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Restructuring and Development of the Banking Sector in Poland. Lessons to be Learnt by Less Advanced Transition Countries

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Part I.
Introduction

The banking sector in transition economies deserves a special attention of policy makers and the public. The first reason for this attention is that financial intermediation plays a special role in an economy: it channels financial savings of enterprises and households into investments. There is no economic growth in a country if this function is not executed in an effective and efficient way, and if the financial sector is not credible. Therefore reestablishment of a sound banking sector has been crucially important for transition countries.

The second general reason is that banks are enterprises of a unique character due to the fact that their performance is important not only to shareholders, as it is the case for enterprises in all other economic sectors, but also to depositors. For that reason the public trust is essential for banking. While its creation is a long and comprehensive process, it is very easy to destroy it.

The third reason, specific for transition economies, is connected with the very bad starting point. Under the communism allocation of funds by banks was carried out by outside orders and not by inside business decisions based on profitability and risk assessment. Therefore, at the start up of transition, in the sector of then state-owned banks there was neither know-how and business culture nor internal governance structures relevant for market economies. At the same time the banking sector was the terrain where the biggest change of culture and behavior was necessary in order to build its credibility. This fact made the task difficult and complex.

The forth reason is that development of the banking sector in transition economies depends on both macroeconomic policy and microeconomic restructuring of enterprises. That is why it cannot be analyzed in isolation.

Despite the fact that all four reasons make development of the banking sector in transition economies crucially important, restructuring and privatization of the sector has been politically a very sensitive issue, highly burdened with prejudices, fears and popular sentiments. It has been unfortunate for the pace of the reform of the sector and the whole economy.

After almost eleven years of market reforms the banking sectors in transition economies differ considerably from each other and these differences are still growing. Explanations for this indicate mostly to differences in government economic policies and in reform agendas. Other factors (like initial conditions, political stability, level of entrepreneurship etc) also mattered, as they influenced the programs and pace of reforms.

Poland is being classified into a group of "advanced reformers" [1]. For that reason the case study of Polish experiences of restructuring and development of the banking sector should serve as a useful supplement to the discussion going on in less advanced transition economies about measures needed for the banking sector's restructuring and development. This report was originally addressed particularly to Bulgarian policy makers, bankers and economic mass media and was prepared alongside with similar reports on two other advanced transition economies: Hungary (by Pal Gaspar from the International Centre for Economic Growth, Budapest) and the Czech Republic (by Michal Mejstrik, Anna Dvorakova and Magda Neprasova from the Institute of Economic Studies of the Charles University, Prague). All three reports were elaborated within the framework of the Partners for Financial Stability program (PfFS), managed by the East-West Management Institute, Inc. (New York – Budapest). Experiences of the three countries were presented and discussed on the international conference on: Restructuring and Development of the Banking Sector in Central and South-Eastern European Countries: Mutual Lessons from Practical Experience in Transition, organized in Sofia on June 22, 2001 by the Bulgarian Economic Policy Institute (EPI).

The report is organized in the following way: Part II describes initial conditions inherited from the centralist

[1] By Lajos Bokros, for example, who used this term at the seminar titled: "Experience and Perspectives of Financial Sector Development in Central and Eastern Europe", organized by CASE Foundation in Warsaw on 31 May 2001. Hungary was also included in the first group. The Czech Republic (together with Slovenia) was classified into the second group of "reluctant modernizers" (for more see: Bokros 2001). The opinion about Poland as a model transition country in transforming its banking sector into a reliable, efficient, well-capitalized sector offering good quality and modern services is shared by many other specialists in the field (see: Hexter 2001).

regime of the command economy. Part III covers the period from 1990 until the beginning of 1997, which is referred to in the text as the first transition period (this term applies to the banking sector alone). The analysis starts with the presentation of the macroeconomic environment and its impact on the banking sector. Later on it presents policy measures, including privatization and adjustment efforts, that established legal and institutional background for the functioning of a healthy banking sector in Poland. A special attention is paid to rehabilitation and recapitalization programs introduced for both state-owned and private banks due to a decisive role that these two processes played in effective restructuring of the banking sector in Poland. The completion of these programs marks in fact the end of the first transition period of the banking sector restructuring and development. Part IV gives an account of the second period of the banking sector transition, which began in 1997, and is referred to in the text as the post-restructuring period. This Part starts with the presentation of macroeconomic developments in the years 1997–2000 and their impact on the performance of the banking sector. It presents changes in the market and the ownership structure of the banking sector as well as in the pace of growth and financial standing of the sector. Government policies aimed at improvement of the prudential behavior are also discussed in this part. Much attention is given to the privatization process, speeded up since late 1997 and resulting in a dramatic change of the ownership structure. Mergers and acquisitions which became characteristic for the second period of development of the banking sector in Poland are also discussed here. Finally, Part V contains conclusions and lessons drawn from the Polish experience.

Part II.
Initial Conditions (1988 – 1989)

2.1. The Initial Structure of the Banking Sector

At the end of the centralist regime the distinction between the central bank and commercial banks' functions did not exist; the banks functioned in the monobank structure.

Until 1982 the National Bank of Poland (NBP) had been supervised directly by the Minister of Finance, and the Chairman of NBP was at the same time the deputy Minister of Finance.

In 1988 there were four state-owned banks that played a supplementary role to the NBP and specialized in specific banking activities (Borowiec 1996). All four were solely state-owned banks. These were:

– Powszechna Kasa Oszczędności (PKO BP) specializing in retail banking and financing of housing development,
– Bank Gospodarki Żywnościowej (BGŻ), which was a refinancing bank for a network of cooperative banks (there were about 1600 of such banks in 1988),
– Bank Polska Kasa Opieki SA (PEKAO SA), which collected foreign currency deposits of individuals,
– Bank Handlowy SA, which was financing foreign trade and settling foreign indebtedness of Poland.

The last two banks, both founded long before WW2, were joint stock companies. Each of the four banks had a monopoly in specified areas and was forbidden to operate outside them, whereas enterprises were not even allowed to choose a branch of a bank. Banks in practice were only cash desks, as loan decisions were made by the state administration.

In the second half of the 1980ties three new banks were established, and this was an outcome of a modest reform program pursued by the communist government seeking instruments to stop an economic decline in Poland. These banks (namely: Bank for Export Development – BRE SA, BIG SA and Development Bank in Łodź SA) established as joint stock companies, were founded by state-owned enterprises, with some participation of other banks, Ministry of Finance and with a small contribution of individual persons [2].

2.2. The Early Start-Up of the Banking Sector Reform

Interestingly enough, the reform of the banking sector started already under the communist regime, i.e. ahead of a market reform which was prepared in the late autumn 1989 by the first non-communist government and commenced in January 1990. In January 1989 two new acts were voted by the Parliament: the Act on Banking and the Act on the National Bank of Poland. They introduced a two-tier system:

– the National Bank of Poland adopted the function of a central bank,
– commercial activities were separated from NBP and transferred to newly established nine banks.

These nine banks [3] which emerged from local branches of the National Bank of Poland were: Bank Depozytowo-Kredytowy in Lublin (BDK), Bank Gdański (BG), Bank Przemysłowo-Handlowy in Cracow (BPH); Bank Zachodni in Wrocław (BZ), Pomorski Bank Kredytowy in Szczecin (PBKS), Powszechny Bank Gospodarczy in Łódź (PBG), Powszechny Bank Kredytowy in Warsaw (PBK), Wielkopolski Bank Kredytowy in Poznań (WBK), and Bank Śląski in Katowice (BSK). Originally they operated as so-called state banks, however, in 1991 they were transformed into joint stock companies (of the State Treasury), in order to make them legally prepared for privatization.

Yet, the National Bank of Poland took some time before it fully delegated commercial activities to other banks. It was no sooner than in 1993 that commercial operations conducted directly by headquarters of NBP were separated and transferred to a newly established especially for that purpose – Polish Investment Bank (PBI).

As a result of the reform undertaken in the years 1988-1989 by the end of 1989 there were 18 state-owned commercial banks (five "old" [4] and thirteen "new" ones) (see: Table 1 in Appendix).

[2] Characteristically for that time, they were either party activists or high rank bank officials.
[3] Further in the text referred to as "state-owned commercial banks" as they were called in a banking jargon in Poland.
[4] The fifth one is Bank Gospodarstwa Krajowego (BGK), whose operations were suspended in 1948 and reactivated in 1989.

Part III.
Restructuring and Development of the Banking Sector in the First Transition Period (1990 – the beginning of 1997)

3.1. Macroeconomic Environment and Macroeconomic Policy in the Years 1989–1997

3.1.1. Transition-Specific Shocks, Macroeconomic Developments and Their Impact on the Banking Sector at the Start-Up of the Transition (1989–1990)

Situation of the banking sector in Poland in the first stage of transition was to a large extent determined by macroeconomic conditions and systemic instruments existing both in the period closely preceding transition and during its first stage. Under conditions of the command economy enterprises had a high financial liquidity and a part of investments was financed directly from public funds. In the 1970ties Poland drew high foreign credits – mostly appropriated for financing production investment. As a result, enterprises' and individual persons' indebtedness to banks was relatively low – in 1988 it constituted 40% of GDP.

As far as assets and liabilities are concerned, their important position was formed by foreign currency positions. On the side of assets these were the budget's liabilities, on the side of liabilities – liabilities to foreign creditors and liabilities to domestic individual persons (Polish foreign currency law allowed individual persons to have accounts in foreign currencies). No sooner than in 1990 foreign indebtedness was separated from the banking sector's balance and transferred to the Fund of Foreign Indebtedness Servicing (Fundusz Obsługi Zadłużenia Zagranicznego). Denominated in foreign currencies liabilities to domestic banks (i.e. indirectly – to individual persons) were altered to long-term bonds of the State Treasury, denominated in USD.

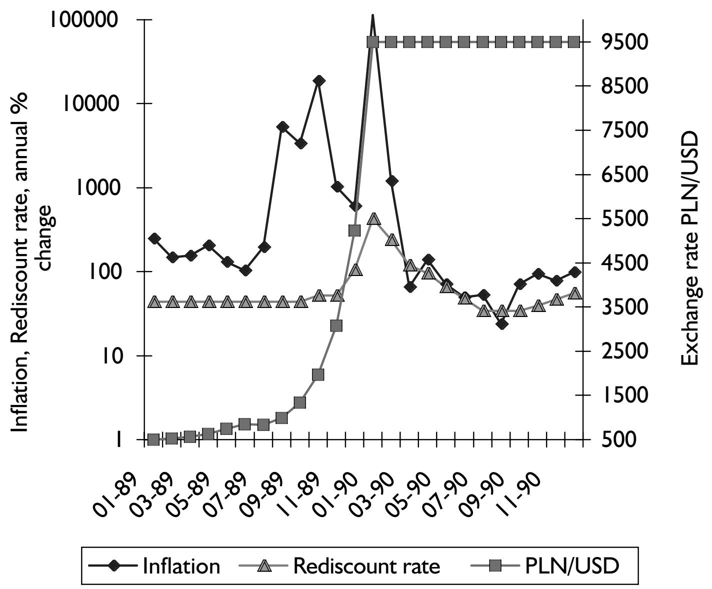
The stage of the proper transition had been preceded by a series of considerable devaluation of the zloty and a very high inflation. Within 1989 the USD exchange rate had grown by 1770% cumulatively (including the 50% devaluation of the 1st January 1990), while prices in December 1989 were by 640% higher than in December 1988. At that time the money supply had risen by 526% (mainly as a result of a growth of the zloty value of foreign currency deposits), whereas the credit supply only by 177%. Dollarization of savings was progressing quickly. In December 1989 deposits in foreign currencies constituted 64% of total deposits.

The process of transition began on the 1st January 1990 by a program joining a radical liberalization of economy with a shock macroeconomic stabilization. The rediscount rate of the central bank was raised in January to over 400%, public expenditure was reduced leading to budget surplus. After the devaluation of the zloty on the 1st January, the fixed USD exchange rate was maintained during the following months. Additionally, a restrictive, progressive tax, limiting the growth of wages, was imposed on state enterprises. Despite the restrictive fiscal, monetary and income policy, liberalization of prices caused their sharp increase. In January prices rose by 80% and in February by the further 24%. The level of inflation fell below 10% monthly no sooner than in the following months, still, the yearly pace of price growth accounted to several tenths %.

The shock stabilization program allowed to lower inflation considerably, however, in consequence of that domestic demand decreased by 20%. Industrial production declined in 1990 by 24%, construction by 13%. Thanks to a series of devaluation of the zloty in 1989 (cumulatively by 1770%) exporters' financial situation in 1990 (mostly intermediate goods' producers) significantly improved. Slightly worse were the results for producers of consumer and investment goods. Still, the profitability indicators were very high despite the decline in production. This was caused by both: a purely book effect of a high inflation and by low competition on the market. The low competition was, in turn, a result of, on the one hand, a high concentration of production, on the other hand, a lack of foreign competition combined with a very high exchange rate of foreign currencies.

Devaluation of the zloty and a low domestic demand caused a radical improvement of foreign trade balance from 240 million USD in 1989 to 2.214 million USD in 1990. This enabled to maintain the fixed USD exchange rate as long as till May 1991. In spite of a high surplus in foreign trade, foreign currency deposits of the enterprises' sector were decreasing quickly. Individual persons' foreign currency deposits in USD were declining very slowly. In connection with a high inflation and related to it fast nominal growth of zloty deposits, a share of dollar deposits in total deposits

Chart 1. Inflation, the Rediscount Rate and the USD Exchange Rate, 1989–1990



was quickly decreasing, falling by the end of 1999 to even less than 36%. In the case of both enterprises and individual persons, the observed in 1989 trend of dollarization was reversed due to a large difference in interest rates on zloty and dollar liabilities, which for foreign currency accounts' owners, at the fixed USD exchange rate, meant a fast fall in the real value of their deposits.

In the years 1989–1990 the price level (GDP deflator) rose by almost 800%, whereas money stock by 370%. Real money stock decreased by a half, at a GDP decline by approximately 12%. In consequence of all these processes, at the end of 1990 the ratio M2/GDP was only about 34% (see: Table 18 in the Appendix). A low share of credit in assets was due not only to a restrictive monetary policy, but also to structure of banks' balance sheets. A share of foreign currency deposits in liabilities was still high, yet steadily decreasing. A considerable part of foreign currency deposits was "bound" to assets by the issued by the State Treasury bond denominated in dollars (these funds were used in the 1980ties by the communist authorities to finance current foreign currency payments). As a result, only about 60% of deposits could be relent in a form of credit. A source of credit supply's growth for enterprises was mostly negative financing of the public sector which in the first year of transition showed surplus, and surplus in foreign trade which was bought out by the National Bank of Poland in order to increase very limited reserves in foreign currencies. After a dramatic decline in the credit real value in 1989, this enabled in 1990 a slight growth of credit for the non-financial sector, not only nominally but also in real terms – by 5%. Therefore, by the end of 1990 credit for the non-financial sector was maintained at the level of only 19% GDP, out of which only about 1% was constituted by credits for individual persons.

Under conditions of very sharp increases of inflation in first two months of 1990 and very high nominal interest rates in those months (432% and 240% respectively) the increase in volume of credits was mainly connected with capitalization of interests from earlier credits. In the situation of highly uncertain economic prospects for enterprises, banks feared to grant new credits on terms which envisaged capitalization of a part of interests. As a result, a new credit was almost solely a short-term credit. A high inflation and high nominal interest rates caused the situation when even in the case of a long-term credit, the most part of such a credit would have to be repaid in real terms in first months after its receipt. Moreover, a considerable decline in production meant a high level of waste of existing production capacities. In such conditions enterprises' investments were those of a modernizing character, not requiring a long-term credit.

High nominal interest rates and a small share of long-term deposits in total deposits caused the fact that the average rate of interest on deposits was much lower than on credits. Thanks to that financial results of the banking sector were very good in the initial stage.

Summing up, breakdown of the macroeconomic stability at the end of the 1980ties led in consequence to a dramatic decline in the economy monetization level and to limiting of a role of financial intermediation in the economy. Highly unstable conditions for taking microeconomic decisions (resulting from the decline in economic activity and rapid fluctuations in the real value of the zloty) sharply limited the decision-making horizon of enterprises and banks. In consequence of that, the banking sector served the function of domestic savings' allocation to a very small degree. Clearly, big domestic enterprises were privileged in getting access to credits. They were traditional clients of state-owned banks and they possessed property collateral, which was, in the situation of rapidly changing microeconomic conditions, the main criterion of credit capacity assessment.

