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STATE - OWNED BANKS FROM ROMANIA

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Abstract: In Romania, as in many Central and Eastern Europe countries, during the communist regime all the banks were owned by the state and their activities were circumscribed by rigid norms. After the communist regime had fallen, the state owned banks had to adapt to a competitive environment. The management inefficiency, the political interests and the corruption led some of these banks to critical situations. Such circumstances convinced Romanian authorities to privatize the banks owned by state. From the seven state-owned banks that activated in the 1990s in Romania, one had to be closed, four were privatized and two are still in the state propriety. In this paper we approach some turning points in the evolutions of these banks. We also try to configure the future of the remained state-owned banks.

Keywords: *Ownership of Banks, Transition, Political Interests, Corruption, Privatization*

JEL Classification: *G18, G21, G32, L33, P34*

Introduction

The dispute over the optimal ownership structure of banks is one of the main dimensions of the controversy about the role that the state should play in the financial sector. In this debate various arguments were brought in favor or against the state-owned banks (SOBs). The so-called development view considers that SOBs are more suitable than the private banks to finance the economic growth in developing countries (Gerschenkron, 1962; Andrianova et al, 2002). It claims that SOBs are suitable especially to support the development in rural and isolated areas where the private banks could hesitate to open branches (Burgess and Pande, 2003). This view is in the line with some development theories that consider that the government should own the firms from the strategic economic sectors (Lewis, 1950; Myrdal, 1968). Other arguments in favor of the presence of SOBs were provided by the so-called social view which assigns to the public sector the role of correcting the markets imperfections (Stiglitz, 1994). A related view justifies the state ownership of banks by considering that some banking services have a public-good nature (Corrigan, 1982).

In opposition with the development and social views, the political view over government's involvement in the banking system considers that the SOBs are created and maintained by politicians as tools to reward their supporters (LaPorta et al., 2002; Sapienza, 2004). This view is in line with theories that criticize the government ownership of enterprises as promoting incompetence and corruption (Shleifer, A. 1998; Megginson, 2004). In case of SOBs, the political influence could affect the economic considerations of the credit allocation (Kane, 1977). As a result, in comparison with the privately owned banks, the state-owned banks have lower management efficiency, lower liquidity and greater credit risks (Cornett et al., 2003; Weintraub and Nakane, 2003; Yeyati et al., 2005; Micco et al., 2007).

SOBs had a significant presence among the incipient forms of capitalist institutions. Megginson (2003) revealed that until 1980s, in countries with French civil law commercial codes the state ownership of banks was generally higher than those with German law, Scandinavian law or English common law codes. In the communist system introduced in the Soviet Union, banks served as instruments of control and funds allocation. The few banks allowed to activate functioned, in fact, as departments of a single bank (Sherif et al., 2003). After the World War II, such financial systems were imposed in the Central and Eastern Europe (CEE) countries which had fallen under the Soviet Union domination. The economic reforms initiated in Soviet Union by Mikhail Gorbachev, known as perestroika, had a major impact on CEE countries. There were some notable attempts to reform the banking system by offering more autonomy to banks. In Hungary, in 1987, it was implemented a two-tier banking system.

Since the late 1980s and the early 1990s, when the neo-liberal policies started to be implemented, significant programs of SOBs privatization were launched in most of the developed countries and in many developing countries. In 1990s, after the fall of communist regimes, CEE countries joined to this trend.

