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***FLASHES FROM THE PAST:
THE ORIGIN AND DEVELOPMENT OF BANKING IN
BULGARIA***

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RESUME

The study aims to outline the specifics related with the emergence and development of banking in Bulgaria. The analyzed time period is divided into four parts, which reflect development of the Bulgarian state. The first period covers the years before the establishment of the Third Bulgarian State (until 1878) and covers development of banking relations in the Ottoman Empire on the territory of the Bulgarian lands. The second period focuses on the development of banking in the newly created Third Bulgarian State (1878-1944) and reflects different aspects of the institutionalization of the state and banks. Third period (1944-1989) focuses on devolution changes in the banking sector came after the nationalization of the banking sector and the imposition of centrally planned economy in Bulgaria. Analysis of the fourth period (after 1989) focuses on the problems of the banking system transition to market relations, and on the causes of the banking crisis (1996-1997).

Keyword: banks, central bank, Bulgarian national bank, history

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**BANKING IN BULGARIAN LANDS UNTIL FOUNDATION OF THE THIRD BULGARIAN
STATE**

Until the middle of the XIX century, banks didn't exist in Bulgarian lands, or generally in the Turkish Empire. The first modern bank in Turkey was created by English and French capital in Constantinople only in 1853 under the name of "Constantinople Bank." It failed to develop a broader business and to establish its branches in the province. A little later, in 1857, the Ottoman Bank was founded with British capitals. It had headquarters in Constantinople and branches in Thessaloniki, Beirut, Larnaca, Aphiwe-Karahisar, Magnesia, Aydin and Sparta, and in 1875 - Ruse and Plovdiv. That bank had the functions of a bank cashier of the Treasury with the right to issue banknotes while also managing the Directorate of sovereign debt in Constantinople on behalf of foreign creditors on the external loans of Turkey. Until 1875 Bulgarian lands were actually outside the scope of lending to the Ottoman Bank and had a complete dominance of the unorganized credit.

For the first time the idea of establishment of the Bulgarian banking office appeared in primitive form in 1859 by publishing a proposal in some Bulgarian newspapers for the establishment of "People's Fund" in Constantinople, which would have branches in various parts of the Bulgarian lands and serve mainly remittances. Unfortunately, this idea was not realized.

A first real attempt to establish a joint stock bank in Bulgarian lands before the Liberation was made in 1869, when in Varna a "Bulgarian commercial company" was founded. There were such attempts in 1871, with the foundation of the Bulgarian borrower company "Napredak" in Constantinople and Bulgarian commercial company "Promishlenie" founded in 1872 in Sliven. The created loan-savings company "Bulgarian chitalishte" Spestyavane "(1868, Gabrovo), "Nameless company "(1871, Montana) and "Foreign company "Napredak" (1876, Pleven) had relatively short existence and local significance.

In 1872, the commercial company of Georgiev brothers - Hristo and Evlogi, tried to establish a joint stock bank in Bucharest with capital 25 mln. francs, but the subscription covered only 5% of the share capital and the project failed. Such fate had another project of Evlogi Georgiev (1873) for the establishment of a joint-stock bank in Plovdiv.

According to some authors, the archetype of the modern banking in our country can be found in the middle of the 60s of the XIX century with the creation of "Common good funds" initiated by Midhad Pasha. The first Common good fund in Pirot was founded by Midhat Pasha as a governor of Nish province in 1864, and over the next two years their number increased to 34, and they were mainly concentrated in Northern

Bulgaria, Sofia and part of the Southwest Bulgaria¹. The development of this type of institutions on the territory of present-day South Bulgaria was significantly slower - in the period 1865 - 1871, only 13 common good funds² were created. They had relatively limited funds raised through mandatory annual contributions of farmers in kind or in cash, which were used mainly for short-term loans awarded to villagers in the district to purchase livestock, equipment and other productive purposes. As far as their performance and organization are concerned, the Common Good funds can be considered as a prototype of the modern cooperative credit organizations.