3.1.2. Macroeconomic Developments and Policies in the Years 1991–1992

In the second year of transition macroeconomic situation changed dramatically. The fixed zloty exchange rate up till May 1991 caused a fast real appreciation of the zloty. Therefore, despite a rapid devaluation of the zloty in 1989, already at the end of 1990 the zloty exchange rate was in real terms by 27% higher than at the end of 1988. In the second half of 1990 domestic demand started to grow, however, because of the appreciation of the zloty, it led to only a slight growth of domestic production and to a strong growth of import. The private sector began to grow fast, initially mostly in trade, later on in other services, construction and industry. At the beginning of 1991 a shift to dollar settlements in trade with the former countries of COMECON (Council for Mutual Economic Assistance) brought about a crisis in export to those countries, and a jump in prices of fuel at the same time. It caused another decline in production, growth of inflation, further restricting of monetary policy and fall in consumer demand. A financial situation of enterprises deteriorated rapidly. In that situation, in May 1991 the zloty was devaluated by 8% and the fixed exchange rate was replaced by a crawling peg related to a currency basket.

Introduction of a crawling peg slowed down but did not stop the real appreciation of the zloty – the dynamics of inflation was higher than the pace of changes in foreign currencies' exchange rates. However, the restrictive monetary policy hindered domestic demand and a cheap dollar lowered costs of equipment modernization. This proved to be sufficient for a quick reorientation of foreign trade from countries of the former COMECON to Western Europe. Still, a financial situation of enterprises remained very difficult, domestic demand was very weak and in consequence, economic growth continued to be negative (GDP declined in 1991 by another 7%, see: Table 18 in Appendix). It was yet another devaluation of the zloty in 1992, which reversed the declining tendency in production and originated a gradual economic growth.

The fall in GDP and weak financial results of enterprises brought about a rapid decline in the budgetary sector results. For banks financing budget deficit became an important alternative to granting credits to the non-financial sector. In 1991 and 1992 the share of credits for budget and State Treasury's securities grew quickly in banks' assets, reaching 25% by the end of 1992. A part of budget financing was executed directly by the central bank, which, together with the crawling peg policy, complicated the control of money supply and slowed down the pace of disinflation.

Liberalization of foreign currency laws (enabled by the growth of foreign currency reserves) and the mechanism of a crawling peg encouraged banks to invest in foreign securities. It was another reason for limiting the more and more dangerous credit expansion for enterprises. At the same time, as the pace of the exchange rate devaluation was slower than inflation and there were very big differences in zloty and dollar interest rates' levels, saving in zloties was much more profitable than in foreign currencies. This caused the further decrease of currency deposits' share in broad money. At the end of 1992 it was only 25%.

Deterioration of enterprises' financial situation in 1991 only slightly worsened banks' financial results. Banks could still realized high interest margins. At a high inflation, nominal interests rates on credits and state securities were also high, whereas interest costs of obtaining money were low. It was connected to a "natural" fact that a part of clients' money is interest-free and to low qualifications of enterprises in managing their liquidity. A small competition on the banking market was, also, of a great importance here. Apart from 3 banks operating countrywide – PKO BP, PEKAO S.A. and BGŻ – the remaining major banks were created from the central banks' local branches (see Section 2.2). Their territorial extent was thus limited – they could not compete with each other. The domestic private sector was too weak in terms of capital in order to constitute a serious competition for state-owned banks, whereas foreign banks were just beginning very cautiously their activity on the Polish market (see Section 3.2.1). The lack of competition as well as the lack of deeper economic motivation for management boards of state-owned banks caused the fact that banks did not do much in order to improve effectiveness of their own activity. The quality of managing all kinds of risk was low. The pace of computerization was similarly very weak; traditional, time-consuming procedures dominated. Non-interest costs of activity were therefore high.

Banks' real financial standing deteriorated quicker than financial statements showed it. Banks were very liberal in evaluating enterprises' borrowing capacity. A high inflation in 1989 and 1990 depreciated old debts of enterprises. Their indebtedness in relation to the book value of owned property was very small. Therefore property collateral was sufficient for banks which allowed enterprises to roll-over credits by drawing new ones. In 1991 the central bank recommended also to commercial banks to increase crediting of the private sector. The lack of property collateral in such companies and banks' little experience with creating other collateral and with business plans' evaluation brought about a fast growth of bad credits in this sector of enterprises. The poor assessment of borrowing capacities was also caused by strong fluctuations of the zloty real exchange rate and fluctuations of demand changing a structure of production profitability and considerably complicating evaluation of financial prospects of banks' clients. As a result, a decline in production and growing indebtedness in the years 1991 – 1992 caused a rapid fall in enterprises' profitability and growing problems with servicing debts. Losses by many enterprises of borrowing capacity and low liquidity of their equipment and machinery constituting the credit's collateral (at the sharp decline in production, use of production capacities was very low) led to a fast growth of bad credits in the banking sector.

The deteriorating equity standing of banks was due not only to the growth of bad credits. A high inflation caused real depreciation of banks' funds. In spite of relatively good financial results, banks' profits turned out to be insufficient to stop this phenomenon, particularly so because their considerable part was transferred to the state's budget. Apart from income tax, state-owned banks in the years 1990– 1991 transferred to the budget a significant part of net profits in a form of dividend. Similarly, rules of creating provisions for classified liabilities were prepared with the aim of securing budget revenues rather than with the intention to thoroughly evaluate a bank's financial situation. As a result, a part of provisions could not be included into costs and the effective profit tax rate was higher than the official 40%.

Summing up, a difficult economic situation in the first stage of transition, lack of strong competition and structural weakness of state-owned banks had a very negative impact on the banking sector. In this stage of transition the sector was passive, and the role of financial intermediation in economy diminished. After a rapid decline in monetization just before transition and during its first year, its rebuilding was complicated by a high inflation. Unstable macroeconomic conditions made credit risk very high. At the lack of a sufficiently strong competition and high inflation, banks could still realize high interest margins, which enabled them to maintain relatively good financial results in spite of limiting credits for the sake of less profitable but saver investments in State Treasury and foreign securities. An attempt to enforce on the sector a more active role in the process of economy restructuring (administrative pressures for increasing credits for the private sector) turned out to be a fiasco which lowered quality of banks' credit portfolio rather than brought about allocation of savings in enterprises having the highest growth potentials. Lack of experience of activity in market conditions as well as quickly changing macroeconomic conditions led to a situation in which procedures used by banks to evaluate credit capacity turned out to be ineffective – a share of bad credits in banks' assets was growing quickly threatening the sector with a crisis. In this situation a decline in monetization had one advantage: bad credits in relation to GDP constituted a relatively small amount. Thanks to that cost of banks' recapitalization by the budget within the frame of the banking sector restructuring was relatively low – it was less than 2.5% GDP.

3.1.3. The Period of High Economic Growth in the Years 1993– 1996

In 1992 the fall in GDP was haltered and in the following years the pace of economic growth accelerated gradually. In 1995 it reached 7%, till 1997 it had maintained the level of over 6% (see: Table 18 in the Appendix). From 1992 to 1995 the monetary policy had an expansive character. Interests rates of the central bank were negative in real terms, the crawling peg of the zloty was maintained and corrected in 1992 and 1994 by sharp devaluation. In these conditions inflation was decreasing, yet the pace of disinflation was slow. No sooner than in 1996 the yearly price increase fell below 20%. An agreement with foreign creditors on reduction of foreign indebtedness improved Poland's credit rating. A volume of foreign direct investments was growing slowly but steadily and since 1994 also portfolio investments increased. Growing inflow of capital in connection with the mechanism of crawling peg led to a fast increase in foreign reserves. A financial situation of enterprises was improving. Likewise, the budget deficit which in 1992 reached the level of 6% GDP, in the following years decreased slowly. Yet, it was no sooner than in 1996 when it fell below 3% GDP and again in 1998 it started to grow (see: Table 18 in the Appendix).

The improvement of macroeconomic situation positively influenced the improvement of credit quality. The share of below standard loans had decreased from 31% in 1993 to 13.2% in 1996 (see: Figure 1 in the Appendix). However, a low pace of disinflation delayed a credit growth but negative – in real terms – deposits' interest rates curbed growth of savings. Thus, the level of monetization remained in 1996 at low level of 35%.

3.2. Entry to the Banking Sector (1989– 1997)

3.2.1. Liberalization of Entry to the Banking Sector and Its Impact on the Structure of the Banking Sector in the Early Years of Transition Period (1989– 1992)

It needs to be pointed out that the new Act on Banking of 1989 introduced a regulation that enabled the establishment of non-state banks in Poland. From the very beginning the National Bank of Poland had pursued quite a liberal licensing policy: the equity requirements were low [5] and there were hardly any requirements from the shareholders as far as the history record in banking was concerned [Borowiec 1996].

The domestic market response was immediate. In the years 1990 and 1991 there was a wave of establishing domestic banks (21 and 20 respectively); by the end of 1992 there were 54 domestic banks that had emerged in the three-years' period of 1990–1992 (see: Table 1 in the Appendix). Yet, they were in general very small and in many cases state-owned companies or municipalities were their shareholders. Often, the newly established banks were to service special sectors of the Polish economy (e.g. energy sector, sugar industry etc.) and some shareholders hoped to have an easy access to credits in their banks [Balcerowicz 1997]. This policy, together with small capital and limited assets, and last but not least, poor human resources and insufficient know-how, and in some cases criminal offences, soon turned out to cause problems in this segment of the banking sector in Poland and in the banking sector in general. The intervention of the central bank and rehabilitation of troubled banks became necessary (see: Section 3.4). The poor outcome of the liberal entry in the banking sector brought about a dramatic change in the licensing policy of the National Bank of Poland (see: Section 3.2.2.) and by 1993 the process of establishment of solely domestic banks ended.

In the light of a hot political debate over the role of foreign capital in bank privatization and a strong dislike of foreign investors by some of political parties expressed in the whole period of privatization (i.e. since 1993), it is interesting to realize that it was already the Act on Banking of 1989 that opened the market to foreign investors. Additionally, there were special incentives offered to foreign investment (including that in the banking sector) like tax holidays and permission to provide and keep the equity in hard currencies. In spite of these incentives in the first years there was not much interest among reputable foreign banks in establishing activities in Poland, and this may be easily explained by a poor macroeconomic situation, the country's indebtedness, and an early stage of market reform at that time (see: Sections 3.1.1 and 3.1.2). However, it is worth noticing that during the first two years of transition (1990–1991) there were 4 banking institutions which established in Poland 3 banks under their brand names. These were: Raiffeisen Zentralbank Osterreich AG and Centro Internationale Handelsbank AG (which together established one bank: Raiffeisen-Centrobank), Creditanstalt and Citibank. Two renowned banks: ING Bank N.V. and Societe Generale established branches in Warsaw. Seven other foreign banks were established in Poland in the years 1990–1993 by a number of other foreign banks, investment funds, foreign companies and, in some cases, with a small participation of Polish state-owned banks or enterprises and state agencies. Initially a scope of their activities was very limited and they concentrated on servicing foreign enterprises active on the Polish market, which is a typical and understandable policy of renowned foreign banks established in early transition economies. Therefore, at that early period foreign banks did not compete with state-owned and new domestic banks – they were active on different markets. It had not been until 1995 that foreign banks started to be perceived as competitors [Dobosiewicz 1996]. This was caused by both: an increase in the number of foreign banks (to 18 in 1995, see: Table 3 in the Appendix) and their shift from a narrow range of services to a wide range of the banking sector activities (see: Section 3.6).

3.2.2. Restrictive Licensing Policy (1992–1997)

Poor and costly outcomes of the policy of liberal entry to the banking sector in the years 1989–1992 made the National Bank of Poland restrict the licensing policy in the second half of 1992 [Kwaśniak 2000]. Equity requirements had subsequently increased up to the equivalent of 5 million ECU in 1996, reaching the minimum EU level that Poland was to have no sooner than in 1999.

However, not everyone who fulfilled capital requirements received a license. It has to be outlined that in the case of foreign banks – late comers [6], the rule of conditional licensing was applied in the years 1994–1996. In order to get a license a foreign bank had to agree to sanify an individual private domestic bank being in financial distress. In the years 1993–1997, 14 renowned foreign banks fulfilled this condition and received a license to establish a bank in Poland. They spent altogether close to 170 million PLN on rehabilitation of small troubled banks [Kwaśniak 2000], therefore it is justified to say that the average cost of a license for banking activities in Poland at that time was in fact 5 million USD [Kawalec 1999].

The disadvantage of such a limitation to entry was that, in practice, it slowed down the development of the banking sector for some time by hampering the increase in competition on the domestic market. While many analysts praised the conditional licensing practiced in Poland, only a few observed that it had a negative effect too.

[5] It was only 1.5 billion (old) zloty in 1989 (ca 286 thousand USD as of end of 1989 and 158 thousand USD as of 1990), and there was not even a requirement of having the money in cash.

[6] In the period from 1992 until the late 1994 renowned foreign banks were not interested in establishing business in Poland. It was only after the agreement with the London Club, that new applications for a banking license were submitted by foreign banks [Kwaśniak 2000].

3.3. Improvement of Operating and Regulatory Environment

In response to bank rehabilitation efforts in most years of the mid 1990s and in order to facilitate growth of a sound banking sector and to build a public confidence in Polish banks, the following measures were implemented:

– A sustained development of an effective banking supervision was ensured.

Banking supervision was initiated as early as in 1989, however, the banking supervision department had been developing from scratch since 1992 when problem with bad debts became visible and serious. The General Inspectorate of Banking Supervision – GINB, established within the structure of the National Bank of Poland, has provided an increasingly effective oversight since the mid-1990s [Borish 1998].

– New accounting principles, to a large extent conforming to the EU guidelines, were introduced in 1995.

The new Act introduced standards of disclosure helpful for banking supervision as well as for the market development, as they contribute to an increase in transparency.

– Liquidity, solvency and general prudential requirements were introduced.

Banks were bound to report regularly needed information to the General Inspectorate of Banking Supervision. There were guidelines and standards established for banks in order to introduce comprehensive risk management processes; internal audit and controls were strengthened.

– In 1995 [7] a deposit insurance scheme and a special institution to entertain requests for assistance from troubled banks: the Bank Guarantee Fund – (BFG) started operation.

BFG was to repay deposits to depositors of bankrupt banks up to the amount of the equivalent of 3.000 ECU [8]. The second task of BFG was to support, on equal terms, banks in financial distress with low-interests loans, collateral or guarantees. In order to get assistance, an applicant bank has to present an audited balance sheet, a rehabilitation program accepted by the President of the NBP and prove that it has already used other sources of financial assistance (shareholders' capital) or that those sources are unavailable for the bank [Jabłoński 1996]. The BFG activities are financed with funds formed from obligatory annual payments of banks, interest rates paid by recipients of the BFG loans, budget subsidies and loans granted by the central bank.

3.4. Extraordinary Policy: Bank Rehabilitation and Recapitalization in the First Transition Period

3.4.1. Decentralized Restructuring Program for the State-Owned Banks (1992–1994)

As it has been discussed in Sections 3.1.1 and 3.1.2, market reforms started in January 1990 caused a dramatic worsening of the financial standing of state-owned enterprises in the second year of transition. The stabilization package adopted by the first non-communist government in January 1990 resulted in a dramatic decline in demand and a sharp increase of the cost of credit. An additional decline in demand occurred in 1991 when exports to the former COMECON collapsed. Many of state-owned enterprises were burdened with debts, some of them stemming from investment decision taken yet in the command economy, some resulting from decisions taken already in the new economic environment.

This, in turn, brought about financial distress of state-owned banks, which became evident in 1991. There was a couple of internal reasons that may explain the mounting of bad debts by state-owned banks. At the early transition stage banks used irrelevant and old credit procedures and were unable to realistically assess their clients financial standing and evaluate credit applications. Similarly, it was difficult to them to estimate the volume of overdue credits, due to poor methodologies inherited from the past [Belka and Krajewska 1997]. Another reason was a yet underdeveloped bank supervision that did not control effectively bank activities.

To evaluate the volume of bad debts and liquidity of banks in 1991 the Ministry of Finance ordered an external analysis of credit portfolio of nine state-owned commercial banks [9]. The audit showed that the banks' standings differed, however, on average the share of credits classified as doubtful or lost was high. While in June 1990 bad credits ranged from 9% to 20% in individual banks, in June 1992 they increased to 24%–68% [Lachowski 1996]. By the end of 1991 bad loans amounted to 34.8% of the total portfolio of the state-owned commercial banks [Borowiec 1996]. It became evident that Poland faced a real danger of a banking crisis.