The dispute between SOBs and private banks, which seemed to be won by the last ones, was reignited by the recent global crisis. In present, the banking sector problems are perceived by the public opinion as one of the main factors which caused and aggravated the global crisis. It is admitted that large profits temptations made banks offer substantial loans with high risks. When the financial crisis erupted, many governments had to rescue, by enormous bailouts, the banks in difficulty which were considered “Too Big to Fail” or “Too Interconnected to Fail” or “Too Systematically Connected to Fail” (Molyneux et al., 2011). However, for the ordinary taxpayers it was not very easy to understand why public funds were spent for saving the rich bankers while the poor employees of small enterprises lost their jobs. It was also difficult to understand the reasons for saving some banks while others were left to fail. The actual global crisis revealed also the bank regulation failure which couldn't keep the pace with the financial institutions irresponsible behavior. One of the main goals of bank regulation is to ensure the banking sector solvability. However, many banks perceive these requirements as impediments to obtain high profits and try to elude them by financial innovations and even by fraudulent practices. In fact, these banks undermine the measures meant to protect them. Such irresponsible behavior is stimulated by the fact these banks are confident the government would rescue them in the case of substantial losses. In the last decades and especially from the beginning of the financial turmoil several attempts to reform the banking sector were made. Such initiatives include more restrictive bank regulation, the narrow banking implementation or even the main banks nationalization.

In this paper we approach the evolution of the Romanian SOBs in the last decades. During the communist regime Romania was a particular case among the CEE countries being considered, between 1964 and 1987, as the least obedient satellite of Soviet Union. From this position, the Romanian Communist Party, initiated, in the 1960s, a sort of economy liberalization but also strongly rejected the perestroika in the later 1980s. The banking system was highly controlled by the members of the former secret police some of them, managing to maintain their influence even after the fall of the communist regime. This influence has to be taken into consideration in any analysis of Romanian SOBs.

The rest of the paper is organized as it follows. The second part describes the Romanian banking system, the third part presents the evolutions of seven SOBs, the fourth part approaches the perspective of the last remaining two SOBs and the fifth part concludes.

The Banking system in Romania during and after the communist regime

Between 1945 and 1948 Romania became the satellite of Soviet Union which imposed a communist regime. In the new financial system most of the credit operations were done by the central bank. In the 1960s and 1970s, the Romanian Communist Party, led by Gheorghe Gheorghiu - Dej and, from 1965, by Nicolae Ceausescu, gained a sort of autonomy from Soviet Union and it improved Romania's political and economic relations with Western countries. In these years Romania was admitted to the International Monetary Fund and the World Bank, obtaining significant loans from these institutions and from the Western Governments. It was a period of liberalization for the Romanian economy and the authorities allowed some reforms in the banking systems. Some Romanian banks established cooperation relations with international financial institutions and with Western commercial banks.

In the 1980s Romania, as many other developing countries, was affected by the foreign debt crisis. In these circumstances, the Romanian government adopted a radical strategy to pay back the whole foreign debt in less than ten years. Drastic measures to reduce the imports and to increase the exports were implemented. In these years, the economy liberalization was stopped. Instead, it was substantially increased the involvement of the Romanian secret police, called "Securitate", in the economic activity. Many banking operations were, in fact, controlled by "Securitate". The drastic austerity measures eroded Ceausescu's popularity among the Romanian people. Moreover, the new trend of political and economical liberalization induced in the Soviet Union by Mikhail Gorbachev, made the independent position of Romania less interesting for Western countries. Nicolae Ceausescu publicly rejected perestroika and any suggestions of reforms.

In December 1989, the regime of Nicolae Ceausescu fell. The new government, obviously linked by the former Romanian Communist Party and by Securitate, adopted rather slow reforms toward the market economy. However, in January 1990, a two-tier banking system was introduced. The main roles assigned to the new central bank – National Bank of Romania (NBR) were to conduct the monetary policy and to supervise the banking operations. Instead, its commercial operations were transferred to a new created bank. The existent banks were organized as companies owned by the state.

The new legislation allowed for the creation of private banks, but the system of supervision was inconsistent. In these circumstances and since the big international private banks were reticent to establish subsidiaries in Romania, most of the private banks in the early 1990s were in fact organized with frauds purposes. Soon they became bankrupted and many deponents lost their money. This situation contributed to a substantial lack of trust regarding the private banks. In fact, in this period of time, substantial losses occurred also in SOBs because frauds or inefficient management, but the authorities avoided radical measures to solve this situation.

In the late 1990s the change of the political regime and the pressures from international financial institutions led to substantial reforms in the Romanian banking system. NBR has tightened the supervision rules. The government had to accept the closing of the largest Romanian SOBs and it engaged to privatize other banks. The Government sold shares of four SOBs to foreign private banks. In the present, only two SOBs still activate in Romania.

