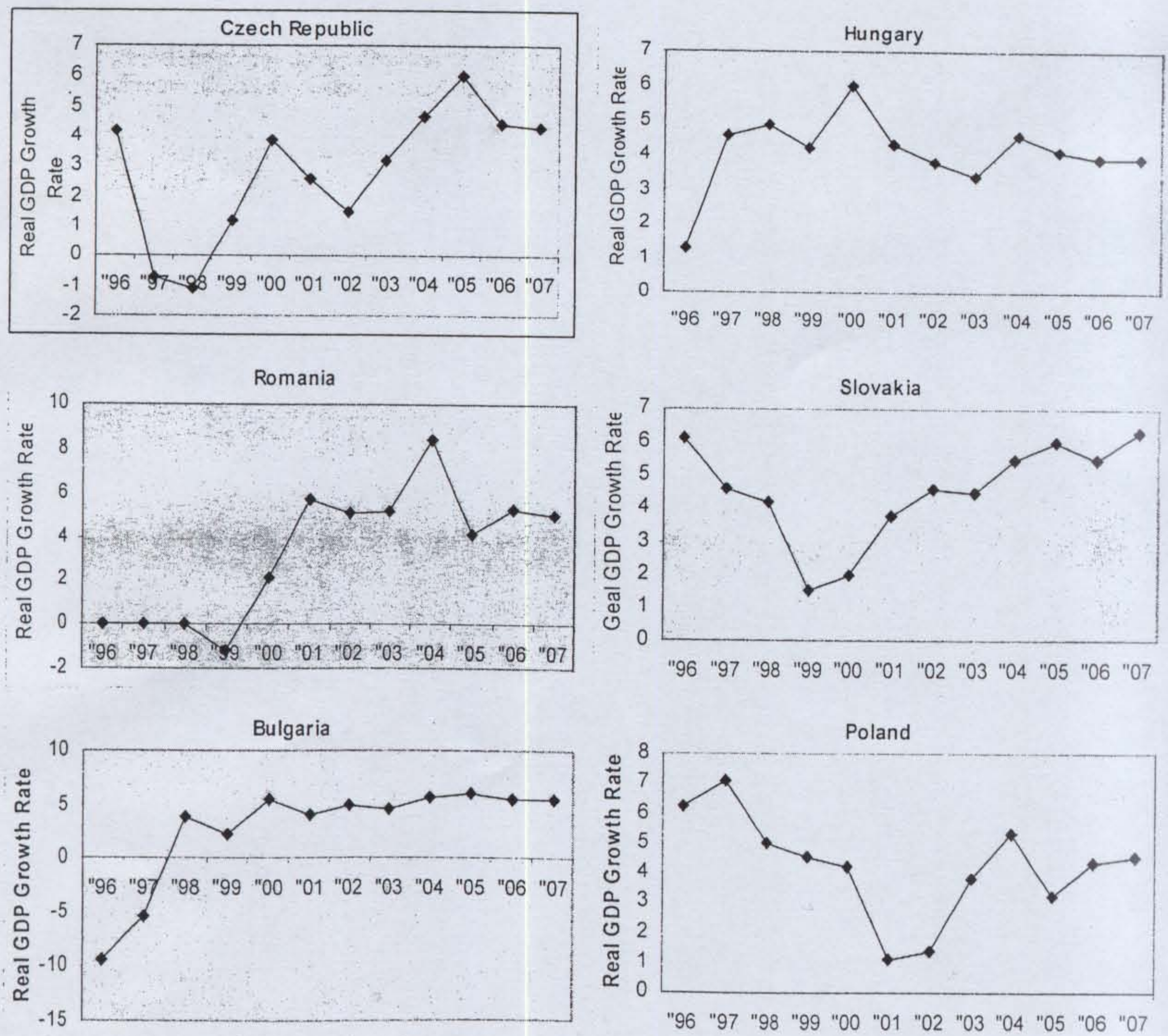
There are some studies examining the determinants of privatization choice, which banks under what conditions. Clarke and Cull (1999) examine the sale of thirteen banks in Argentina and find that poorly performing banks are more likely to be privatized than well performing banks. However, banks selected for privatization in East Asia are generally well performing. Overstaffing tends to reduce the possibility of privatization because of political reasons. So that smaller banks are more likely than large banks to be privatized. Privatization becomes harder when public employees and unemployment in rural area is higher. Raising the financial costs of continued state bank subsidization, like the Tequila Crisis in 1995, increases the likelihood of privatization (Megginson, 2005; 1945-1946).