The Polish government asked international financial institutions for help in preparing a program on restructuring bad portfolios and recapitalization of state-owned commercial banks. Foreign experts advised to introduce standard instru-

[7] However, the Act on Bank Guarantee Fund was voted by the Parliament in December 1994.
[8] Fully for deposits up to 1.000 ECU and 90% for deposits from 1.000 to 3.000 ECU.
[9] See: footnote 2.

ments of centralized consolidation policy, which include a single operation of cleaning banks assets by transferring bad loans to a specially created restructuring agency and recapitalization of banks with government bonds. However, the advice was rejected for the following three reasons [Sikora 1993, Kawalec 1994]:

- The Ministry of Finance, responsible for elaboration of the program, did not believe that a restructuring agency could be created in a short time and could employ competent staff, able to deal effectively with bad debts;
- Additionally, there was a fear that a government-controlled restructuring agency would not be in a position to resist political pressures, and therefore there was a danger that the outcome of the program would be poor and that bad debts would reemerge;
- Finally, the centralized approach would not allow to deal with reasons of bad loans mounting in state-owned banks, whereas if banks were to deal with their bad debts themselves, they would be forced to analyze origins of bad loans and draw lessons on how to improve internal credit procedures and risk evaluation.

Therefore in Poland a decentralized approach was chosen. The idea was [Kawalec 1994]:

- to recapitalize state-owned commercial banks so that they could write off bad loans, and at the same time
- to introduce an incentive system that would motivate banks to take by themselves reasonable and effective actions against bad debtors.

While the Ministry of Finance elaborated the program during the year 1992, nine state-owned commercial banks prepared themselves to the consolidation program and specifically were obliged [Kawalec 1994]:

- to separate loans classified by auditors as doubtful or lost ,
- not to extend new credits to clients whose current debts were classified as doubtful or lost, and
- to create special units (later on called as departments for bad debts) that would be able to manage a separated non-performing portfolio. Directors of these new departments were chosen in an open competition; the choosing criterion was that they had to be well educated (lawyers or economists) and could not have worked in state-owned banks before.

An innovative program, the so-called "Enterprise and Bank Financial Restructuring Program" was voted (as an Act of law) by the parliament in February 1993 and came in force in March that year. It is worth underlining that the goal of the Program was not limited to rehabilitation of the banking sector alone. The Program was aimed to accomplish the following three goals [Belka and Krajewska 1997]:

- to general strengthen the banking sector in Poland through restructuring of state-owned commercial banks which at that time had a dominant position; cleaning of the credit portfolio, creating new units in banks and introducing new know-how on dealing with bad loans were to increase value of the banks and prepare them for privatization;
- to speed up restructuring of the real sector through either eliminating those state-owned enterprises which did not have any prospects to operate in the new market environment, or helping promising state-owned enterprises to restructure through reducing debt burden and implementing the agreed restructuring program;
- to speed up privatization of state-owned enterprises through opening a new privatization path (debt/equity swaps).

The state-owned commercial banks were recapitalized [10] ex ante with 15-years' State Treasury bonds [11] at the total nominal value of 11 trillion old zloty (1.1 billion PLN, i.e. 538 million USD). This capital injection was intended to enable banks to create adequate loan loss provisions and to achieve at least 12% capital adequacy after making provisions for classified loans. In return, recapitalized banks were obliged to restructure earlier separated bad loans originally within a 12 months' period (March 1993 – March 1994) [12]. Banks were free to choose between the following range of accessible instruments [Belka and Krajewska 1997, Pawłowicz 1995]:

- Bank Consolidation Agreement (BCA), which was a new instrument designed especially for the Program. This was a simplified version of a court settlement agreement existing in the Polish Commercial Code. Banks were granted the right to work out directly [13] an agreement with their bad debtors (state-owned enterprises only) on restructuring of bad loans;
- a court conciliation agreement;
- a civil conciliation agreement;
- public sale of debt;
- filing for enterprise bankruptcy or launching of liquidation procedure;
- a debt-to-equity swap, within the frame of BCA or as an independent restructuring procedure.

[10] Exactly seven out of nine banks. Two banks: Wielkopolski Bank Kredytowy (WBK) and Bank Śląski (BSK) were not, and at that time they were already in the privatization process (see: Section 3.5.2.1).

[11] The so-called restructuring bonds.

[12] BCA had to be started before 18 March 1996.

[13] I.e. without intermediation of a court.

It is worth pointing out that recapitalization of banks made ex ante implied that there was no correlation between the amount of loans repaid to banks and the amount of the capital injection. It was assumed that under such a regulation the banks would be motivated to regain as much as possible from their bad debts.

The Polish program of rehabilitation of state-owned banks hit by transition shocks, as well as by the lack of good governance and experience in operating in a market economy, turned out to be a success [Kawalec 1999]. The decentralized approach chosen against the advice of external advisers, viewed from today's perspective, brought expected results:

- state-owned banks' solvency was restored,
- there was no repetition of mounting of bad debts in state-owned banks,
- a bank culture in state-owned banks was changed to some extent during the realization of the program and a moral hazard was contained,
- the Program contributed to restructuring and privatization of some enterprises, although here the results were below the original expectations of the authors of the program [14],
- debt/equity swaps provided some impulse for the internal modernization of bank structure and the emergence of investment banking.

Finally, it needs to be added that apart from seven state commercial banks, also three other specialized banks were recapitalized and with the much bigger amount. In the years 1993–1996 PKO BP, PEKAO S.A. and BGŻ received a capital injection of 3.6 billion PLN (1.8 billion USD). In total 4.7 billion PLN (2.3 billion USD) was provided to all 10 banks [Kawalec 1999]. In the cases of PKO BP and PEKAO SA the same legal framework was used as for state-owned commercial banks.

As far as PKO BP is concerned recapitalization was related only to the portfolio of commercial credits. The big portfolio of old housing loans (inherited from the previous economic system) was left aside and until now has remained unsolved. The current (in the year 2000) value of this portfolio is 4.3 billion PLN (1 billion USD) and it constitutes 15.1% of the bank's credits and 6.1% of the bank's assets. This legacy of the past has to be dealt with by the government in order to get PKO prepared for privatization.

BGŻ received the biggest capital injection: altogether 45% of the total amount for all 10 banks. There were disputes and controversies within the government over the question whether the government should support a then state-cooperative bank, having in fact no influence on the governance of the bank due to unfavorable voting rights in the bank council [Niemczyk 1996]. Despite these reservations the first installment of State Treasury bonds was given under the framework of the Enterprise and Bank Financial Restructuring Program. The second capital injection was made under the new Act on Restructuring of Cooperative Banks and BGŻ of June 1994. Under the pressure of interests groups a new, three-level structure of cooperative banks was introduced, which soon turned out to be a bad solution [Kwaśniak 1998]. BGŻ received State Treasury bonds for restructuring of its own credit portfolio as well as that of cooperative banks. Alongside with bonds other instruments of government and the NBP support were used in order to help rehabilitation of cooperative banks, to make them increase the equity or facilitate takeovers of distressed ones. These instruments included: relief from income tax payments (by the Ministry of Finance), release from obligatory provision (by the NBP), credit from the NBP and loans from the Bank Guarantee Fund [GINB 1998]. The support in the form of government bonds ceased at the end of 1997, and it is interesting to note that not all of them were used by recipients for a bunch of reasons [Skarbek 2001] [15]. The unused bonds were redeemed in December 2000.

The process of eliminating inefficient cooperative banks has been progressing since 1994 (see: Table 2 in the Appendix). In the years 1993–1997 altogether 116 cooperative banks were declared bankrupt, 41 were liquidated and sold (in most cases to commercial banks), 202 merged [GINB 1998]. It is interesting that while bankruptcies dominated in the first three years of that period (1993–1995), in the last two years (1996–1997) there were more mergers and acquisitions of banks in financial distress by banks in a good financial situation. As a result, by the end of 1997 the number of cooperative banks was by 12.1% lower than at the beginning of 1993. Still, there were as many as 1,295 cooperative banks.

In spite of the huge capital injection, the economic standing of BGŻ, which has 4.6% share in the total banking assets (as of 2000) has remained bad. It has low capital in relation to

[14] None of big state-owned enterprises was restructured within the Program [Bochniarz 1996]. Also none was announced bankrupt, however, here the reservation has to be made that bankruptcy in general is initiated very reluctantly due to a prolonged procedure and small chances of satisfying claims.

[15] A rule was adopted that restructuring bonds were to be channeled from BGŻ to cooperative banks through regional banks established under the 1994 Law on Restructuring of Cooperative Banks and BGŻ. As two regional banks refused to join the three level structure, they could not receive restructuring bonds for the grouped cooperative banks. Another reason was that some bad debts were burdened with legal or formal shortcomings and they could not be restructured with the help of governmental bonds. Finally, some cooperative banks resigned from the participation in the restructuring program.

assets: with the capital assets ratio of 5.5% vis-a-vis required 8%, deficiency in capital amounts to 459 million PLN. At the same time it is not clear what the ownership structure of the bank and its future character will look like, which makes the BGŻ situation uncertain (see: Section 4.3).

3.4.2. Extraordinary Policy vis-a-vis Newly Established Troubled Banks, 1993–1996

Not only state-owned banks but also newly established domestic banks accumulated bad debts in the early transition period. The reasons were presented in the Section 3.2.1.

While the government was involved in rehabilitation and recapitalization of state-owned banks, the National Bank of Poland bore direct and indirect costs of rehabilitation or liquidation of new small banks that were in financial distress. Foreign banks` money was also involved in the process, at that time since the central bank employed a policy of combining licensing with rehabilitation of small domestic banks (see: Section 3.2.2.)

In order to rehabilitate this group of banks a range of measures was adopted [GINB 1998, Markiewicz 2001]:

- some banks were taken over by the NBP, restructured and then sold,
- some were taken over by other banks with the NBP financial support,
- some were taken over by foreign banks or were provided with preferential subordinated financing; another scenario was that a foreign bank provided soft financing to a bank that took over a troubled institution; in the years 1994–1997 16 domestic banks altogether were supported by foreign banks;
- a few banks went bankrupt,
- one bank was liquidated, as its license was withdrawn.

Since 1995 the NBP financial support for banks under rehabilitation had been gradually limited to releasing them from reserve requirements. The burden of financing distressed banks was imposed on the newly established Bank Guarantee Fund (see: Section 3.3).

In Autumn 1997 out of the total number of 63 new domestic banks established in the transition period, only 37 were still in operation. The difference in these two figures is a good measure of the consolidation process happening in the Polish economy at that period. Apart from a "pushed" consolidation, which was the effect of "conditional" licensing policy for foreign banks and a few bankruptcies, there was also a bottom (market-driven) consolidation [Balcerowicz 1997]. Since September 1993 five small private domestic banks had been bought by foreign banks, more than ten – by other new domestic banks, six small domestic banks had been taken over by the state-owned commercial banks in order to increase their network.

3.5. Privatization of State-owned Banks 1991–1997: Politicized, Unstable and Prolonged Process

Privatization was one of the main goals of the Polish reform commenced in January 1990, and it was to include the banking sector as well. It is worth stressing that, contrary to the former Czechoslovakia and some other countries, in Poland voucher privatization of banks had not been seriously considered and from the very beginning the classical method of privatization was in use. This choice turned out to be fortunate for the development of the country's banking sector in the last nine years.

3.5.1. Unrealistic Hopes

The original program of the privatization of state-owned banks was approved in March 1991 and it envisaged [Balcerowicz 1997]:

- "Commercialization" of nine commercial banks, i.e. change of their legal form from the so-called "state bank" (in Polish: BP) to a joint stock company (in Polish: SA) in order to get them legally prepared for privatization,
- fast privatization of nine commercial banks (those created in 1989): the plan was to privatize 2 or 3 banks per year in the period 1993–1996,
- privatization of all the banks according to the same method to facilitate a quick completion of the whole program,
- completion of the program by the end of 1996,
- postponement of privatization of the "specialized" banks (Bank Handlowy SA, PKO BP, PEKAO SA) till after 1996.

While evaluating the realization of the first program of bank privatization, it should be underlined that the process turned out to be much more time consuming than expected. The preparation of each privatization was a complicated task and as time was passing, more and more politically sensitive. Frequent changes of the government until 1993, when a post-communist coalition took power for four years, did not facilitate a smooth continuation of privatization process. Individual cases of bank sales were hotly debated in public, much and often unfair criticized by the opposition parties, sometimes even opposed to within the government and a ruling coalition. Debates in the parliament as well as in the media expressed a lot of fears and prejudices against foreign capital. All ministers in charge of privatization (at all three stages of privatization, as described below in Section 3.5.2) had been accused of accepting too low prices, choosing a wrong method of privatization or a wrong buyer. They all [16] met with accusation by the parliamentary opposition (and sometimes even by coalition partners) of acting against public interests. Moreover, the procedure of passing a vote of censure on each subsequent minister of privatization had been included in the agenda of the parliament.

3.5.2. Stages of Privatization Process

The privatization process had not started until 1993, i.e. in the fourth year of transition. This delay was caused by bad financial standing of state-owned banks, which became evident in 1991 (see: Section 3.4.1 above). The government decided to postpone the privatization and to deal with banks' bad debt portfolio first. Such a sequence of taken measures made the government (i.e. the state budget) bear the cost of bank restructuring, but as a result market value of the rehabilitated banks increased sharply [Lachowski 1996].

The privatization process was very uneven over time and was subject to changes, therefore the whole transition period may be divided into three different stages. The first stage may be called "A Difficult Beginning", the second one would be best described by the term "From Privatization to Consolidation", whereas the third one evidenced a really "Fast Privatization". The first two stages took place in the first transition period and are presented here.

3.5.2.1. Difficult Beginning (1993–1995)

Only two out of nine commercial banks did not require recapitalization and these were the two banks which initiated privatization of the banking sector in Poland. In April 1993 Wielkopolski Bank Kredytowy (WBK) was privatized, and it was followed by Bank Śląski (BSK) (the end of 1993 and the beginning of 1994). Both banks were sold via IPO and in both cases a foreign strategic investor became a shareholder (EBR&D and ING Bank respectively). Yet, the strategic investors' share in stock was limited to 28.5% and 25.9% respectively and the State Treasury retained a vast share in equity (44.3% in WBK; 33.16% in BSK). As a result, the privatization of these two banks was far from being completed (see: Table 17 in the Appendix).

The privatization of BSK ended with a strong attack on the Ministry of Finance responsible for the privatization process (exactly against the Deputy Minister of Finance who was in charge of the sector of state banks and financial institutions). The Ministry was accused of selling shares at a too low price. This attack coincided with the parliamentary election campaign and the change of the government in 1993. The new parliamentary coalition of the post-communist party (SDRP) and the peasant party (PSL) (the latter hostile to any foreign investors in Poland) formed a new government which, in spite of using a pro-reform propaganda, slowed down the privatization of banks, which become evident already in 1995.

In January 1995 the third commercial bank: Bank Przemysłowo-Handlowy (BPH) was put to sale exclusively in a public offer. Due to a limited demand, an underwriting contract was executed and EBR&D took over 15.06% of shares. More than 48% of shares remained with the State Treasury.

In December 1995 the fourth commercial bank: Bank Gdański (BG) was privatized via IPO. Another domestic bank, BIG S.A. (established in 1989) turned out to be the biggest investor. Together with its daughter companies, BIG SA bought 26.75% of shares. Another 25.1% of shares were sold to foreign investors with the use of a new instrument on the Polish market: Global Depository Receipts (GDR). 39.94% of shares remained with the State Treasury.

Summing up, by the end of 1995 out of nine commercial banks only four were partly privatized: in WBK and BSK the State Treasury's share in stocks had decreased since 1994 but still remained high: 25.1% and 33.2% respectively (see: Table 17 in the Appendix).

3.5.2.2. From Privatization to Consolidation (1995–1997)

A need to update and modify the privatization program and replacement of the pro-reform government by post-communists made room for the shift of the policy focus from privatization to an administrative consolidation of state-owned banks [Balcerowicz 1997]. The following arguments appeared in the official explanation of this shift [Sikora 1996]:

- Polish banks are relatively small and too small to stand up a foreign competition, and
- the privatization of commercial banks turned out to be a slow and complicated process,
- it will be reasonable to: first, strengthen banks still remaining state-owned by merging them and afterwards, to privatize a smaller number of bigger banks at a higher price.

However, a real reason of the shift in the program was a strong ideological assumption that the banking sector has to remain "national" and that foreign capital in general is hostile to "national interests". The first governmental consoli-

[16] Except for one in the post-communist government (formed by SDRP and PSL), and one in the AWS minority government who dramatically slowed down privatization, therefore they could be accused only of not fulfilling their duties, which naturally did not happen.

dation initiative appeared in 1994. Four out of six commercial banks that remained 100% state-owned were asked to consider a "friendly consolidation". Negotiations that followed and lasted for several months were fruitless. In spite of that fact the government went on with the idea and worked out three subsequent plans for mergers.