Evolutions of the Romanian SOBs

In the early 1990s seven SOBs functioned in Romania: Bancorex, Banca Agricola, CEC Bank, Banca Comerciala Romana, Banca Romana de Dezvoltare, Bancpost and Exim Bank. Since then they experienced different ways: one of them was closed, four were privatized and two are still owned by the state.

1. **Bancorex -** In 1968, when Romania's economic relations with Western countries flourished, the authorities established a specialized bank for financing the foreign trade activities: Banca Romana de Comert Exterior (BRCE). From the beginning, BRCE was supervised by DIE, a department of the former secret police specialized in foreign relations. In 1980s, when Ceausescu regime decided to accelerate the pay back of the foreign debt, BRCE was involved in secret and, sometimes, illegal operations performed by ICE Dunarea, a firm owned by DIE.

After December 1989, when the communist regime fell, some changes were operated in the bank top management, but its functional structure remained unchanged. In 1990, BRCE was transformed in Bancorex, a state-owned bank. In the early 1990s Bancorex was the largest bank of Romania and its employees enjoyed the reputation of being familiarized with capitalist business. It was also preferred by the government in financing the foreign trade. In fact, Bancorex was used as a tool for offering subsidies to the state enterprises in forms of loans which were never repaid.

Beside that, the political influence facilitated a massive corruption. As later enquires revealed, during 1990s several politicians and businessmen with political connections obtained from Bancorex substantial loans in very favorable conditions. By sophisticated transactions, the bank financed also political parties. Moreover, in order to obtain a kind of immunity for the eventual investigations, the Bancorex managers signed an agreement with Interior Ministry by which loans with very low interest rates were offered to Romanian policemen.

Over the years, such practices generated massive losses which became unbearable. In 1997, under the pressures of international financial institutions, the Romanian Government publicly admitted the dangerous situation and it announced a 600 million dollars aid meant to solve the problem of the nonperforming loans. However, in the absence of a real restructuring of the bank management, this substantial amount proved not to be enough to save Bancorex.

In 1999, a new estimation indicated that the largest Romanian SOB needed another 2 billion dollars aid. Unable to provide this amount, which represented more than 5 percent of Romania's GDP, the government had to accept the closing of Bancorex. In order to avoid new tensions on the financial markets, government announced that the majority of Bancorex's assets and liabilities were transferred to Banca Comerciala Romana and to a new created institution designed to deal with the banks bad assets: Agentia de Valorificare a Activelor Bancare (AVAB). Then, what remained from Bancorex merged with Banca Comerciala Romana. The officials enquire about the frauds from Bancorex failed to disclose the involvement of politicians.

The former general manager of the bank was jailed for some years, but finally he was not found guilty by the Romanian justice. For the public opinion it was offered the explanation that Bancorex was sacrificed for the Romanian citizens that could buy, thanks to the bank operations, energy at low prices.

2. **Banca Agricolă -** In 1968 Banca pentru Agricultură si Industria Alimentară (BAIA) was created for financing the agricultural activity. In December 1990 BAIA was transformed in Banca Agricolă (BA). As in the case of Bancorex, the political influence led to a massive corruption and the bad credits brought the bank in a critical situation. In 2000 its losses were estimated to 800 millions USD.

The lesson of Bancorex convinced the Romanian authorities to act with determination. It was found a foreign bank, Raiffeisen Zentralbank Osterreich AG (RZB), that had already established a Romanian subsidiary: Raiffeisenbank (Romania) S.A. In November 2001 RZB agreed to borrow BA that was renamed as Banca Agricola Raiffeisen S.A. In June 2002 Raiffeisenbank (Romania) S.A. and Banca Agricola Raiffeisen S.A. merged, forming Raiffeisen Bank Romania S.A. Under the new management the bank performances improved substantially and from the next years the losses were replaced by profits.