LAYING THE FOUNDATIONS OF THE BANKING SYSTEM AFTER THE THIRD BULGARIAN STATE FOUNDATION

The start of building of the modern banking system in Bulgaria began only after foundation of the Third Bulgarian State. One of the first measures of the Provisional Russian Government (1878) was designed to restore the activities of Common Good funds (renamed as agricultural funds) with natural contributions (renamed as agricultural funds). In 1879, the Bulgarian National Bank was established as a national lending institution with state funds, to operate as a commercial bank.

In the very first years after the restoration of their functioning, the need for reorganization and a new law on agricultural funds become clear due to imperfection in their current organization and the way of lending. The first attempts for reforms were associated with the

¹ 1865 г. - Tarnovo, Lom, Ruse, Provadija, Shumen, Razgrad, Gabrovo, Balchik, Sevlievo, Nikopol, Kula, Vidin, Hadzhioglu Pazardzhik (Dobrich), Osman Pazar (Omourtag) Oriahovo, Berkovitza, Kyustendil, Sofia, Zlatitza, Radomir, and Ihtiman, and in 1866 - in Dupnitsa, Samokov, Orhaniye (Botevgrad), Svishtov, Belogradchik, and Tutrakan. See. **Angelov**, D. Et al. History of financial and credit system in Bulgaria, vol. I, G. Bakalov Publishing, Varna, 1981, p. 408.

Plovdiv, Pazardzhik, Stara Zagora, Haskovo, Kazanlak, Chirpan, Sliven, Nova Zagora, Yambol, Karnobat, Ajtos, Burgas, and Anchialo (Pomorie). See. Opt. cit., p. 409.

proposals of the Finance Ministers G. Nachovich, Ivan Salabashev, P. Slavkov, and Ivan Ev. Geshov. In 1903, the then Finance Minister Anton Manushev proposed a draft law to create a general institute for agricultural credit, which was adopted the same year by the National Assembly. By the law of the Bulgarian Agricultural Bank, a bank of the same name was founded which became the only central state institute for all types of agricultural loans and lending of all types of agricultural cooperatives. The new bank incorporated all agricultural funds, which themselves became branches of the bank.

In 1934, the Bulgarian Agricultural Bank absorbed the established in 1911 Bulgarian Central Cooperative Bank, thus becoming a unifying institute not only for lending but also for supervision and direction of all cooperatives. In the same year the bank (under the name of Bulgarian Agricultural and Cooperative Bank) began to lend not only individual farmers, but also comprehensive rural cooperatives.

In the process of building a banking system, the state focused on stimulating the personal savings of the population, creating the Postal Savings fund. Although the law for the establishment of the new bank was adopted as early as in 1885, it started its operation only in 1896 with the adoption of an entirely new law on its organization.

Immediately after its creation, the Postal Savings fund established itself as an authoritative and reliable retail deposit taking institution that gained the confidence of Bulgarian small savers. Its main activity was retail deposit taking and its aim was to enable those who wished to invest their savings at any time (even amounts to 1 lev). Consequently it was responsible for the organization of services for domestic and international postal money orders, and organization of the postal giro service in 1933-34.

The high degree of public confidence in the fund allows it to easily overcome the financial crisis that shook the Bulgarian economy around the wars. The Postal Savings fund ceased to exist in 1951, with the establishment of the State Bulgarian Savings Bank.

With the establishment of the Bulgarian National Bank as a real central bank, it was separated from the activities related to typical commercial banking, incl. and long-term lending. This requires the adoption of the Law on organization of the mortgage loan in Bulgaria in 1927, under which the Bulgarian mortgage bank was established. The main shareholders of the Bank are the Bulgarian state, the Bulgarian Agricultural Bank, the Bulgarian Central Cooperative Bank and insurance companies that held 40% of the capital, while the remaining 60% being foreign capital. In 1936 the Bulgarian Agricultural and Cooperative Bank purchased the shares of foreign shareholders. Thus the Bulgarian mortgage bank becomes a state bank.