The whole concept of banks consolidation prior to their privatization triggered a huge professional and political discussion and created some opposition. The danger of a further slowdown of the privatization and risks of an administrative consolidation were publicly debated [see: Sikora 1996, Lachowski 1996, Pawłowicz 1996, Leach and Vergot 1996]. The argument against the administrative consolidation raised by the opponents was that physical increase of assets would not automatically lead to an increase in quality of management and banks' services. On the other hand, there were strong arguments raised for a market-driven consolidation, which would occur once banks were privatized.

Despite all serious arguments against the administrative consolidation, in October 1995 "The Outline of the Program of Consolidation and Privatization of State-Owned Banks" was prepared. Although the program envisaged continuation of privatization, the stress was put on the consolidation of the state-owned banking sector. The political aim of the consolidation and the privatization policy was to halt a further foreign capital involvement in privatization of financial institutions in Poland.

After a long-lasting discussion and a strong opposition of managers of some state-owned banks, the Ministry of Finance revised its program. Instead of merging banks, in July 1996 a decision was taken to form a banking group (only one and not two, as originally planned). Three commercial banks that had been finally chosen: Bank Depozytowo-Kredytowy (BDK), Powszechny Bank Gospodarczy (PBG) and Pomorski Bank Kredytowy (PBKS) made a bank group together with PEKAO S.A. The latter bank was to be a dominant partner for the other three subordinate banks. At that time a new bank group, called PEKAO Group, was the biggest banking institution in Poland in all terms. i.e. as far as capital, assets, deposits and network were concerned. In a 2-years time this move turned out to be an unsuccessful attempt due to the fact that managing boards of individual banks took advantage of legal settlements of the consolidation in order to resist a merger [Wiśniewska 1998 and1999].

While the government was occupied with concepts of consolidation, and was rather reluctant to foreign strategic investors, two banks (PBK – one of the nine state-owned commercial banks, and Bank Handlowy) worked out their own privatization plans and successfully pressed for their acceptance by the government. In the first half of 1997 both plans were realized. The minority of shares of PBK was sold to 3 financial institutions: Creditanstalt, the Polish insurance company WARTA and the former domestic Kredyt Bank (altogether 39%). The State Treasury retained over 50% of shares. Such an equity structure, reinforced by a weak serving of the owner's function by the State Treasury, allowed management of banks to serve real owner's functions.

The concept of BH privatization was an even more sophisticated version of the insider privatization. The State Treasury sold 25.96% of shares to three foreign investors (J.P. Morgan, Swedbank and Zurich Insurance Company) and 59% was sold by IPO. The State Treasury kept only 7.9% of votes at the general assembly of shareholders, and 28–30% of shares (via convertible bonds) [see: Kawalec, Nieradko and Stypułkowski 1997]. As a result, the State Treasury deprived itself of decision making, the ownership was dispersed, and it was the bank management that governed the bank.

Finally, it is worth pointing out that the last state-owned commercial bank (Bank Zachodni) was to be privatized separately, whereas privatization of two other major Polish banks: BGŻ and PKO BP was further postponed, this time till after the year 2000.

3.5.3. Main Features of the Polish Privatization in the First Transition Period

Privatization process undertaken in the year 1993–1997 was characterized by the following features:

- The pace of privatization was in general rather slow with a tendency towards selling a bank "bit-by-bit", which prolonged individual cases of privatization;
- Too much equity in individual banks was left for the State Treasury; this made improvements in a corporate governance difficult or delayed as there was much room for politicization in nominations to boards of directors;
- The majority of privatization cases took place via IPO, which resulted in shareholders' dispersal and consequently, in a poor corporate governance, lack of know-how and additional capital;
- Despite a growing understanding of the need for strategic investors in privatized banks, the participation of foreign banks and strategic investors was limited in the privatization process and consequently, in restructuring of state-owned banks;
- A negative attitude towards foreign capital made room for an insider privatization of some Polish banks, which made the main problem of finding a real owner remained unresolved for some years; explanation for this is that an insider privatization goes along with a poor governance;
- Two years and a half were lost, due to the fact that, instead of privatization, the government and state-owned banks were occupied with a preparation of an administrative consolidation, introduction of which fortunately failed.

3.6. Changes in Structure and Financial Results of the Banking Sector in the Years 1993–1997

3.6.1. Quantitative Development and Financial Results

In the years 1993–1997 there was a fast increase in the banking sector assets – in real terms by 33%, yet it was slightly slower than the growth of GDP. In consequence of that, the ratio of bank assets to GDP had decreased from 59% to 55%. The increase in M2 was faster than that in assets, thanks to which monetization had increased from 35.9% GDP in 1993 to 37.3% GDP in 1997 (see Table 18 in the Appendix). Bank revenues had grown in real terms even more slowly than assets – by 14%. At the same time employment had increased by 23% (see: Table 14 in the Appendix). Banks' financial standing had improved radically. The share of bad debts had declined from 31.1% to 10.2% (see Figure 1 in the Appendix). Profitability had significantly increased: from 6.4% to 17.3%. Improvement in the quality of portfolio made the balance of provisions in relation to interest costs fell from 21.6% to 2.9%. Another reason of the growth of profitability was the growth in interest margins. In 1993 the balance of interests formed 3.3% of assets, in 1997 – 4.6%. Thanks to those changes ROA had improved from -1.3% to +1.9%. ROE indicator had increased from -33.8% to +27%. In the years 1993–1997 a number of commercial banks with the capital adequacy ratio below 8% had decreased from 18 to 8. The necessity to improve profitability by banks explains why in this period banking intermediation in economy had come to a standstill.

Indexes in the Table 1 (referring only to commercial banks) illustrate a considerable improvement of financial results of domestic banks. In 1997 private domestic banks slightly exceeded state-owned banks in profitability and return on assets. ROE indicator, for state-owned banks higher than for other groups, reflects a relatively weaker capital position of those banks. A sharp decrease in all indexes in the case of foreign banks results from a shift from a small-scale activity, limiting to most profitable services (mostly servicing of foreign companies starting their activity in Poland) to a typical activity, embracing a wide range of the banking activity services.

3.6.2. Changes in the Ownership Structure and Concentration of the Banking Sector

Changes in the assets structure reflect a fast decline in significance of state-owned banks, brought about by privatization. Their share in total assets had decreased from 80% in 1993 to 49% in 1997 (see: Table 4 in the Appendix). A number of banks had declined from 29 to 15 and their share in the banking system capital – from 77% to 34% (see Tables 3 and 7 in the Appendix). The role of private banks with the majority of domestic capital had noticeably increased (in 1993 they had 10% of assets, 13% of capital, 10.9% of credits and 9.2% of deposits of the banking system). Although their number, due to liquidation of small, economically weak banks, had fallen from 48 in 1993 to 39 in 1997, their share of their assets had grown to 30.9%, their credits – to 43.2%, deposits – to 58%. Cooperative banks had always played a small and continually diminishing role. Their share in assets had decreased from 6.6% to 4.5%, and in capital from 8% to 4.8%.

The share of banks with the majority of foreign capital was increasingly visible in the market, yet not so fast as it was the case of domestic private banks. In 1993 10 such banks operated on the Polish market and their assets constituted only 2.6% of the banking system. Their number had increased up to 29 in 1997, but their share in the market measured by assets had still remained at the level of 15.3%, measured by capital – 24%. Their credit activity constituted 18.2%, their deposit activity – 12.7% (see: Tables 3–7).

As far as traditional commercial banking was concerned the dominant position was still held by two state-owned savings banks: PKO BP and PEKAO S.A. In 1997 their share was: 32.8% in assets and 44.6% in deposits (see: Table 13 in the Appendix). In the case of deposits, BGŻ had a significant share of 6.3%. In that way three biggest banks possessed 51% of total deposits of the banking system. PEKAO SA had, however, very low own capital and weakly developed credit activity (State Treasury bonds, denominated in USD constituted a considerable part of its assets). As far as credits are concerned PKO BP had a visible majority with a share of 17.3%. Bank Handlowy S.A. and BGŻ also had a significant position (9.9% and 8.9% respectively). Those banks had in total 36.1% in total banking sector credits. The concentration of credits was therefore smaller than the

Table 1. Financial Indicators of Commercial Banks, 1993 and 1997

	State-owned		Private domestic		Foreign	
Year	1993	1997	1993	1997	1993	1997
Profitability	-1.8%	10.3%	-4.0%	16.1%	39.5%	9.5%
ROA	-0.3%	1.6%	-0.7%	1.9%	4.7%	1.6%
ROE	-9.6%	35.3%	-15.4%	24.4%	79.9%	13.2%

Source: Own calculations based on data from GINB 2001 concentration of deposits. This lack of equilibrium made PKO BP become the main provider of liquidity on the interbank market during that period.

Concentration of capital was even smaller than concentration of credit. In this respect, in 1997 Bank Handlowy was the first on the market with the share of 13.4%, PKO BP was the second with 11% and Bank Przemysłowo-Handlowy was the third with 7.1%. Three biggest banks in this respect had in total 30.5% of share in the banking system capital (see: Tables 10 and 13 in the Appendix).

Concentration in the sector measured by the Herfindahl – Hirschman index was the highest in the case of deposits (the indicator was 1359) and the lowest in the case of capital (the indicator was 561). For assets and credits the value of the indicator was respectively 831 and 748. Since 1995 the concentration index have slightly increased in the case of deposits and decreased in other cases (see: Table 8 in the Appendix).

3.6.3. Institutional Development of the Banking Sector, and Changes in the Services Structure

Legal regulations of the Polish banking system from the very beginning of transition were based on the model of universal banking. Commercial banks existing at the start-up of transition (as the only economically strong financial institutions) had played a key role in the capital market from the very moment of its creation, and most of them transformed into universal banks. However, due to the fact that the capital market was in its infancy, a traditional deposit and credit activities dominated in those banks. Credits were primarily given to big, and to a lesser extent, medium-sized enterprises. In 1993 credits for individual persons formed slightly less than 7% of total credits for the non-financial sector. In the next years this credit was increasing fast, reaching in 1997 a 17% share in total credit for the non-financial sector. As far as deposits are concerned, deposits of individual persons dominated. Their share in total deposits was 68% in 1993 and 72% in 1997. Alongside the progressing macroeconomic stability, the significance of dollar deposits was decreasing. Their share in individual persons' deposits had declined from 77% in 1989 to 51% in 1993 and 25% in 1997.

The development of the money market was a reflection of market changes in the banking sector. It was accompanied with technical improvements of the interbank settlement system. In 1993 the National Clearing House (Krajowa Izba Rozliczeniowa – KIR) was created, which took over the most of settlements from the central bank. KIR associates major banks with high liquidity and a good financial standing. Minor banks realize their payment orders with the intermediation of banks – KIR members. After compensations of mutual liabilities are made, KIR settles net balances with the NBP (with the exception of high-volume transactions, settled directly with the NBP). The new system, based on tele-transmission, has enabled to get rid of most traditional paper operations and has radically shortened settlements.

Initially, on the money market there was a domination of long-term deposits, obtained for financing particular credit agreements. It resulted from the banking market asymmetry. Banks separated from the NBP had a small deposit base but strong relations with big corporate clients, whereas big savings banks had not yet developed a cooperation with such clients. The bills' market was developing gradually: first, the market of the national bank's bills, then the Treasury bills market. At low liquidity of the secondary market, those instruments initially played the role of investments. It was only after introduction of computer settlements that the secondary market began to grow fast and transactions connected with liquidity management started to dominate the market. Likewise, the share of the non-financial sector in the market was increasing gradually. Introduction by the NBP of a system of licensing of banks – dealers speeded up the development of the Treasury bills market. Only those banks were entitled to make direct transactions with the NBP. Receiving a license was conditioned by a dynamic activity of a given bank on the money market, which had led to the increase in the volume of transactions on this market. The market of repo transactions has been functioning since January 1993, however, mainly as a market of open market transactions of the central bank.

The market of commercial papers and certificates of deposits has been developing since 1994, yet pace of growth of this market is low due to low liquidity of those instruments on the secondary market.

The development of investment banking was conditioned, on the one hand, by pace and character of privatization processes, on the other hand, by adopted regulations of the capital market. The dominant in Poland strategy of individual privatization with a participation of a strategic investor, together with requirements concerning admitting companies to the stock exchange listing caused that quantitative development of the capital market was slower than in countries where more widespread was the use of voucher privatization and less restrictive regulations of the public market of securities. Although the Warsaw stock exchange began activity as early as in 1991, in 1993 capitalization of the stock exchange was only 1.3% of GDP. Since 1994 the capital market has been growing faster, however, in 1997 the capitalization of the stock exchange was still only 4.3% GDP. Nevertheless, this market has been characterized by a high transparency and a relatively big liquidity, thanks to which foreign investors quickly appeared. This fact speeded up the growth of the capital market in the next years.

Similarly, in these years the debt market was growing relatively slow. Although the supply of medium- and long-term Treasury bonds was growing fast on the primary market, the secondary market of those securities was little liquid. Alongside a relatively slow growth of the capital market, the investment banking was similarly growing slow and was dominated by a few biggest banks. In this situation, investment activity of medium banks had a marginal share in their total activity, and a universal character of their activity remained in the sphere of aspiration rather than real facts.

It was a few big specialized banks that managed to evolve in the direction of universal banking. They were: Bank Handlowy, Bank PEKAO, Export Development Bank (BRE) and Polish Development Bank (PBR) (a new state-owned bank established in 1990 in order to finance investment ventures). Foreign banks entering the Polish market focused primarily on servicing big enterprises which were most interested in taking advantage of opportunities created by the capital market. This had determined the important role of investment banking in these banks.

Banks had a leading role in development of other segments of the capital market (investment funds and pension funds). There was also a development of services connected with the capital market and money market (assets management, liquidity management).

Thanks to the support of the public sector, a few small niche banks were founded: Bank Budownictwa Mieszkaniowego, Bank Ochrony Środowiska, Bank Inicjatyw Społeczno-Ekonomicznych (which supports SME sector).

Part IV.
Post-restructuring Development of the Banking Sector in the Years 1997–2000

4.1. Macroeconomic Disturbances in the Years 1997–2000

A low pace of disinflation in the years 1992–1995 forced the central bank to take stronger measures to accelerate it. Still, in the situation of growing foreign capital inflow and the mechanism of crawling peg, the control of money supply was of little effectiveness and attempts to sterilize the capital inflow with open market operations were very costly. Initially, the central bank tried to hinder the growth of money supply by maintaining a very high level of obligatory provisions. Apart from that, it gradually slowed down the pace of the crawling peg and widened the crawling band. The bigger volatility of the exchange rate led to acceleration of the pace of the zloty real appreciation and fast increase of deficit on the current account. It did not, though, bring about limitation of capital inflow. There was quite a reverse effect – faster appreciation of the zloty together with a very big difference in zloty and dollar interest rates caused that both the non-financial sector as well as banks themselves were increasing their foreign indebtedness. In such a situation the central bank in order to increase attractiveness of zloty credit and to stimulate propensity to save, decided to lower the level of obligatory provisions and simultaneously widened the band. Those changes significantly increased the exchange rate risk, which was made evident during the Asian crisis when the zloty experienced a short but rapid weakening.

Fast economic growth prepared favorable conditions for quantitative and qualitative growth of the financial sector. The monetization of the economy grew gradually reaching 43% GDP in 1999 (see: Table 18 in the Appendix). The increase in the volume of credits was faster, but in 1999 they still constituted only 29% GDP. The fast increase in the volume of credits was connected with the increase in demand for credits in the non-financial sector and with a relative decrease in demand for bank loans in the public sector. The increase in demand for credits resulted from both the decrease of nominal interest rates and augmented demands for external financing of enterprises and individual persons. In the conditions of the fast economic growth the level of usability of existing production capacities was increasing quickly. Therefore since mid 1990ties apart from modernization investments, more and more importance was attached to new investments with a longer completion period, connected with layouts for construction works. Likewise, growing income of individual persons stimulated the increase in consumption – consumption credit began to grow rapidly. Its share in total credit had increased from less than 5% to 23% in 2000.

Relatively lower demand for bank credit by the budget sector resulted from several reasons. A good economic situation and increasing revenues from privatization slowed down the pace of growth of the budget's credit demands. Instruments of financing public debt had changed. The State Treasury resigned from drawing new credits in a bank system for the sake of issuing State Treasury securities. Initially, they were primarily T-bills and short-term floating interest rates bonds. However, the structure of issued securities was changing – there was an increase in the share of medium-term and long-term bonds (including fixed-interest bonds). Together with Poland's growing borrowing capacity, resulting from improvement of its macroeconomic indicators, increased the demand for Polish securities by foreign investors. There was also a gradual increase in purchases of those securities by the domestic non-financial sector. What we encounter here may be called a phenomenon of "crowding out" the banking sector from the securities market by foreign investors and the domestic non-financial sector.