3. CEC Bank. In 1864, five year after the modern state Romania was born, the government established "Casa de Depuneri şi Consemnațiuni" – first state owned deposit and consignments institution. Sixteen years later, the government created "Casa de Economii" – a state owned savings institution which was formally attached to "Casa de Depuneri şi Consemnațiuni". In 1930, in the context of a deep recession accompanied by the instability of the banking system, "Casa de Economii" was separated from "Casa de Depuneri şi Consemnațiuni" and reorganized under the name "Casa Generală de Economii". After two years, "Casa Generală de Economii" was renamed as "Casa Națională de Economii şi Cecuri Poştale".

In 1949, the communist authorities decided to reunify "Casa de Depuneri şi Consemnațiuni" and "Casa Nationala de Economii şi Cecuri Poştale" under the name of "Casa Nationala de Economii şi Consemnațiuni" (CEC). The new state owned institution was the only one authorized to attract the population savings. In time, CEC developed a network of branches localized in small and big cities. New savings and payments instruments were introduced and in 1970s. CEC was allowed to offer credits for houses acquisitions.

The fall of the communist regime brought significant changes in CEC activity. In the early 1990s, despite the competition from the new established banks, CEC remained the most important savings institution. Although, in comparison with other banks, CEC applied lower interest rates, it was preferred by large categories of population, especially by old or rural people. The Government used the large financial resources collected by CEC in operations with government securities or even to borrow banks in needs of liquidity. In 1996 CEC was transformed in a joint-stock company with the Finance Ministry as the unique shareholder. In these years, the bank efficiency was affected by the fact that its leaderships failed to introduce modern and diversified services that CEC competitors applied.

The substantial financial resources of CEC attracted a lot of politicians and businessmen. The most famous of them was Sorin Ovidiu Vîntu, considered as one of the richest Romanian businessmen in 1990s and 2000s (he was also involved in the losses occurred at Banca Agricolă). In 1983, when he was imprisoned for embezzlement, S. O. Vintu was recruited as informer by the former communist secret police. His activity in the service of the secret police is still controversial. However, in 1990s Vîntu appeared as the owner of some firms specialized in investments on the financial markets in which he employed a lot of former Securitate's officers. One of these firms, SOV Invest S.A., created in 1996 a mutual fund called "Fondul Național de Investitii" (FNI), which promised average annual returns that surpassed 300%. In fact, FNI was a Ponzi scheme in which the real assets were inflated by fraudulent practices. By an aggressive publicity, FNI managed to attract the investors becoming in few years the Romanian largest investment fund. To this achievement, the political connections played a major role. In 1999 the leadership of CEC signed an agreement that guaranteed FNI investment certificates. Moreover, CEC invested 290 billions ROL (about 18 millions dollars) in FNI certificates. These facts induced a kind of moral hazard in the investors' behavior which believed that the state guaranteed FNI. Lately it was estimated that after it had been announced the agreement between CEC and SOV Invest S.A. about one hundred thousands of investors bought FNI certificates.

As in all the Ponzi schemes, the fabulous returns promised by FNI couldn't last for long. In May 2000, it was announced the FNI's failure. More than three hundreds thousands of investors found out that their certificates became useless and they claimed that their losses to be covered by CEC. The eventuality of FNI investors' compensation by public funds raised a concern about the macroeconomic stability. In June 2000, the Romanian Government sent a Supplementary Letter of Intent to the Managing Director of the International Monetary Fund engaging that the FNI investors wouldn't be compensated. The investors addressed to the justice trying to recuperate their losses but the trials lasted for many years with no conclusive result.

An official enquire about the fraudulent practices of FNI management was opened but failed, for many years, to elucidate the circumstances in which a state-owned institution guaranteed a Ponzi scheme. However, in time, there were revealed the linkages between Sorin Ovidiu Vîntu (who had managed to sell SOV Invest shortly before the collapse of FNI) and politicians and personalities from mass media.