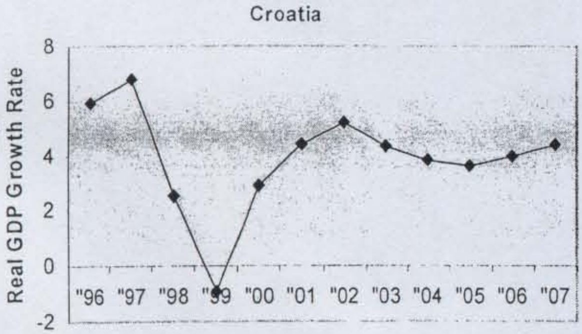
The Privatization Process in the Transition Economies

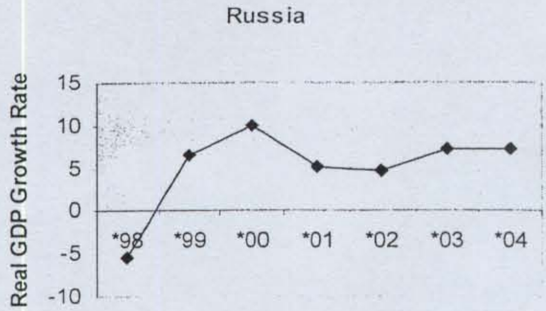
There had been some different evolutions observed among the Central and South Eastern European countries and the members of Commonwealth of Independent States. The Banking reform period and implementation differs between the countries. The financial development came front in the latest EU members for example; Czechs Republic, Hungary, Poland, Estonia and Slovenia. The experiences in these countries demonstrated that the financial reform measures are taken seriously by decision-making corporations. Furthermore. high economic growth rates, the sensitivities to external shocks and foreign market harmonization will be provided by the new financial reforms.

The financial crisis in Asia (1997) and then the Russian economic devastation had a depressing effect on transition economies. The growth rate scores below explicitly demonstrate the economic performance of the selected countries.

Diagram 1 Economic Growth Rates of Several Selected Countries (%)







Source: IMF

Beyond the economic growth rate fluctuations, Czech Republic, Hungary, and Poland, embarked on significantly different bank privatizations programs during the first half of the 1990s. Even before the political change, the Hungarian government had been receptive to foreign bank activity as it allowed three foreign banks to operate in the country from 1985. by the end of 1996, three of the four large state owned banks in Hungary had attracted strategic foreign owners. In the Czech Republic, three of the largest four banks participated in the first wave of voucher privatization in 1992 and no Czech bank was sold to a foreign owner until 1998. Polish authorities set a three year timetable at the beginning of 1993 for privatizing the nine medium sized, regional, state owned banks that were created from the commercial portfolio of the national bank. However, by the end of 1996, only one of these banks had a foreign owner holding a controlling stake.

In Bulgaria and Romania the situation is quite different. Macroeconomic instability and financial sector distress composed the bank privatization efforts infeasible during the first half of the 1990s as well as foreign ownership of banking assets was also negligible. Bulgarian government privatized its first bank to a consortium of investors in 1997. By the end of 2000, eight of the ten largest banks in Bulgaria were foreign owned.

Croatia has an exception in all other transition economies. After Croatia seceded form Yugoslavia all bank deposits were frozen and banks faced a serious crisis because deposits were remitted to the National Bank of Yugoslavia. At the end of 1995, four state owned banks created for government rehabilitation in Croatia. In 1995, only one foreign bank was operating and foreign ownership of banking assets was less than 0.5%. In 2000 84% of banking assets were foreign owned and in 2002 ten largest banks sold to foreign investors.

By the end of the 20^{th} century, no more than five of the six countries have been wholly completed the privatizations of their public banks. They have just put 75% of their banking assets under foreign control since the year 2002 (Bonin, Hasan, Wachtel, 2005; 2159-2160).