Other factor limiting the development of traditional banking was development of other segments of the financial sector: the capital and insurance market. Development of the capital market made big enterprises financed themselves to a much bigger extent by issuing stocks, bonds and shares. The growth of Poland's investment attractiveness and growing activity of foreign banks on the Polish market enabled big enterprises to directly use foreign loans. Development of investment funds and life insurance companies created an alternative to bank terrain for allocation of savings of individual persons.

The improvement of economic condition positively influenced the improvement of credit quality. The share of below standard loans decreased from 31% in 1993 to 10.5% in 1998 (see: Figure 1 in the Appendix). However, the growth of the financial market was accompanied by the increase in other bank risks. Alongside the improvement of managing liquidity by enterprises and emergence of alternatives for investing savings grew costs of money. Development of other segments of the financial market caused the share of deposits with maturity over a year to still remain at the minimal level. Additionally, due to decreasing interest rates, the pace of increase in the volume of credits was faster than that of deposits and credit maturity was extended. The increase of the share of credits and long-term bonds (little liquid on the Polish market) in assets diminished liquidity of those assets. Thus, the risk of liquidity was increasing. Problems with money acquiring forced banks specializing formerly in enterprising servicing to a costly development of their own retail network. Their problems was further worsened by the fact that state-owned savings banks – PKO BP and BGŻ had had till 1999 state guarantees for deposits. Taking advantage of a big difference in spreads between domestic and foreign interest rates, banks increased financing of their credit expansion with foreign loans. Together with the bigger volatility of the exchange rate mechanism it led to further strengthening of real appreciation of the zloty, increase in deficit on the current account and, in consequence, to the increase of the exchange rate risk. The growing exchange rate risk was a reason of bigger volatility in foreign capital flows (with the reservation that this volatility to a greater extent concerned foreign investors' demand for long-term securities). Volatility of capital inflow was accompanied with changes of the interest rates' maturity structure and thus, with the increased interest rate risk.

Investment profitability of the public sector and big enterprises decreased an improving access to foreign financing in those segments of market and increased banks' interest in crediting smaller enterprises and the public. Growing competition in the traditional banking sector was one of reasons of banks' increasing activity in the sphere of investment banking. It also forced banks to broaden the range of their services and created pressure to cut costs. Enlarged banking supervision requirements (see: Section 4.2.3) and increasing risk of bank activity enforced improvement of this risk management. This all meant for banks a necessity of radical technological changes, primarily computerization of banking transactions which required considerable investment layouts. These demands accelerated both the process of banks' consolidation as well as the increase in the share of foreign capital in the Polish bank system. Foreign capital provided Polish banks with funds for development and with a modern know-how.

Economic growth in the years 1997–1999 was accompanied with a quick increase in the deficit on the current account of the balance of payments (in 1998 the deficit reached over 4% GDP). In spite of the steady real appreciation of the zloty, the inflation declined very slowly (in 1996 it reached almost 20%) (see: Table 18 in the Appendix). Under such conditions the central bank decided in the half of 1997 to restrict monetary policy. Harder monetary conditions in 1997 coincided with effects of the Asian crisis and the Czech Republic's currency problems, which in 1998 led to slowing down of economic growth pace and acceleration of the disinflation pace. Those processes intensified after the Russian crisis. The growth in GDP reached in 1999 4.1% and inflation declined to 7.3%. The weakening GDP growth pace made the NBP further loosen the monetary policy. From April to December 1998 interest rates were decreased by 7 percentage points. The Russian crises caused a decline in economic activity at the end of 1998 and in the first half of 1999. However, already in the second half of 1999 the growth accelerated, amounting in the first quarter of 2000 to over 6% yearly. Unfortunately, lower interest rates, the increase in world raw materials prices and the decrease of the zloty exchange rate to dollar caused prices to grow faster again. In 2000 inflation reached 10.1%. The central bank reacted to the growth of inflation with a new series of interest rates rises by 5 percentage points cumulatively from November 1999 to August 2000.

It once again enabled to lower inflation, at the price of a clear decline in economic activity, though. At the end of 2000 the GDP dynamics fell to only 2%. Slower economic growth allowed, in turn, to decrease deficit on the current account of the balance of payments (the deficit decreased from 8.3% GDP in the fourth quarter of 1999 to 4.8% GDP in the fourth quarter of 2000). Big changes in economic growth pace, inflation and deficit on the current account were accompanied with even greater volatility of the zloty exchange rate. In the years 1997–1999 the fluctuations had the form of short-term falls during crises in Asia and Russia, at a general trend of real appreciation stronger in 1989 and slightly weaker in 1999. In 2000 the situation became even less stable and the exchange rate fluctuations were to a larger extent determined by a domestic economic situation. An increasing deficit on the current account and declining pace of GDP growth brought about two (in spring and in autumn), lasting several months waves of the zloty weakening. After the waves, together with the improvement of foreign trade results, the zloty extremely strengthened in December and has remained strong since then. The strong zloty may be expected to cause a further slowdown in economic growth and another worsening of the current account balance. The situation of public finances deepens uncertainty about the future development of economic situation. A sudden slowdown of economic growth and faster than expected disinflation brought about a decrease in budget revenues and unexpected increase in budget deficit. Therefore, despite still very high interest rates, a possibility of further volatility of capital inflow and the zloty exchange rate has to be taken into account.

The Polish economy turned out to be immune to disturbances on international financial markets caused by crises on other emerging markets. Weakening of the exchange rate and rises of the market interest rates during those crises lasted short time and did not have any serious bad consequences. More serious problems were caused only by the Russian crisis but negative contagion was connected to foreign trade, and not to the financial channel (the Russian market was a direct recipient of about 10% of Polish export). Indirect negative effects (like the decline in export to other Central European countries) had also appeared. However, within several months the Polish economy managed to compensate for a considerable part of losses occurred in Eastern Europe by an increased export to the EU.

The following reasons are responsible for Poland's immunity to crisis on other emerging markets:

– low short-term indebtedness in relation to foreign reserves, a continuing moderate level of total foreign indebtedness of Polish enterprises,
– strong trade relations with the EU, very weak with countries endangered by currency crises,
– strong capital relations of Polish banks and big enterprises with banks and enterprises in developed countries, constituting an additional safety measure against a sudden loss of financial liquidity,
– approaching prospects of the EU accession,
– flexible exchange rate policy and high revenues from privatization cushioning bad effects of not always sufficiently restrictive monetary policy (1992–1997) and fiscal policy (2000 and 2001),
– the policy of managing the public debt aiming at conversion of foreign indebtedness into indebtedness denominated in zloties.

It does not mean, though, that Poland is not endangered by a currency crises. The macroeconomic policy introduced in mid 1990ties minimized the risk of a currency crisis at the price of tolerating high inflation. Liquidation of the exchange rate and more restrictive monetary policy together with less restrictive fiscal policy have produced some, though not fully satisfying, effects in the sphere of lowering inflation, however, at the price of a bigger risk of losing external equilibrium. This risk is reflected by a high deficit on the current account of the balance of payments and slowdown of economic growth caused by a very fast pace of the zloty appreciation (especially in relation to the euro; during the last two years the zloty appreciated 19% in nominal terms and about 34% in real terms against the euro). For banks which misjudged directions of the zloty exchange rate changes, fluctuations of the exchange rate were the source of losses on the currency market. Moreover, foreign indebtedness of Polish enterprises is still increasing, therefore the influence of the zloty exchange rate fluctuations on a financial situation of enterprises is getting stronger.

The increase of bad credits' share in bank assets up to 15.3% (the end of 2000) has been so far the most negative effect of the present macroeconomic situation. The increase resulted from a sharp decline in the pace of economic growth. If the zloty weakened considerably, the quality of the banking system assets would further decline, whereas positive effects of diminishing foreign competition would appear with some delay. The present condition of the banking sector can hardly be regarded as fully safe, although it is still very unlikely that the weakening of the zloty will lead to a more serious financial crisis of domestic enterprises, and in consequence of that, to a crisis in the whole banking sector.

It is much more probable that the exchange rate fluctuations will lead to a yet another rise of inflation. Such a situation will produce negative consequences for banks, but they will be more spread in time. The rise of inflation will make loosening of the monetary policy and return on the path of faster economic growth impossible. A weak economic climate brings the danger of a further increase of bad credits in banks' assets and is certain to halter the growth of this sector.

To minimize dangers resulting from the current macroeconomic situation, a change of policy-mix is necessary. A more restrictive fiscal policy would help to loosen monetary policy, which would probably weaken inflow of portfolio capital, decrease pressure on the zloty appreciation and enable to reach a higher pace of economic growth. A more radical solution (taking advantage of the Polish economy's strong integration with the EU) could be a change of the exchange rate mechanism leading to the zloty fixed parity with the euro [Bratkowski and Rostowski 1999 and 2001]. This solution would create best conditions for accelerating the financial market development in Poland (a stronger integration with the European market, possibility of following a less restrictive monetary policy), yet, provided that the followed fiscal policy guaranteed a gradual improvement of relations between the public debt and GDP. The same circumstances which, in the regime of the liquid exchange rate pose a danger of a currency crisis, at the fixed exchange rate can lead to financial default.

4.2. Policies Aimed at Strengthening Banks and Increasing Public Confidence to the Banking System

The years 1997–2000 had witnessed further strengthening and growth of effectiveness of banking supervision institutions, polishing and changes of prudential norms and increasing the level of guarantees for bank deposits. As a result, on the one hand, the banking sector had strengthened, on the other hand it had been generally adjusted to the European Union norms.

4.2.1. Licensing Policy in 1998–2001

On 1 January 1998 a new Act on Banking and a new Act on the National Bank of Poland came to force. The first Act introduced a minimum capital requirement (up till then regulated by acts of lower instance), at the minimum European Union level of 5 million ECU [17]. The Act obliged banks which on the day of its coming to force did not fulfill the minimum capital requirement to increase capital within two years (i.e. until the end of 1999). This requirement speeded up the growth of smaller banks and increased foreign capital involvement in the Polish banking sector, since banks with capital below the required level started to seek for foreign investors, offering them the purchase of their stocks' block [Kwaśniak 2000].

On 1 January 1999 Poland removed restrictions applied formerly to foreign banks, concerning purchases of bigger stock blocks, opening new branches and receiving a license to establish a bank in Poland. This liberalization was a consequence of commitments undertaken by Poland when joining OECD [Sadowska-Cieślak 1998]. As a result, the environment for business in the banking sector in Poland became more competitive.

4.2.2. Increased Deposit Insurance

In the years 1997–2000 the Bank Guarantee Fund's responsibility for deposits had considerably increased. The limit of a guaranteed amount had been gradually increased: to 4.000 ECU in July 1997, to 5.000 ECU in January 1998, to 8.000 ECU in January 1999, to 11.000 ECU in January 2000 and to 15.000 ECU this year. In January 2003 the level of a guaranteed amount of a deposit will reach 20.000 ECU.

However, until the end of 1999 there had been an additional deposit insurance settlement that made the competition between banks uneven. Deposits of individual persons in the three state-owned banks (PKO BP, PEKAO SA and BGŻ SA) were fully guaranteed, i.e. beyond the limit adopted by all other banks within the BFG scheme. This was a leftover of old State Treasury guarantees concerning deposits in state-owned banks established before 10 February 1989.

At the same time, position of the Bank Guarantee Fund was strengthened: it was given the right of access into banks' confidential data, whereas banks were obliged to provide more information to the BFG.

4.2.3. New Institutional Structure of Banking Supervision and Improved Prudential Norms

The two new acts: Act on Banking and Act on the National Bank of Poland introduced a new model of functioning of banking supervision. Serving supervision functions, so far belonging to the NBP, was assigned to a collegiate organ of public administration – the Commission of Banking Supervision. This Commission is supported by the General Inspectorate of Banking Supervision (GINB), which remained within the NBP, yet, it was organizationally separated. The General Inspector of the Banking Supervision, who is in charge of GINB, is appointed and dismissed by the President of the National Bank in agreement with the Minister of Finance.

GINB employs close to 500 persons; this number includes 300 well trained banking supervisors.

The two new banking laws equipped GINB with increased control and supervisory rights over banks. Prudential norms have improved subsequently in recent years, and the regulatory framework conforms to prudential guidelines rendered by the Basel Committee for Banking Supervision, as well as to the EU Council directives and guidelines for the banking sector [GINB 1999, 2000 and 2001].

All these changes and a good practice of GINB makes the Polish banking supervision a very strong point of the Polish banking system [Bokros 2001, Kornasiewicz 2001]. The only thing which has remained unresolved is the consolidation of the supervision.

4.3. Fast Privatization in1997–2000

The new pro-reform coalition government (AWS – Election Action "Solidarity" and UW – Freedom Union) that took over after the September 1997 parliamentary election, speeded up privatization of the remaining state-owned banks. The main concept of the privatization policy adopted at that time by a new Minister of State Treasury [18] was to choose reputable foreign strategic investors in order to achieve a good governance structure in banks and receive capital and technology injections. An additional aim was to collect big privatization revenues [19] in order to support financially the forthcoming pension reform. At that

[17] With the exception of cooperative banks, to which lower capital requirements apply (see: Section 4.4).

[18] After the central government reform had been introduced on January 1, 1997, the former Ministry of Privatization changed its name to the Ministry of State Treasury and took over some responsibilities from branch ministries: besides privatization it is also responsible for managing State Treasury stakes and state-owned companies.

[19] The sale to a strategic investor gives a good opportunity to negotiate a higher price per share because, in the case of buying the majority of shares the value of the bank for a new owner is relatively higher (he may execute the owner's rights).

time it became evident that the shift from the Pay-As-You-Go system to a fully funded system, which was under preparation and was to be introduced on January 1, 1999, would require much public money to subsidize pensions paid in the first pillar [20]. The need to financially support the pension reform was helpful for speeding up privatization as there was a general social consent for such a destination of privatization revenues [Golinowska 1998].

Although there was a general acceptance for speeding up the privatization, there was not one uniform position towards the banking sector privatization strategy. In fact there was strong opposition against the government's privatization policy in the parliament and even within the ruling coalition. Despite this fact, in a three-years' period (1998–2000) the privatization of the remaining 4 state-owned commercial banks [21] had been completed, and two other big banks had been privatized as well:

- the 3 state-owned commercial banks (BDK, PBG, PBKS) and PEKAO were merged during 1998 [22], and the merged Bank PEKAO was sold in 1998 by IPO (15%) and in 1999 to a strategic investor: UniCredito Italiano (52.09% together with Allianz);
- the remaining state-owned commercial Bank Zachodni was sold to a strategic investor: Allied Irish Banks (80% of shares).

The price per share negotiated by the Ministry of State Treasury was in both transactions very high.

- The remaining shares of the State Treasury in already partly privatized banks were sold to dominant shareholders, thanks to which the structure of ownership became clear.

The privatization of banks in the years 1997–1999 had fulfilled revenues at the amount of 9.7 billion PLN and they constituted as much as 45.4% [23] of the total privatization revenues.

Finally, the Ministry of State Treasury cleaned up the two cases where, due to insider privatization conducted at the beginning of 1997 (see: Section 3.5.2.2) the ownership structure was dispersed. With the cooperation of the Ministry of State Treasury, PBK was finally taken over by Bank Austria Creditanstalt, while Bank Handlowy was bought in 2000 by Citibank.

Despite speeding up the privatization, the agenda has not been yet closed. After 11 years of the banking sector reform, there are two big banks that are still state-owned, and the future of which remains unclear. The first one is PKO BP, which has retained the position of the biggest bank in Poland (17% in assets), although its position since 1999 has been threatened by PEKAO which closely precedes it (see Table 13 in the Appendix). The problem of old housing loans has remained unresolved [24], and the bank requires huge financial support due to its poor financial standing. This support is granted by both the Bank Guarantee Fund and to the bigger extent by the National Bank of Poland [Markiewicz 2001] [25]. PKO BP needs a concept of its future role in the changing environment and a program for its privatization. Moreover, in autumn 2000, following the proposal of the Parliament, the government (which at that time was yet a minority government due to the collapse of AWS – UW coalition) declared that 51% of PKO capital would remain in the hands of the State Treasury. By this move the government limited possibility of choosing a privatization model for the bank, with much harm for its future. The next step was taken a few days ago (in July 12, 2001) when the Economic Committee of the cabinet adopted the following proposal by the Ministry of Treasury of the privatization strategy of PKO BP: up to 30% of stake will be offered through IPO only to physical persons of the Polish nationality. As the official statement says, employment of such a privatization strategy will guarantee that "the national character of the bank will be preserved" . An important goal declared in the strategy is also an increase in the bank's equity, and here: "the participation of foreign institutions is not excluded in the adopted strategy", however, under the condition that over 50% of the stake will remain state-owned. The strategy envisages the completion of privatization and recapitalization of the bank in the second half of the year 2002. Nevertheless, it is obvious that the future of PKO BP will be decided yet by the next government elected in the autumn 2001 parliamentary elections. Election surveys show that the post communist party SLD is most likely to win and it alone will be in a position to form a government. Being familiar with the program of SLD it is justified to assume that,

[20] According to calculations made by the Office of the Government Plenipotentiary for Social Security Reform in 1997 financing the temporary deficit of the pension system would require the privatization revenues at the level of 2% GDP during ten years (1999–2009), under the condition that some rationalization in the first pillar was introduced [Hausner 1998]. When the pension reform was introduced in 1999, it soon turned out that the costs were higher than forecasted.