The bankruptcy of the largest investment fund and the involvement of the state-owned savings bank raised a concern about the Romanian financial system stability. Many deponents of CEC and other SOBs rushed to withdraw their deposits. A lot of credit cooperatives which, as FNI, attracted hundreds of thousands of deponents by promising high interest rates, became also bankrupted. The economic consequences were accompanied by political ones. The largest party of the governmental majority (PNȚ-cd, the party that had named the leadership of CEC), dropped sharply in popularity and disappeared from Parliament at the next elections.

In the years that followed FNI scandal, the new leaderships of CEC tried to restore the bank credibility. Modern banking practices were introduced, enabling CEC to compete with the commercial banks. In 2005, pressed by international financial institutions, the Romanian Government approved a strategy of privatization for CEC. However, since the price offered by a foreign bank was too low, the privatization was delayed. In 2008 a new statute was introduced and the name of institution was changed to CEC Bank.

3. **Banca Comercială Română.** In 1990 the Romanian government established a new SOB, called Banca Comercială Română (BCR) which was aimed to take over the commercial operations from NBR. In the early 1990s the main payments of state enterprises were operated by BCR. Perhaps because this situation the authorities tried to keep BCR away from the financial scandals. The bank leadership was opened to bring new instruments on the Romanian banking markets: payments through EUROPAY or by cards, treasury loans for individuals etc.

In 1999, BCR had to absorb Bancorex, becoming the largest Romanian bank. In the next year the bank had to face the turbulences on the Romanian financial system caused by FNI bankruptcy. In never elucidated circumstances, rumors about linkages between BCR and FNI appeared making a significant part of its clients to withdraw their deposits. However, with the help of NBR and the government, BCR managed to pass this difficult situation.

In the 2000s the bank continued to act as a pioneer in introducing new banking services. BCR was the first Romanian bank which traded securities on secondary markets, which launched mortgage loans or which installed Currency Exchange Machines. The bank also established two branches specialized in leasing and in insurance. In 2003 the Romanian government initiated the privatization of BCR selling a block of shares to the European Bank for Reconstruction and Development and to the International Finance Corporation. In 2006, the Austrian bank Erste Bank bought more than 60 percent of the BCR shares.

4. **Banca Română de Dezvoltare**. In 1957 in Romania it was established Banca de Investiții (BI) aimed to finance the investment in industry. During the communist regime, BI was used for receiving most of the funds provided by the World Bank.

In 1990 BI was transformed in a commercial state-owned bank named Banca Romana de Dezvoltare (BRD). During the negotiations with international financial institutions, Romanian authorities agreed to allow foreign banks to buy BRD shares. In these circumstances, BRD was in generally kept away from big fraudulent practices that affected Bancorex, BA and CEC. However, in 1990s it was revealed a fraud committed by a politician who had managed to obtain substantial credits from BRD.

In December 1998 the French bank Société Générale (SG) became the owner of 51 percent of BRD shares. In the next years the participation of SG to BRD shares gradually increased. In 2003 BRD changed its name in BRD - Société Générale.

5. **Bancpost**. In 1991, when the Romanian state-owned company of telecommunications, RomPostTelecom, was reorganized, a part of its assets was used in creating a new commercial bank, called Bancpost. In 1997 the authorities elaborated a plan for the bank’s privatization. As in the case of BRD, the inclusion on the list of privatization kept Bancpost away from the big financial frauds.

In 2003, the Greek bank Eurobank Ergasias bought the majority of Bancpost shares. Until 2009, its participation in Bancpost shares increased to 99 percent. In these years Eurobank Ergasias initiated programs for the modernization of Bancpost.

6. **Exim Bank**. As a part of the new foreign trade policy, in 1992 Romanian authorities established bank aimed to finance Romanian exporters, named Exim

Bank. The model was Export-Import Bank of the United States, an institution specialized in financing US exports.

Until now, the support provided by Exim Bank to Romanian exporters was criticized. There were also allegations that the very well paid managers of the bank were named on political criteria. It was found that some of them were officers of the former secret police.

Perspectives of the two remaining SOBs from Romania

In present only two Romanian banks are state-owned: Exim Bank and CEC Bank. The missions they have to fulfill make their situations quite different.