Table 1 Important Banking Privatizations in Transition Economies

Country	Company	Date	Amount of offer (US $ million)	Method of sale	Fraction sold (%)
Bulgaria	United Bulgarian Bank	1997	30	Asset sale	65
	Post Bank	1998	38	Asset sale	78,23
	Express Bank	1999	39,5	Asset sale	67
	Bulbank	2000	345	Asset sale	98
	DSK Bank	2003	336	Asset sale	100
Czech Republic	Komercni Bank	1995	85	SIP	4
	Komercni Bank	1996	50	SIP	3,2
	Investicni a Postovni Banka	1998	81,8	Asset sale	36
	Ceskoslovenska Obchodni Banka (CSOB)	1999	1175	Asset sale	69,99
	Komercni Bank	2001	1210	Asset sale	60

Hungary	Magyar Kulkereskedelmi Bank	1994	92	Asset sale	42
	Budapest Bank	1995	87	Asset sale	-
	National Savings & Commercial Bank (OTP)	1995	89	SIP	30
	Magyar Hitel Bank	1996	89	Asset sale	-
	OTP Bank	1997	213	Asset sale	25
	OTP Bank	1997	140	SIP	16,4
	Kereskedelmi es Hitelbank	1997	30	Asset sale	-
	Mezobank	1997	25	Asset sale	-
	Penzintezeti Kozpont Bank	1997	18,9	Asset sale	-
	OTP Bank	1999	162	SIP	14,1
Macedonia	Stopanska Banka	1997	17,6	Asset sale	55
Poland	Bank Slaski	1994	64	SIP	30
	Bank Premyslowo Handlowy	1995	150	SIP	50,1
	Bank Gdanski	1995	67	SIP	-
	Polish Development Bank	1995	17	SIP	-
	Bank Slaski	1996	196	Asset sale	7,25
	Petrobank	1996	48	Asset sale	-
	Wielkopolski Bank Kredytowy	1996	60	Asset sale	-
	Bank Gdanski	1997	83,4	Asset sale	32
	Powszechny Bank Krediytowy	1997	300,2	SIP	65
	Polish Investment Bank	1997	67	Asset sale	100
	Bank Premyslowo Handlowy	1997	660	SIP	-
	Export Development Bank	1997	94,5	Asset sale	15,9
	Powszechny Bank Krediytowy	1997	264	SIP	65
	Polish Development Bank	1998	52,8	Asset sale	44,54
	Bank Pekao	1998	260	SIP	15
	PKBL	1998	51,9	Asset sale	99,93
	BPH	1998	600,6	Asset sale	36,7
	Bank Pekao	1999	1090	Asset sale	52,09
	Bank Zachodni	1999	580	Asset sale	80
	Powszechny Bank Krediytowy	2000	76,07	Asset sale	10,30
	Bank Pekao	2000	133	SIP	-
Romania	Banca Romana pentru Dezvoltare	1998	200	Asset sale	41
	Banc Bost	1999	42,8	Asset sale	42
	Banca Agriola	2001	52	Asset sale	98
Slovakia	Slovenska Sporitelna	2000	347	Asset sale	87
	Vseobecna Uverova Bank	2001	473	Asset sale	94,5
Croatia	Zagrebacka Bank	1996	25	SIP	-

Source: Megginson W.L.(2005) "The Economics of Bank Privatiztion" Journal of Banking & Finance, 29

Conclusion

Privatization concept transpired for more functional market economy construction. Further more the privatization progress aimed to build up the infrastructure of the market. The capitalist block has attended to the privatization improvements after the beginning of 1980s; therefore the transition economies have accelerated their privatization programs by the 1990s and the share of government in the banking system is diminishing and shifting to the Anglo-Saxon model banking is broadening among the transition economies especially in eastern European countries. In general, the foreign banks (local bank purchaser) are determining their own limits in the domestic banking system. Thereby, there will be a reduction on loan opportunities of the domestic firms. In addition to that, the foreign loan providing authority will put some difficulties for domestic loan barrowers and the decision making power will be transferred to foreign enterprises.

However, the main objectives of privatization operations are; the more productive and effective economic development, reducing the share of government in economy and providing alternative revenues for public as well. The privatization of the public banks has to be evaluated under these circumstances and objectives. There are quite a lot of academic studies can be found in the literature on productivity, efficiency and performance perspectives of the public and private banks.

The countries rating records by means of the successful implementations for attracting the foreign direct investments had been ascended among the transition economies like Czech Republic, Hungary and so on. According to our findings, in some cases, the privatization enforcements of public banks could not give the same successful results for all countries. The conquering privatization progress is based on the reliable public approach, strong constitute of infrastructure of corporations with legal arrangements. The scheduling of privatization and global cyclical changes can be classified as external factors. Hence, some of the pre-privatized banks were nationalized during the financial catastrophes due to the sharp movements of capital between the continents. Finally the privatization could not be seen as a life boat for protecting the domestic economy from the outsider treats.

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