[21] Out of nine that were separated from the NBP in 1989 (see: Section 2.2).

[22] See: Section 4.4.

[23] Own calculations based on Yearly Reports on Privatization by the Ministry of State Treasury. These are revenues from sales of shares in companies where the State Treasury had stake exceeding 10%. The total revenues from bank privatization were yet even bigger than those presented in the reports.

[24] See: Section 3.4.1.

[25] The direct involvement of the central bank (instead of the government) is being criticized as it makes both the public finances and the central bank's revenues less transparent [Markiewicz 2001].

[26] Bank dla Polaków (The Bank for Poles). RZECZPOSPOLITA Daily, 13 July, 2001.

regrettably, there will not be any dramatic changes in the newly approved privatization strategy.

Adoption of such a privatization program is likely to brought about the following results:

- the market price of shares will be low, due to the fact that the majority of equity will remain state-owned; therefore privatization revenues will be lower than they could be under other strategy of the privatization,
- for the same reason interest of institutional foreign investors in acquiring minority stake will decrease, and
- a chance for effective restructuring of the bank will diminish as well (politicization of the management – poor corporate governance); as a consequence the banking sector (via Bank Guarantee Fund) and the state budget may be burdened with further costs stemming from the wrong privatization strategy of the bank,
- the bank's market share will decrease gradually, as it will not be able to compete with other, more efficient and innovative banks.

The future of the other state-owned bank BGŻ still remains unclear. The new Act on cooperative banks, on their association and associating banks of 7 December 2000, which had been prepared under the pressure of interests groups, does not seem to be of much help, quite the contrary. The Act made room for two competing consolidation movements within the cooperative sector: one around regional banks and the other around BGŻ. If the latter wins, the ownership structure of BGŻ will become dispersed [27], if the first movement succeeds – then a different privatization method of BGŻ will have to be chosen.

4.4. Mergers

It is not only a fast pace of privatization but also a high pace of mergers and acquisitions that are characteristic for the second (post-restructuring) period of the development of the banking sector in Poland. Reasons for M&A in Poland are as follows [Kostrzewa 1998 and 1999]:

- a small size of Polish banks, even by West European standards,
- a too slow organic growth of banks,
- increasing competition on the domestic market, and from pan-European banks,
- maintained high costs and interest margins of Polish banks (they realize 3 times higher interest margins than banks in EU), which makes them weak competitors [Betlej 1999],
- privatization,
- mergers of foreign banks which bring about mergers of their daughter banks in Poland,
- poor economic standing of some smaller banks which needed to be rehabilitated and were taken over by healthy institutions.

In case of cooperative banks there was an additional reason: introduction of the requirement to increase capital to the minimal level of 300 thousand ECU by 31 December 1998 and in individual cases until the end of 1999 [GINB 1999]. This regulation resulted in speeding up of the consolidation of the cooperative banks sector in 1998 (see Table 2 in the Appendix). In 1999 there was a record number of mergers (406), however it was still 44% below the planned number [GINB 2000]. The lower than expected number of mergers was in turn caused by an extension of a deadline for capital increase until 31 December 2000. 256 out of 406 merger cases took place in the first quarter of the year, before the postponement was voted by the parliament in May 1999. When the decision was made the market response was immediate: a number of mergers went down to 29 in the second quarter of the year, 83 and 38 in the third and fourth quarter respectively. In the year 2000 the pace of consolidation slowed down dramatically (to 99 cases) due to the same reason: the final date for an increase of the minimal capital was once again postponed, this time till 31 December 2001. Altogether, in a three-years' period (1998–2000) 601 cooperative banks (46.4% out of the total number of 1295 as of the end of 1997) had merged (see: Table 2 in the Appendix). In the whole transition period the number of cooperative banks had shrunk by 60% (see: Tables 1 and 2 in the Appendix).

More mergers of cooperative banks are expected to take place this year, since by the end of 2000 150 out of 680 banks (22% of the total number) had not fulfilled the minimal capital requirement. However, as the size of this sector is rather small (4.2% of the total assets of the banking sector, 5.4% of credits, see: Tables 4 and 5 in the Appendix) and its credit activity is concentrated in the agriculture [28], the role of which in the economy is also limited [29], the sector does not pose a serious risk for the whole banking sector and the country's economy.

Mergers and acquisitions taking place in the sector of big banks raise interests of bankers and analysts. The biggest mergers are the most interesting because their size makes them have the most significant impact on the concentration in the total banking sector. In the years 1997–2000 15 banks had been taken over or merged. Below, there is a list of the 4 biggest mergers and acquisitions in a chronological order:

[27] Because small cooperative banks will become shareholders.

[28] 41% of the credit portfolio in the year 2000; the cooperative banks' share in total volume of credits to agriculture is 63% [GINB 2001].

[29] Agriculture sector's share in GDP is 4.2% only.

- BIG (No. 16 by assets in 1996) and Bank Gdański (BG) (No. 11) merged in September 1997; the new bank – the BIG Bank Gdański was ranked 10 in 2000.

The merger was a next step after the privatization deal done in 1995 (see: Section 3.5.2.1) and the following two subsequent increases in BG' capital from initial 24.07% (in 1995) to 63.42% in March 1997;

- in 1998 BRE Bank (No. 13 in 1997) bought Polish Development Bank (No. 20); after the acquisition BRE Bank became No. 9 (in 1998);
- in 1999 4 state-owned banks: PEKAO (No. 2 by assets in 1997), BDK (No. 14), PBG (No. 50) and PBKS (No. 15) which had been subjects to an unsuccessful administrative consolidation (see: Section 3.5.2.2) were merged into one bank under the name of Bank PEKAO.

The reason of the merger was the sale of the bigger banking institution to a foreign investor; the merged bank has 16.7% of the total banking sector assets, which makes it the second in the ranking (in 2000), and very close to the leader – PKO BP (a 17% share [30]);

- In November 2000 Bank Austria Creditanstalt decided to merge two of its banks operating in Poland: Powszechny Bank Kredytowy (No. 4 in 1999) and Bank Austria Creditanstalt Poland; the merged Powszechny Bank Kredytowy is ranked third (with a 5.6% share in the total banking assets);

PBK was bought by Creditanstalt in the privatization deal in 1998. Creditanstalt Poland was established by Creditanstalt in 1991, and after the merger of Bank Austria and Creditanstalt, it became a daughter banking company of the merged Bank Austria Creditanstalt.

Next mergers were announced for the year 2001 and this year will witness a record in this sphere: the number of commercial banks is likely to decrease by 15 (from 74 by the end of 2000 to 59). The biggest planned mergers are listed below:

- This year Allied Irish Banks has decided to merge 2 banks in which it has the majority stake: Wielkopolski Bank Kredytowy (No. 11 in 2000) and Bank Zachodni (No. 14); in 2001 the new bank Bank Zachodni WBK will be fifth in the banking sector by assets;
- Citibank merged early this year its two banks: Bank Handlowy (No. 4 by assets in 2000) and Citibank Poland (No. 13). The merged bank will be operating under the Bank Handlowy brand name, which is a unique settlement in the history of Citibank; the new banking institution may rank fourth in 2001;
- ING has started preparations for merger of its two banks operating in Poland: ING Bank N.V. (No. 15 in 2000 and with 10 years of functioning) and BSK (No. 5) privatized in 1993;
- The biggest merger which has already started this year will include BPH (No. 7 in 2000) and PBK (No. 3); the merger is a result of an acquisition of one of the mother bank: Bank of Austria (the owner of PBK) by HypoVereinsbank (BPH). Due to the privatization agreement signed by HypoVereinsbank and the Ministry of Privatization in 1994, it is the smaller bank BPH that takes over the bigger bank. The merged bank with 10% share in assets of the total banking sector will be big enough to compete with the two leader banks: PKO BP and PEKAO SA.

4.5. Changes in Structure and Financial Results of the Banking System in the Years 1998–2000

4.5.1. Quantitative Development and Financial Results

Acceleration of economic growth in the mid-1990ties and completion of banks' restructuring processes helped to speed up the growth of the banking sector in Poland. Monetization of economy had increased from 37.3% to 42.6%, and the banking system assets from 55% to 66%. However, the Russian crises in 1998 and restrictive monetary policy in the mid 1990ties led to slowing down of economic growth and another increase in bad credits in the banking system. Their share had increased from 10.2% to 14.7% (see: Figure 1 in the Appendix). It was the main reason of decline in profitability and ROA. The faster credit expansion under more difficult economic conditions forced banks to decrease spreads between credits and deposits. It had a more severe effect on foreign banks (more involved in credit activity), less severe effect on state-owned banks (keeping a relatively bigger portfolio of Treasury securities). In the case of foreign banks, the decline in profitability was also connected with a rapid growth of activity in the sphere of foreign currency exchange (which is realized at low margins). Nevertheless, profits from exchange helped those banks to reach a better ROA index than that for state-owned banks. Similarly to previous years, a better ROE index of state-owned banks in comparison to foreign banks was due to their lower capital.

[30] The distance to PKO BP had shrunk dramatically in the years 1997–2000: in 1997 PEKAO SA had 11.56% of the total banking assets, while PKO BP – 21.27% (see: Table 13 in the Appendix).

Table 2. Financial Indicators of Commercial Banks, 1997 and 2000

	State-owned		Private domestic		Foreign	
Year	1997	2000	1997	2000	1997	2000
Profitability	10.3%	5.1%	16.1%	0.3%	9.5%	3.2%
ROA	1.6%	0.9%	1.9%	0.0%	1.6%	1.0%
ROE	35.3%	24.8%	24.4%	0.7%	13.2%	12.8%

Source: Own calculations based on data from GINB 2001

Very weak results of private domestic banks show that only banks very weak economically have remained in that group.

4.5.2. Changes in Ownership Structure and in Concentration of the Banking Sector

Acceleration of privatization in the years 1997–2000 led to a further decrease in state-owned banks' share in the banking sector. Their share in assets declined to 22.9%, in credits to 21.2%, in deposits to 28.9%, and in capital to 14.3% (see: Tables 4–7) Improvement of banks' financial situation in the years 1993–1997 increased foreign investors' interest in the banking sector. Foreign banks took over shares not only in state-owned banks undergoing privatization, but also in domestic private banks. In consequence of that, private banks with the majority of Polish capital have only a marginal share in the banking sector. Their share in assets had fallen from 33.2% in 1998 to only 3.3% in 2000 (see: Table 4 in the Appendix). In this period, their share in credits had decreased from 34.3% to 3.2%, and in deposits from 27.5% to 2.4% (Tables 5 and 6 in the Appendix). Those banks' share in capital had declined from 37.7% to 3.7%. In the same period banks with the majority of foreign capital had increased their share in assets from 16.6% to 69.6%, in credits from 21.9% to 70.2% and in deposits from 13.7% to 63.5%. The biggest increase took place in the share of foreign banks in capital: from 24% in 1997 to 77.5% in 2000.

Foreign banks have a dominant position as far as servicing big corporate clients is concerned. This domination concerns both credits and foreign settlements servicing, but, first of all, investment banking [Janiszewski 2001]. Although foreign banks made only 42 out of 234 IPOs, they made 20 out of 26 IPOs, each exceeding 500 million PLN (total capitalization of which constitutes 84% of the total stock exchange capitalization).

Two biggest savings banks: the state-owned PKO BP and privatized in 1999 PEKAO S.A. have retained the dominant share in deposits and credits. However, whereas the share of PKO BP in the market has been gradually decreasing, PEKAO S.A. has increased its share in the market by close to 5 percentage points. PKO BP has remained the main provider of liquidity in the interbank market – its share in total banking deposits is by 7 percentage points higher than in credits. Similarly, the bank dominates in the market of housing credits and consumption credits. Yet, its position in the market of credits for enterprises is much weaker, and its activity in the sphere of investment banking is insignificant. PEKAO S.A., which in the past was a saving bank focusing on collecting foreign currency deposits of individuals, has dynamically developed credits for enterprises and investment banking and has transformed into a typical universal bank. The role of BGŻ, the third major saving bank has visibly diminished. This bank tries to convert into a universal bank, too, yet, it has not managed to achieve a dominant position in the market either in credits or in investment banking.

Concentration of the Polish banking sector is very high. However, since 1997 the share of the biggest bank PKO BP in assets has decreased by 3.8 percentage points and in deposits by 5.9 percentage points (see: Table 13 in the Appendix). During this period the share in the market of the three biggest banks remained the same (40%) in the case of assets, had increased by 2.2 percentage points in the case of credits and had decreased only by 3.6 percentage points in the case of deposits. Changes in shares of 5 and 10 biggest banks are insignificant, which shows that the level of concentration of assets, credits and deposits has remained stable.

As far as capital is concerned it is difficult to point out an unquestionable leader on the market. Each year between 1997 and 1999, a different bank became a leader, and differences to the second biggest bank were insignificant. It was only in 2000, when PEKAO S.A. found a strategic investor, that the bank started to clearly dominate the market with the 16% share in total capital of the banking sector (see: Table 13 in the Appendix).

However, undergoing mergers and those planned for the next year (see: Section 4.4), can bring about changes in concentration of the market. What can be expected is diminishing of differences in the group of 5–7 biggest banks and increase of their dominance over the remaining part of the market.

Herfindahl – Hirschman indexes for concentration show the lack of change in assets' concentration, a small increase in concentration of credits and capital and a slightly bigger decrease in concentration of deposits (see: Table 8 in the Appendix).

Mergers and development of new technologies as well as growing competition have led to a decline in the employment in the banking sector by 2%, in spite of growth in the number of branches and growing monetization of the economy (see: Tables 14 and 15 in the Appendix).

A few niche banks have been still functioning on the market. Yet, their position is weakening gradually, which will probably result in their takeovers by bigger banks.

4.5.3. Changes in Structure of Services

The years 1997–2000 witnessed changes in the structure of banks' activity. The share of credits had slightly increased in assets, whereas the share of securities had decreased. Retail banking was growing fast. The share of consumption credits had increased fast: from 17% to 25% in the total credits. After a period of intensified development of branches in the previous years, banks have started to concentrate on the development of new IT. There was a dynamic development in new products of retail banking: credit cards, home banking. Competition of the capital market as a source of financing for big enterprises has forced banks to give more interest to credits for medium and small companies. However, banks continue to lack a necessary know-how needed for limiting costs and risk connected with granting such credits. Therefore, this segment of the market has been growing very slowly. Despite lower inflation, high interest rates and a very bad functioning of the judicial system hinder growth of mortgage banks. They have appeared on the Polish market, but the scale of their activity is minimal.

A lower inflation allowed the State Treasury to increase the use of fix-income securities for issuing the public debt. The mechanism of a free float exchange rate was introduced. It considerably increased the foreign capital interest (both long-term and speculative) in the Polish market of Treasury bonds and in the forex market. Fluctuations of interest rates and increase of the exchange rate risk raised the importance of protection against those risks for banks, and in the case of the exchange rate risk, also for non-financial enterprises. All those factors led to a rapid growth of derivatives' market and currency exchange transactions. The value of these transactions had increased in the years 1998–2000 almost 5 times, amounting to close to 120 milliard USD. 80% of derivatives' transactions and forward instruments' transactions were of a speculative character, the remaining part – of a protective character. Those operations were almost solely made by banks with foreign capital. Additionally, those banks tried to develop instruments of the domestic money market: commercial papers and certificate of deposits. Nevertheless, these segments of the market have remained weakly developed.

In the reported period privatization speeded up and the stock exchange capitalization increased fast (it had grown from 4.3% GDP in 1997 to 19.5% GDP in 2000) This situation was favorable for growth of investment banking. Other factor accelerating the growth of capital market was the introduction of a pension reform, in which private pension funds (the so-called "of the second pillar" – obligatory insurance, and "of the third pillar" – additional voluntary insurance, employees' pension funds) play an important role. Banks that were most active in creation of those funds beside insurance companies, also offer services of assets management and serve the required by law function of the depositary of the funds' deposits. Moreover, banks attempt to join traditional banking services with other types of insurance services (distribution of life insurance, management of investment portfolios of insurance companies).