With the outbreak of the economic and credit crisis at the end of 1929, in all Bulgarian joint-stock banks continuous withdrawals occurred of the savings of individuals. Many of these banks suspended payments and were bankrupt or in silent liquidation. The three major Bulgarian joint-stock banks - Bulgarian Bank, Bank for National Credit and French-Bulgarian commercial bank for international trade - because of losses and the continuous withdrawal of deposits were united in the "United Bulgarian banks" joint-stock company with a total capital of 100 mln. levs, 17 branches and five agencies in the country.

The process of withdrawal of deposits continued at a fast pace until 1934, the number of Bulgarian joint-stock banks being reduced from 137 in early 1929 to 82 in 1934, with only 35 of them actually working (the others ceased activity due to liquidation or bankruptcy). The stabilization of local joint-stock banks with Bulgarian capital was

performed by the decree-law crafted by the BNB and approved by the government on 15 June 1934. The decree-law provided for the establishment of the "Bulgarian credit" bank whose capital involved 23 joint-stock banks in trouble, the state, the Bulgarian Agricultural and Cooperative Bank and others. The state joint-stock company "International Bank" also entered the new bank.

After its creation in 1935, the "Bulgarian Credit" bank developed rapidly and occupied over 80% of the capital, reserves and deposits of all joint-stock banks in Bulgaria. Thus it became the largest credit institution in the banking system of the country, with the exception of the BNB and the Bulgarian Agricultural and Cooperative Bank, and had a leading role in financing the national economy - mainly industry and trade.

The first entry of foreign capital in the banking sector of the new Bulgarian state was associated with the establishment of three banks with foreign capital in 1906 - Bulgarian General Bank³, Credit Bank⁴ and Balkan Bank⁵. The three banks ever since their foundation developed broad activity due to the access to cheap resources (at a rate 2-3%) of the parent banks and European banking markets. Thus, they successfully competed with Bulgarian provincial banks because of the lower interest on their loans granted by 8 and 9% versus 12 to 14 % of the banks with Bulgarian capital. Besides in the area of credit, they took an active part in the trade of grains, transportation of goods, provision of insurance of transport as an agent of foreign insurance companies, and other areas of the Bulgarian economy.

³ Shareholders Banque de Paris and Pays Bas, chief banker of the Bulgarian state at the loan contracts made in 1902, 1904 and 1906

⁴ Shareholders, a German consortium of banks - Disconto-Gesellschaft, Bleichroeder and Nord-Deutsche Bank.

⁵ Major shareholder - Wiener Bankverein, with the participation of other Austrian capital.

In 1912, an attempt was made for the foreign capital to enter the field of mortgage lending with the formation of two mortgage banks with French capital: Franco-Bulgarian mortgage bank and Franco-Bulgarian mortgage bank in the Balkans. Of these, only the first remained to act with no success in developing large activity, while the latter was liquidated at the outbreak of the Balkan War.

After World War I, the entry of foreign banking capital in the country continued. In 1915, the Ungaro-Bulgarian Bank⁶ was established. The bank existed until 1922, when it merged with the Bulgarian General Bank. After 1919, a few more new banks were established - Italian Commercial Bank⁷, Limited Partnership bank "A. Kouyoumdjisky"⁸ (converted in Franco-Bulgarian Bank in 1923), Deutsche Bank⁹, and Prague Credit Bank¹⁰.

BANKING SYSTEM OF BULGARIA DURING SOCIALISM

The change of socio-political structure of Bulgaria in 1944 affected the organization of banking in the country. By the Banking Act Adopted in 1945, the nationalization of the banking system was carried out. All joint-stock banks ceased to exist independently, and their assets and liabilities fully transferred on the BNB. The only exceptions were Bulgarian mortgage bank and the existing savings-construction companies whose assets and liabilities were transferred to Bulgarian Investment Bank (specializing in long-term loans). Only the Postal Savings Bank, popular banks, and comprehensive agricultural

⁶ Major shareholder - Banque Commerciale Hongroise de Pest.

⁷ Major shareholder - International monopoly bank " Banca Commerciale Italiana".

⁸ Major shareholders Credit Foncier d'Algerie - Paris and Banque Belge Pour l'Etranger.

⁹ Branch of the banking corporation - Berlin.