Since the adhesion to European Union, the necessity of redesign the Romanian foreign trade policy became obviously. In this context Exim Bank had to be reorganized, to be more closed to exporters and more efficient. Although the bank could remain state-owned it would be desirable the transparency in naming its leadership and even introducing a private management.

In the actual context of the global crisis the privatization of CEC Bank has to be postponed. Usually, during such critical conditions, the deponents trust more in SOBs than in the private banks so the announcement of the bank privatization could spread some worries among the clients. In fact, CEC Bank could play a major role in the efforts to reorganize the national banking system. Such a reform could have four main dimensions:

1. implementation of a state-owned payment and saving system;
2. establishment of state insurance system specialized in bank activities;
3. the ban, by law, of the government to bailout banks;
4. the gradually relaxation of the minim capital requirements for banks.

1. Implementation of a state-owned payment and saving system. A state-owned payment and saving system will offer an alternative to people and enterprises which want to eliminate the counterpart risk in such transactions. In order to bring stability to this system strict requirements have to be fulfilled. Only less than 75 percents of the collected funds could be lent and only to the central government. The interest rates for deposits will be established by the government taking into consideration the inflation forecasts. Anyway, these interest rates could be lower than those practiced by the banks since the involved risks are insignificant.

2. Establishment of state insurance system specialized in bank activities. In the case of a big financial institution bankruptcy, a private insurance corporation could have some difficulties in fulfilling its obligations. Instead, a state owned insurance system would be more appropriate to deal with such a situation. The commercial banks will not be obliged to use the new insurance system but those will do will gain, probably, the customers trust. The insured banks have to respect strict requirements regarding their capitals and the risks taken in their operations. The indemnities will be granted only after rigorous analysis of the circumstances in which the losses occurred.

3. The ban, by law, of the government to bailout banks. In fact, after the state payments and the savings systems implementation and the new insurance system creation, the government will have no reason for such an intervention since the affected customers were aware of the risks taken when they chose to use the bank services instead of those provided by the state.

4. The gradually relaxation of the minim capital requirements for banks. Since the government no longer bailout the financial institutions it is justified a relaxation of the bank regulation, especially the minim capital requirements. However, this process will be implemented only gradually, in order to not disturb the monetary stability. In the new circumstances the banks will gain more freedom by the relaxation of regulation, but they have to learn to act responsibly in such a context. They and their customers should be aware they couldn't count on the government intervention in critical situations. It is possible that these changes to make many banks voluntarily adopt prudential norms for their operations.

In applying such a reform CEC Bank could be easily transformed in a state-owned payment and saving system. In order to avoid political interferences it will be desirable that the new institution to be subordinate not to the Government but to the central bank.

Conclusions

In this paper we approached the changes experienced by the state-owned banks from Romania during and after the communist regime.

One of them had to be closed and other two passed critical situations mainly because of the political interferences that facilitated fraudulent practices. In that transition period, the SOBs privatization was viewed as the most adequate solution to heal the Romanian banking system. Four SOBs were bought by foreign private banks which provided the capitals and experience needed for surviving in the increasing competitive environment. The experience of Banca Agricolă, which was near bankruptcy in 2000 and became profitable in short time after the privatization it is an obvious proof about the private management advantages.

However, the critical situation of the three SOBs in the 1990s does not mean that state ownership of the banks has to be always associated with inefficiency and corruption. During transition, when the supervising system of banking activities was very relaxed, many Romanian private banks also collapsed. In that turbulent period the state institutions were weak and unable to fight against corruption. In fact, any analysis of the economic processes occurred in the 1990s in Romania and in other CEE countries has to take into consideration the influence of the former secret police and the groups of interests inherited from the communist regime.

The future of the two remaining SOBs is very difficult to anticipate. In the case of Exim Bank, the existence of a SOB that finances the exports is a controversy not only in Romania but also in the United States. Anyway, it is indicated a rethinking of Exim Bank strategy. In the case of CEC Bank, the privatization should be postponed at least after the end of the actual global crisis. Meanwhile, CEC Bank could be transformed in a state-owned payment and savings system.

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