Part V.
Conclusions and Lessons to Be Learnt

There are several lessons that may be drawn from the restructuring and development of the Polish banking sector in the transition period. Since Poland started to reform the banking sector as early as in the beginning of 1989, it has accumulated eleven years of vast experience which not only may but definitely should be shared with less advanced transition economies. The lessons are as follows:

1. Transition shocks are strong and unavoidable, but the point is how to manage them

1.1. Rapid changes of macroeconomic situation at the first stage of economic transition are unavailable. All dramatic changes of macroeconomic conditions pose a threat of destabilization of the financial sector. Therefore at this stage of economic changes stability of the banking system and its restructuring has to be a priority for a policy towards the financial sector. Before such transformations are made, the banking system will not be able to effectively serve the function of a savings' reallocation mechanism – it will rather petrify old structures.

1.2. At this stage of transformation a limited access to "soft" bank financing helps to accelerate privatization processes and overcome reservations about foreign investors. The presence of the latter not only allows to accelerate processes of economic integration with stable economies of developed countries (the more open a given economy is, the stronger it feels good effects of such an integration), but also quickens introduction of high standards of corporate governance. These advantages of privatization with participation of renowned foreign investors are the most relevant for the banking sector.

2. Banks' restructuring: the sole recapitalization will not solve the problem of bad debts

2.1. The Poland's example shows that standard solutions worked out in developed economies may not be relevant for transition countries. A centralized consolidation of state-owned banks was given a careful consideration, however, it was deliberately rejected by the Polish government and a decentralized approach to bad debt restructuring was applied instead. An innovative program on restructuring both banks and state-owned enterprises was designed and effectively accomplished. Banks' solvency was restored, a bank culture in state-owned banks was changed to some extent and a moral hazard was contained. The problem of bad debts of the state-owned bank was solved for good.

2.2. However, Polish experience is a story of two tales. Beside the good example of bank rehabilitation there is also a bad experience that should be used as a warning. The case of BGŻ shows that recapitalization of a bank not combined with a proper program of structural and organizational changes is useless because problems reemerge and final costs of rehabilitation are much higher than they could have been under other scenario.

3. Macroeconomics matters

3.1. Fast economic growth creates an exceptionally favorable climate for the development of the banking sector. If, however, a fast pace of growth leads to weakening of macroeconomic stability, a process of restoring the stability can entail high costs for the sector or even its deep crisis. That is yet another reason why macroeconomic policy cannot stimulate economic growth at the price of losing its stability.

3.2. Macroeconomic policy is not able to eliminate the risk of a currency crisis. Nevertheless, fiscal discipline and the public debt managing policy (reducing the share of short-term liabilities in the structure of the public debt) can minimize that risk. Microeconomic factors are equally important as far as immunity to external shocks is concerned. Strong trade relations with developed countries and a significant share of foreign investors in domestic enterprises (including banks) radically diminish the danger of transferring international disturbances onto the domestic economy.

4. Development of the banking sector: quality more important than quantity

4.1. Fast economic growth entails an increasing openness to the world economy and necessity of using more complex financial instruments. An effective functioning of the banking sector in such conditions requires using modern methods of risk managing, transparency of the whole financial system and a strong banking supervision. A progress of transition stimulates fast growth of new segments of the financial market - competition for the traditional banking. Under such conditions a model of universal banking creates the most flexible frames for stable growth of the financial sector. Yet effective functioning of the sector is possible only if very high standards of banking supervision are adopted.

4.2. An effective supervision of banks has to enforce high standards of corporate governance and it is achieving those standards that should determine the pace of the banking sector growth. The greater the role of financial intermediation is in economy, the higher potential pace of growth is, but, at the same time, the more serious can be effects of disturbances on the domestic and foreign financial markets. It is structural characteristics of the banking system: ownership and institutional structure, quality of bank supervision and corporate governance that decide whether the banking system plays the role of an accelerator of economic growth or rather a channel for transmission of negative domestic and foreign shocks.

4.3. Poland's experience proves that it is essential to introduce effective bank supervision very early in transition. Lack of fulfillment of this condition creates room for poor, risky or even fraudulent management of banks which brings banks to financial distress and may lead to costly banking crises (which have to be dealt with public money by rather poor governments in transition countries). Inevitable public distrust that may hamper growth of the country's banking sector in the future is an additional cost.

5. Entry to the banking sector must not be easy

This conclusion is opposite to the one that applies to any other economic sector where establishment of a new business should be very easy. Poland's experience proves that the entry into the banking sector has to be difficult, even at the beginning of transition and even if conditioned; otherwise, the banking crisis is unavoidable and public trust in banks may be impaired and, in extreme cases, damaged.

6. Privatization of banks is the key task for governments, however, there are many myths, controversies, false opinions and a lot of bad policy concerning the matter that can lead to bad and costly decisions

6.1. First of all, it needs to be understood by decision-makers that the key objective of bank privatization is to create the best conditions for long-term development of banks. This requires providing of capital, know how and a good governance.

6.2. A government in a transition economy has to strive to reach this aim, however difficult politically it might be. Outcomes of choosing a wrong method of privatization or a wrong investor under pressure of interest groups will appear in a medium term, and the economy and taxpayers will have to pay a price for bad decisions.

6.3. There is no other option for a genuine privatization. A voucher privatization, at the first sight a very attractive method of making privatization in transition countries in a short time, in a medium run turned out to be a costly experiment which had to be financed with tax-payers money. At the end a genuine privatization had to be realized anyway, but this time under worse conditions.

6.4. The optimal solution is to sell a bank to a strategic investor who is capable of controlling the bank efficiently, transferring know-how, investing and supporting financially in a crisis situation. As there are not such investors in a country at the early transition stage, foreign banks are often the only good candidates.

6.5. However, there is a hostile approach of some parts of societies in transition countries against foreign capital, especially that investing in the banking sector. This approach is being strengthened and built by some political parties. In transition countries, particularly at the early stage of reforms, there is not enough domestic capital that could be injected into banks listed for privatization. Neither is there a necessary know-how on managing a bank in market environment. It has to be added that there were numerous cases in Poland when domestic investors were privileged as buyers, yet, after some time they sold their shares to foreign investors at a much higher price than they had been bought. It was the domestic investor who received the premium, and not the state budget which could get a much higher price when selling directly to a foreign investor.

6.6. Dispersed ownership of a bank is attractive to management that is then free to govern, but not to a bank that needs to have a strong ownership control in order to develop fast.

7. State-owned banks continued to lose their share in the market

At the start up of transition three state-owned saving banks dominated over the banking market: PKO BP, PEKAO S.A. and BGŻ. Yet, their market standing weakened gradually for the sake of earlier privatized smaller banks. They have been particularly quickly losing the market in the case of credits. As far as deposits are concerned, still only two banks: PKO BP and PEKAO S.A. have an unquestionably dominant position. Their deposits constitute 43% of total deposits in the banking sector.

8. Market reforms and macroeconomic stabilization stimulate growth of new segments of the banking sector

Creation during first years of transition of a legal framework for functioning of the securities market, based on international standards enabled a dynamic growth of investment banking. Banks played a dominant role in an institutional growth of the equity and debt market and investment funds, yet, an unstable macroeconomic situation hampered development of other segments of banking services. Fast growth of traditional banking services took place in the period of accelerated economic growth. It was then when the credit market for individual persons and new segments of retail banking (credit cards, home banking, etc.) started to develop. Because of sustaining of high inflation, mortgage credits still constitute a margin of banking services.

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[33] The distance to PKO BP had shrunk dramatically in the years 1997–2000: in 1997 PEKAO SA had 11.56% of the total banking assets, while PKO BP – 21.27% (see Table 13 in the Appendix).

List of Tables and Charts

Appendix

Appendix

TABLE 1: Structure of the Banking Sector in the Early Transition Period, 1989–1993

	1989	1990	1991	1992	1993
1. Commercial banks of which:	18	40	72	84	87
1.1 **Banks directly owned by the State Treasury or NBP**	18	18	25	21	18
1.1.1 old	6	6	6	4	4
1.1.2 new	12	12	19	17	14
1.2. New commercial banks (other than owned by the State Treasury or NBP)	0	22	47	63	69
1.2.1. domestic	0	21	41	54	59
1.2.2. foreign	0	1	6	9	10
2. Cooperative banks	1550	1666	1667	1665	1653

Source: Yearly Reports of the National Bank of Poland, 1990–1994 and authors' own calculations Source: Own calculations based on data from GINB 2001

TABLE 2: Number of Cooperative Banks, 1993-2000

	Specification	1993	1994	1995	1996	1997	1998	1999	2000	1993-2000
1	Number of banks at the beginning of the year	1663	1653	1612	1510	1394	1295	1189	781	1663
2	Number of banks at the end of the year	1653	1612	1510	1394	1295	1189	781	680	680
		The Decrease in the Number of Banks During the Year								
3	Bankruptcies	10	23	57	30	6	4	-	-	130
4	Liquidations	-	5	9	12	15	6	1	-	48
5	Mergers	-	13	37	74	78	96	406	99	803
6	Takeovers by another bank	-	-	-	-	-	-	1	2	3
7	Restarting operation	-	-	1	-	-	-	-	-	1
8	Total (3+4+5+6-7)	10	41	102	116	99	106	408	101	983

Source: The General Inspectorate of Banking Supervision 2001

TABLE 3: Number of Banks1, 1993–2000

	Specification	1993	1994	1995	1996	1997	1998	1999	2000
1	Commercial banks, of which:	87	82	81	81	83	83	77	74
2	with the majority of state capital[2], of which:	29	29	27	24	15	13	7	7
	*directly owned by the State Treasury[3]	16	15	13	8	6	6	3	3
	*indirectly owned by the State Treasury	11	11	11	13	8	7	4	4
	*owned by the National Bank of Poland	2	3	3	3	1	0	0	0
3	with the majority of private capital, of which:	58	53	54	57	68	70	70	67
	*with the majority of Polish capital	48	42	36	32	39	39	31	20
	*with the majority of foreign capital[4]	10	11	18	25	29	31	39	47
4	Cooperative banks	1653	1612	1510	1394	1295	1189	781	680
5	Total banking sector (1+4)	1740	1694	1591	1475	1378	1272	858	754

Notes:
[1] Excluding suspended banks or under liquidation
[2] Banks, in which the State Treasury, state corporate bodies or the National Bank of Poland owned the majority of shares
[3] Banks, in which The State Treasury directly owned the majority of shares
[4] The branches of foreign banks and banks in a form of a joint stock company, in which foreign corporate bodies or individual persons own indirectly or directly the majority of shares
Source: The General Inspectorate of Banking Supervision 2001

TABLE 4: Assets 1 of the Banking Sector (%), 1993–2000

	Specification	1993	1994	1995	1996	1997	1998	1999	2000
1	Commercial banks	93.4	94.7	95.2	95.4	95.5	95.7	95.8	95.8
2	With the majority of state capital, of which:	80.4	76.1	68.3	66.5	49.3	45.9	23.9	22.9
	*directly owned by the State Treasury	76.1	70.8	63.0	51.1	38.2	36.7	22.1	21.1
3	With the majority of private capital, of which:	13.0	18.6	26.9	28.9	46.2	49.8	71.8	72.9
	*with the majority of Polish capital	10.4	15.4	22.7	15.1	30.9	33.2	24.6	3.3
	*with the majority of foreign capital	2.6	3.2	4.2	13.7	15.3	16.6	47.2	69.6
4	Cooperative banks	6.6	5.3	4.8	4.6	4.5	4.3	4.2	4.2
5	Total banking sector (1+4)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes:
[1] Total volume of net assets decreased by redemption, obligatory provisions and depreciation
Source: The General Inspectorate of Banking Supervision 2001

TABLE 5: Total Net Credits [1] of the Banking Sector (%), 1993–2000

	Specification	1993	1994	1995	1996	1997	1998	1999	2000
1	Commercial banks	92.9	93.3	94.5	93.9	94.5	95.0	94.9	94.6
2	with the majority of state capital, of which:	79.3	73.0	63.7	61.3	43.2	38.8	21.4	21.2
	*directly owned by the State Treasury	76.6	69.1	58.5	42.0	27.9	26.3	19.7	19.4
3	with the majority of private capital, of which:	13.6	20.3	30.8	32.6	51.3	56.2	73.5	73.4
	*with the majority of Polish capital	10.9	15.9	25.0	16.6	33.1	34.3	22.6	3.2
	*with the majority of foreign capital	2.7	4.4	5.8	16.0	18.2	21.9	50.9	70.2
4	Cooperative banks	7.1	6.7	5.5	6.1	5.5	5.0	5.1	5.4
5	Total banking sector (1+4)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes:

[1] Credits and loans (excluding bought out debts and realized guarantees and warranties, which have been presented separately since 1996) decreased by obligatory provisions

Source: The General Inspectorate of Banking Supervision 2001

TABLE 6: Total Deposits of the Non-financial Sector (%), 1993–2000

	Specification	1993	1994	1995	1996	1997	1998	1999	2000
1	Commercial banks	92.4	94.1	94.5	94.5	94.8	94.8	95.0	94.8
2	with the majority of state capital, of which:	81.1	77.3	71.3	70.1	58.0	53.6	29.3	28.9
	*directly owned by the State Treasury	75.6	71.6	65.6	57.2	49.5	46.4	27.9	27.4
3	with the majority of private capital, of which:	11.3	16.8	23.2	24.4	36.8	41.2	65.7	65.9
	*with the majority of Polish capital	9.2	14.1	20.2	12.2	24.1	27.5	20.1	2.4
	*with the majority of foreign capital	2.1	2.7	3.0	12.2	12.7	13.7	45.6	63.5
4	Cooperative banks	7.6	5.9	5.5	5.5	5.2	5.2	5.0	5.2
5	Total banking sector (1+4)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: The General Inspectorate of Banking Supervision 2001

TABLE 7: Total Capital of the Banking Sector (%), 1993–2000

	Specification	1993	1994	1995	1996	1997	1998	1999	2000
1	Commercial banks	92.0	94.3	94.6	95.1	95.2	95.6	95.6	95.5
2	with the majority of state capital, of which:	76.8	72.6	61.4	55.9	34.0	33.2	16.4	14.3
	*directly owned by The State Treasury	72.8	66.7	55.4	43.7	25.6	25.7	14.0	12.0
3	with the majority of private capital, of which:	15.2	21.7	33.2	39.2	61.2	62.4	79.2	81.2
	*with the majority of Polish capital	13.0	18.0	25.6	18.3	37.2	37.7	29.0	3.7
	*with the majority of foreign capital	2.2	3.7	7.6	20.9	24.0	24.7	50.2	77.5
4	Cooperative banks	8.0	5.7	5.4	4.9	4.8	4.4	4.4	4.5
5	Total banking sector (1+4)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: The General Inspectorate of Banking Supervision 2001

TABLE 8: Herfindahl - Hirschman Indexes for 50 Biggest Commercial Banks in Poland, 1995–2000

	Years					
	1995	1996	1997	1998	1999	2000
HHI for assets	900.44	855.30	831.2	893.54	894.23	827.41
HHI for equity	693.93	689.05	560.87	594.26	640.66	675.06
HHI for deposits	1279.89	1240.98	1358.62	1251.01	1189.02	1135.09
HHI for credits	891.10	721.46	748.14	657.79	780.46	786.44

Source: authors' own calculations based on data presented in: BANK. Financial-Banking Monthly, Special Editions, March 1998, March 1999, and March 2001

TABLE 9: Concentration of Assets in the Polish Banking Sector, 1995–2000

	Years					
	1995*	1996	1997	1998	1999**	2000
Share of the biggest bank in total assets (%)	20.33	20.23	21.27	21.85	18.40	17.50
Share of the 3 biggest banks in total assets (%)	42.71	41.13	40.11	41.47	42.40	40.49
HHI for assets for 50 biggest banks	900.44	855.30	831.2	893.54	894.23	827.41

* Data for 47 banks only.
** Data for 49 banks only.
Source: authors' own calculations based on data presented in: BANK. Financial-Banking Monthly, Special Editions, March 1998, March 1999, and March 2001

TABLE 10: Concentration of Equity in the Polish Banking Sector, 1995–2000

	Years					
	1995*	1996	1997	1998**	1999*	2000***
Share of the biggest bank in total equity (%)	14.51	14.38	13.39	11.39	12.76	16.11
Share of the 3 biggest banks in total equity (%)	37.54	36.57	28	29.97	31.23	32.63
HHI for equity for 50 biggest banks	693.93	689.05	554.82	594.26	640.66	675.06

* Data for 47 banks only.
** Data for 48 banks only.
*** Data for 49 banks only.
Source: authors' own calculations based on data presented in: BANK. Financial-Banking Monthly, Special Editions, March 1998, March 1999, and March 2001.