¹⁰ Branch of the Grand Czech Bank - Prague.

cooperatives and departmental funds continued to exist, with the BNB having the right to delegate them the performance of certain banking transactions.

In 1951, the Council of Ministers and the Central Committee of the Bulgarian Communist Party issued a Decree 218 for the reconstruction of the banking system, by which the Bulgarian National Bank was differentiated as a single emission centre regulating currency circulation in the country. The popular banks functioning until then become the BNB branches. The decree established a central retail deposit taking institution - State Savings Bank (an extensive network of funds across the country), and reformed the headquarters of the Postal Savings Bank in Central Office of the State Savings Bank.

By the merger of popular banks in the structure of BNB, the bank was put in charge of operations typical for commercial banking - organizing estimates between enterprises, exercising control on the implementation of production-financial, commercial and financial plans of enterprises, mobilizing all available funds of the departments, organizations, and businesses.

In 1964, Bulgarian Foreign Trade Bank was founded. It specialized in making currency and credit operations of commodity and non-commodity nature with foreign countries, lending and control on foreign trade enterprises, monetary and economic research, and analysis for the country and abroad.

At the end of 1966, the Council of Ministers adopted another Decree on the reorganization of the banking system, by which in the beginning of 1967, the BNB and Bulgarian Investment Bank merged. The BNB took over the activity, assets, rights and obligations of the Bulgarian Investment Bank, with the exception of activities, rights and obligations on the housing-savings accounts and loans for housing for

citizens. They were taken over by the State Savings Bank. At the same time, the Bank became directly subordinated to the Council of Ministers and acquired the status of a committee at the Council of Ministers without rank of ministry.

There was some return to the two-tier banking system in the country after 1969, when a Decree on the organization of the banking system created Bulgarian Industrial Bank, and Bulgarian agricultural and commercial bank. The first specialized in servicing enterprises in the field of industry, transport, communications, construction, and design work, while the second served the state and cooperative associations, enterprises and organizations of agriculture, forestry, domestic trade, material and technical supply, food industry, and communal activities. It also financed the capital investments of non-profit ministries, departments and organizations, and housing for the population, performed by assignment.

Unfortunately, the separation of commercial and central banking was brief. At the end of 1970, Bulgarian Industrial Bank and Bulgarian Agricultural Bank passed into the BNB, becoming Directorates, and in the beginning of 1971, the State Savings Bank also became a separate deposit and lending institution under the authority of the BNB. This organization of the banking system remained until the early 80s of the twentieth century.

In 1980, the Council of Ministers adopted a decree which established "Mineralbank" whose main activity was to attract foreign capital in the form of equity participation and loans from foreign banks, financial institutions, companies and others for the needs of the investment process in Bulgaria in the development and maximum utilization of local energy and mineral and raw material resources. In 1983, the bank was transformed into a Bank for Economic Initiatives

"Mineralbank" with subject of activity participation with equity and loans in local and foreign currency in effective business enterprises which are not calculated in their state planned tasks.

With the adoption of "Rules of business" at the end of the 1986, for the first time in the conditions of planned economy, the creation of "commercial banks" was allowed. Under these rules banks were:

- ◆ Central Bank (BNB);
- ◆ banks formed with the participation of self-governing business organizations, called "commercial banks";
- ◆ Economic Bank, which performs the main banking and lending of the self-governing business organizations;
- ◆ Bulgarian Foreign Trade Bank, which performs basic banking services of foreign economic activity of self-governing business organizations and the country;
- ◆ Bank for Economic Initiatives "Mineralbank", which credited technological innovation and the development of small and medium enterprises and facilities;
- ◆ Agricultural and Cooperative Bank, which served and credited agricultural enterprises and cooperative organizations;
- ◆ Bank for Development of the Consumer Goods Industry ;
- ◆ other banks for lending and equity participation in the development of certain economic activities;
- ◆ State Savings Bank, as a specialized savings and credit bank for servicing of population. It can perform banking also of self-governing business organizations of local importance.

The Decree for the reorganization of the banking system adopted on 3 June 1987 by the Council of Ministers, initiated the largest banking

reform after 1947. In fact, it marked the beginning of the restoration of the typical two-tier banking system in the country. The decree created 8 new banks:

- ◆ "Electronica" Bank - for economic organizations that are key members of "Electronica" association;
- ◆ Bank "Biochim" - for economic organizations that are key members of biotechnology and chemical industry association;
- ◆ "Avtotechnika" Bank - for economic organizations that are key members of the association for transport, agricultural and construction equipment ;
- ◆ Agricultural and Cooperative Bank - for economic organizations that are key members of "National Agro-Industrial Union" and "Forestry and forest industry" associations, and cooperative organizations;
- ◆ Construction Bank - for economic organizations that are key members of building and construction industry association;
- ◆ Transport bank - for economic organizations that are associated as key members of the Ministry of Transport;
- ◆ Bank for economic initiatives - for enterprises that are key members of the "Industry for man" association;
- ◆ Economic Bank - for the other economic organizations.

By the decree of the Council of Ministers, Rules of banks were adopted, which governed the management of banking activities, rights, obligations, responsibilities of banks and their relations between themselves, as well as with other business organizations.

In 1989, the Council of Ministers issued a decree to adopt Rules of banks, by which an agreement was given for certain divisions of the

bank to be transferred as divisions of the existing commercial banks in return for payment of their property, and based on the intention for some of the divisions of the bank to form new banks as joint-stock companies.

BANKS AND BANKING DURING THE TRANSITION TO A MARKET ECONOMY

With the social and political changes in Bulgaria after 1989, the banking system transitioned from a centrally planned to a market-based one. The first and fundamental step in this direction was the National Bank Act of 25 June, 1991, under which the Bank began to act like a typical central bank in the conditions of a two-tier banking system. It is a "bank of banks", "bank of the country" and "bank that stored and managed the foreign exchange and gold reserves of the country."

In 1992, the Law on Banks and Credit Activity came into force, which laid the foundations of the legal regulation of commercial banking. Besides, it sets out regulations aimed at protecting the interests of depositors and guarantees the stability of the banking system by limiting the risks in banks. The law also regulated the banking supervision over commercial banks, exercised by BNB.

In the same year, "Banking Consolidation Company" AD (BCC) was also created, with the subject of activity the acquisition, management, evaluation and sale of shares in local banks; organizing and conducting control in the reorganization of banks in which BCC had acquired shares for management; organizing and / or participating in financial restructuring of individual banks and privatization of banks under current law. Founders of BCC are BNB, whose shares in commercial banks were transferred to the new company, and Bulgarian Foreign Trade Bank.

The problems of transition in Bulgaria also affect the development of our banking system. In many ways, the commercial banks are not prepared for the new market conditions and continue to function in accordance with the stereotype constructed during socialism. The lack of sufficiently qualified professionals, good banking practices for evaluating the risks involved, and sometimes purely criminal behaviour of some bank employees led to deterioration the entire banking system which developed into a banking crisis in 1996.

30 November, 1995 is considered to be the beginning of the crisis in Bulgaria, with the acquisition of "Agrobiznesbank" AD, Plovdiv by BNB against one lev, not less than 90% of the shares with voting rights, if possible, all preferred shares without voting rights. Next year BEI "Mineralbank" AD and "First Private Bank" AD were placed under special supervision, and a little later BNB found their insolvency and asked Sofia City Court to open insolvency proceedings. The same fate befell "Private Agricultural and Investment Bank" AD, CB "Crystalbank" AD, "Agrobiznesbank" AD, "Bank for Agricultural Credit" AD, and CB "Elitbank".

As part of measures to overcome the crisis the Law on State Protection of Deposits and Accounts in commercial banks was adopted and entered into force in 1996. For those commercial banks the BNB petitioned the institution of bankruptcy proceedings, and since the beginning of 1997, a preparation began for the introduction of the currency board in Bulgaria. As part of this preparation the BNB stopped the refinancing of commercial banks and open market operations with government securities.

On 10 June, 1997, the new law on the BNB was adopted, which repealed the 1991 Act and regulated the legal status of the central bank

as an institution applying the currency board regime, by which the banking crisis in our country was finally under control.

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