TABLE 11: Concentration of Deposits in the Polish Banking Sector, 1995–2000

	Years					
	1995*	1996	1997	1998	1999	2000
Share of the biggest bank in total deposits (%)	27.95	28.06	29.87	28.90	24.57	23.93
Share of the 3 biggest banks in total deposits (%)	51.56	50.73	52.58	49.49	50.29	49.03
HHI for deposits for 50 biggest banks	1279.89	1240.98	1358.62	1251.01	1189.02	1135.09

* Data for 48 banks only.
Source: authors' own calculations based on data presented in: BANK. Financial-Banking Monthly, Special Editions, March 1998, March 1999, and March 2001.

TABLE 12: Concentration of Credits in the Polish Banking Sector, 1995–2000

	Years					
	1995*	1996	1997	1998	1999	2000
Share of the biggest bank in total credits (%)	19.58	16.16	17.29	15.97	16.69	16.72
Share of the 3 biggest banks in total credits (%)	42.48	36.44	36.14	31.55	38.28	38.83
HHI for credits for 50 biggest banks	891.10	721.46	748.14	657.79	780.46	786.44

* Data for 47 banks only.
Source: authors' own calculations based on data presented in: BANK. Financial-Banking Monthly, Special Editions, March 1998, March 1999, and March 2001.

TABLE 13 Biggest Banks in Poland by Assets, Equity, Deposits, and Credits;1995–2000

	YEARS								
	1995			**1996**			**1997**		
CATEGORY		Volume	Share in %		Volume	Share in %		Volume	Share in %
ASSETS	PKO BP	27 867 616.70	20.33	PKO BP	36 501 304.20	20.23	PKO BP	49 700 000.00	21.27
	PEKAO SA	19 051 800.00	13.9	PEKAO SA	23 027 400.00	12.77	PEKAO SA	27 006 900.00	11.56
	BGŻ SA	11 627 200.00	8.48	BANK HANDLOWY SA	14 673 326.10	8.13	BANK HANDLOWY SA	17 011 681	7.28
EQUITY	BGŻ SA	1 602 800	14.51	PKO BP	2 537 513	14.38	BANK HANDLOWY SA	2 618 067	13.39
	BANK HANDLOWY SA	1 492 325.30	13.51	BANK HANDLOWY SA	2 413 109	13.68	PKO BP	2 424 000	11.03
	PKO BP	1 051 593.20	9.52	BGŻ SA	1 502 400	8.51	BANK PRZEMYSŁOWO -HANDLOWY	1 565 017	7.12
DEPOSITS	PKO BP	24 246 019.80	27.95	PKO BP	31 991 785.90	28.06	PKO BP	41 107 329	29.87
	PEKAO SA	15 253 000	17.58	PEKAO SA	18 628 500	16.34	PEKAO SA	22 570 855	16.4
	BGŻ	5 230 000	6.03	BGŻ	7 221 100	6.33	BGŻ	8 678 400	6.31
CREDITS	PKO BP	9 060 495.30	19.58	PKO BP	11 065 038.80	16.16	PKO BP	14 519 061	17.29
	BGŻ	6 134 100	13.26	BGŻ	7 458 800	10.89	BANK HANDLOWY SA	8 345 485	9.94
	POWSZECHNY BANK GOSPODARCZY	4 460 856.10	9.64	POWSZECHNY BANK GOSPODARCZY	6 362 328.40	9.29	BGŻ	7 481 300	8.91

	YEARS								
	1998			**1999**			**2000**		
CATEGORY		Volume	Share in %		Volume	Share in %		Volume	Share in %
ASSETS	PKO BP	58 370 500	21.85	PKO BP	60 497 964	18.4	PKO BP	69 542 623	17.5
	PEKAO SA	34 666 503	12.98	PEKAO SA	59 733 817	18.17	PEKAO SA	68 539 822	17.24
	BANK HANDLOWY SA	17 746 625	6.64	BANK HANDLOWY SA	19 159 876	5.83	POWSZECHNY BANK KREDYTOWY SA	22 872 602	5.75
EQUITY	PKO BP	2 937 900	11.39	PEKAO SA	3 753 437	12.76	PEKAO SA	5 520 824	16.11
	BANK HANDLOWY SA	2 858 029	11.08	BANK HANDLOWY SA	3 230 840	10.98	BANK HANDLOWY SA	3 241 687	9.46
	PEKAO SA	1 934 845	7.5	BANK PRZEMYSŁOWO-HANDLOWY SA	2 202 851	7.49	BANK PRZEMYSŁOWO-HANDLOWY SA	2 421 231	7.06
DEPOSITS	PKO BP	51 172 900	28.9	PKO BP	54 797 428	24.57	PKO BP	62 152 200	23.93
	PEKAO SA	26 039 781	14.71	PEKAO SA	44 580 752	19.99	PEKAO SA	49 735 289	19.15
	BGŻ	10 419 200	5.88	POWSZECHNY BANK KREDYTOWY SA	12 767 831	5.73	POWSZECHNY BANK KREDYTOWY SA	15 444 912	5.95
CREDITS	PKO BP	17 760 500	15.97	PEKAO SA	26 723 009	16.69	PEKAO SA	29 862 167	16.72
	BANK HANDLOWY SA	9 292 679	8.36	PKO BP	24 350 446	15.21	PKO BP	28 535 734	15.99
	BGŻ	8 027 300	7.23	BANK HANDLOWY SA	10 208 815	6.38	BANK ŚLĄSKI	10 932 609	6.12

Source: BANK. Financial-Banking Monthly, 1996–2001

TABLE 14: Number of employees[1] in the banking sector (excluding foreign branches), 1993–2000

31 December of:	Total banking sector	Commercial banks			Cooperative banks
		total	with the majority of:		
			Polish capital	foreign capital	
1993	na	119 733	119 045	688	na
1994	na	128 705	127 708	997	na
1995	na	136 048	134 048	2 000	na
1996	169 534	144 201	129 102	15 099	25 333
1997	172 227	147 095	130 823	16 272	25 132
1998	174 044	149 067	131 266	17 801	24 977
1999	174 748	149 638	86 199	63 439	25 110
2000	171 235	145 541	60 714	84 827	25 694

Notes:
1 employed on permanent terms.
Na - not available
Source: The General Inspectorate of Banking Supervision, 2001

TABLE 15: Number of commercial banks' branches, 1993–2000

31 December of:	Specification	Commercial banks			Cooperative banks
		total	with the majority of:		
			Polish capital	foreign capital	
1993	Branches	1 436	1 426	10	na
1994	Branches	1 454	1 441	13	na
1995	Branches	1 501	1 472	29	na
1996 [1]	Branches	1 580	1 437	143	502
	Other divisions[2]	7 981	7 888	93	634
1997 [3]	Branches	1 629	1 460	169	581
	Other divisions	8 023	7 808	215	674
1998 [4]	Branches	1 864	1 572	292	668
	Other divisions	7 615	7 385	230	730
1999 [5]	Branches	2 235	1 243	992	1 048
	Other divisions	7 987	6 939	1 048	790
2000 [6]	Branches	2 406	960	1 446	1 148
	Other divisions	8 614	6 610	2 004	875

Notes:
[1] 12 banks (4 with the majority of Polish capital and 8 with the majority of foreign capital) did not have their branches, including 11 (correspondingly 3 and 8) which did not have other divisions either
[2] Sub-offices and agencies
[3] 13 banks (2 with the majority of Polish capital and 11 with the majority of foreign capital) did not have their branches, including 11 (correspondingly 2 and 9) which did not have other divisions either
[4] 17 banks (2 with the majority of Polish capital and 15 with the majority of foreign capital) did not have their branches, including 12 (correspondingly 1 and 11) which did not have other divisions either
[5] 16 banks (1 with the majority of Polish capital and 15 with the majority of foreign capital) did not have their branches, including 11 with the majority of foreign capital which did not have other divisions either
[6] 16 banks (1 with the majority of Polish capital and 15 with the majority of foreign capital) did not have their branches, including 11 with the majority of foreign capital which did not have other divisions either
Source: The General Inspectorate of Banking Supervision 2001.

Table 16. Privatization History of the Specialized State-Owned Banks, 1991–2001

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
PKO BP										Commercialization: joint stock company, 100% State Treasury ; change of name to: Kasa Oszczędności Bank Polski S.A.	Government announces privatization strategy: 30% for physical persons through IPO, over 50% will remain with the State Treasury
BGŻ				Commerciali-zation: joint stock company; 66% State Treasury; 33% Regional Banks							
PEKAO SA						Administrative consolidation with BDK, PBG, Pomorski Bank Kredytowy; the group named Grupa PEKAO S.A.		Merger with BDK, PBG, Pomorski Bank Kredytowy ; 100% State Treasury; 15% IPO	52,09% UniCredito and Allianz, increase in capital: UniCredito and Allianz raise their stakes to 55.27%	IPO at the London Stock Exchange	
Bank Handlowy SA							IPO 59%; 25,96%: J.P Morgan, Swedbank, Zurich Insurance Company; 7,9% State Treasury (plus 30% in convertible bonds)	23,33% The Bank of New York; 16,21% J.P Morgan; 7,27% State Treasury (plus 30 % in convertible bonds); 6,08% Zurich Insurance Company	State Treasury recapitalizes PZU (state owned insurance company) with BH convertible bonds; Merger with BRE Bank fails	PZU sells convertible bonds to BH; Merger with Citibank (Poland) S.A.; the merged bank will operate under the name Bank Handlowy State Treasury stake in the merged bank decreases to 3% only	
Bank Gospodarstwa Krajowego										Commercialization: joint stock company, 100% the State	

Table 17. Privatization History of the Nine State-Owned Commercial Banks, 1991–2001

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Bank Depozytowo-Kredytowy in Lublin (BDK)	Commercialization: joint stock company, 100% State Treasury					Consolidated with PEKAO S.A.					
Bank Gdański	Commercialization: joint stock company, 100% State Treasury				IPO; State Treasury retains 39.9%; BIG S.A buys 26.75%; 25,1% GDR	BIG SA Group has 63.42%; GDR 19.46%; State Treasury 5.47%;	Merger with Bank Inicjatyw Gospodarczych S.A.: BIG Bank Gdański S.A.				
Bank Przemysłowo-Handlowy in Cracow (BPH)	Commercialization: joint stock company, 100% State Treasury				IPO; EBRD buys 15.06%, ING Bank 13%; State Treasury retains 48%;			Bayerische Hypo- und Vereinsbank AG buys 37.8%	Bayerische Hypo- und Vereinsbank AG increases its stake in BPH to 81%; Bayerische Hypo- und Vereinsbank AG announces merger of BPH and Hypo Vereinsbank Polska S.A.		HVB announces merger of its two banks: BPH and PBK
Bank Zachodni in Wroc ław	Commercialization: joint stock company, 100% State Treasury								AIB buys 80%	AIB announces merger of BZ with WBK; the merged bank will operate under the name of Bank Zachodni WBK SA	Increase in capital (IPO)
Pomorski Bank Kredytowy in Szczecin	Commercialization: joint stock company, 100% State Treasury					Consolidated with PEKAO S.A.					
Powszechny Bank Gospodarczy in Łódź (PBG)	Commercialization: joint stock company, 100% State Treasury					Consolidated with PEKAO S.A.					

Powszechny Bank Kredytowy in Warsaw (PBK)	Commercialization: joint stock company, 100% State Treasury						IPO; Creditanstalt, WARTA, Kredyt Bank buy 13% stakes each; Polish Development Bank acquires 1%; WARTA increases its stake to 20%	Creditanstalt increases its stake to 27.5%	IPO at the London Stock Exchange; 19,8% BACA; 7,66% Bank Austria AG	State Treasury sells 12% to BACA; BACA surpasses 50%; BACA merges its two banks: PBK and Bank Austria Creditanstalt Poland	HVB announces the merger of its two banks: BPH and PBK
Wielkopolski Bank Kredytowy in Poznań (WBK)	Commercialization: joint stock company, 100% State Treasury		IPO; EBRD buys 28.5%; the State Treasury retains 44.3%;	AIB buys 16% stake;	AIB increases its stake to 26.6%; EBRD sells some of its shares to AIB and retains 23.88%; State Treasury stake reduced to 25.1%	AIB increases its stake to 60.2%; State Treasury Stake reduced to 5.1%		60.2% AIB; 5,1% State Treasury; 5,0% Creditanstalt;		AIB announces merger of PBK and Bank Zachodni the merged bank will operate under the name of Bank Zachodni WBK SA	
Bank Śląski in Katowice (BSK)	Commercialization: joint stock company, 100% State Treasury			IPO; ING Bank buys 25.9%; 33,16% remains with the State Treasury;		ING Bank increases its stake to 54.98%; State Treasury stakes reduced to 5%;					ING Bank increases its stake to 74.73% ING Bank starts preparations for merger of its two banks: BSK and ING N.V. Polska

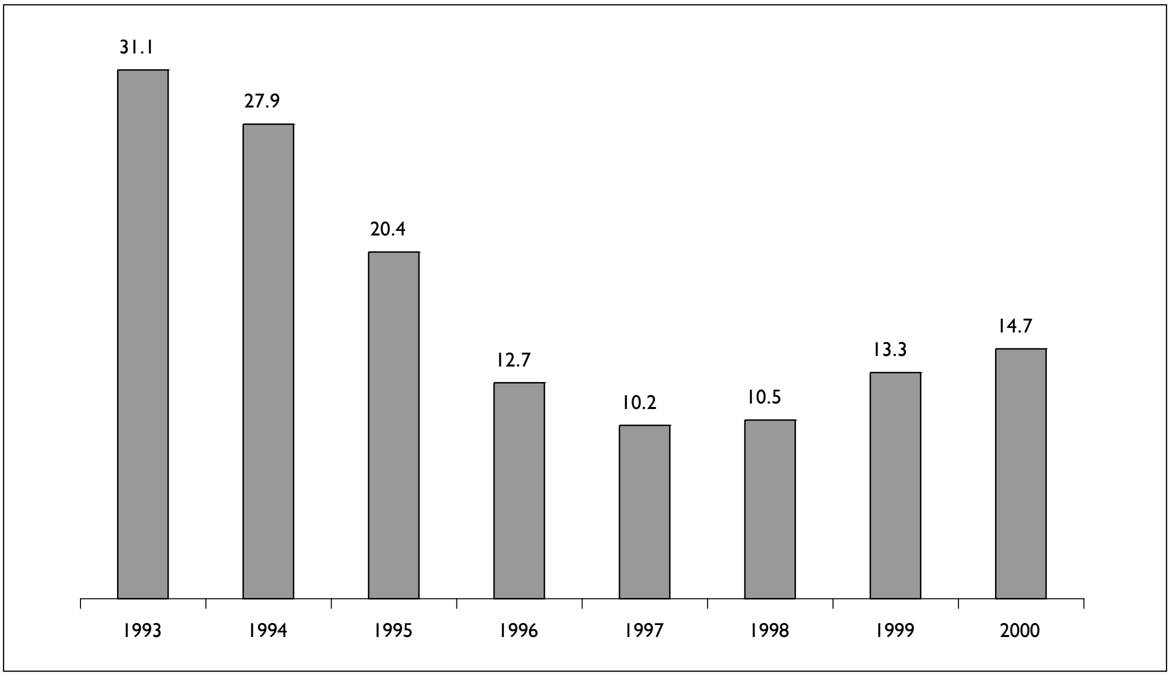
Source: data from different sources

TABLE 18: Main Macroeconomic Indicators, 1990–2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP growth	-11.7%	-7.0%	2.6%	3.8%	5.2%	7.0%	6.0%	6.8%	4.8%	4.1%	4.1%
Inflation	585.8%	70.3%	43.0%	35.3%	32.2%	27.8%	19.9%	14.9%	11.8%	7.3%	10.1%
Exchange rate USD/PLN	0.95	1.06	1.36	1.81	2.27	2.42	2.70	3.28	3.49	3.97	4.35
Average rediscount interest rate	48.0%	36.0%	32%	29%	28.0%	25.0%	22.0%	24.5%	18.2%	19.0%	21.5%
Budget balance % GDP	0.4%	-3.9%	-6.0%	-2.8%	-2.7%	-2.6%	-2.4%	-1.2%	-2.4%	-2.0%	-2.2%
Current account balance % GDP	0.7%	-1.8%	-0.3%	-2.7%	-1.0%	-1.9%	-1.0%	-3.0%	-4.3%	-7.5%	-6.3%
M2/GDP	34.0%	32.3%	35.8%	35.9%	36.7%	36.1%	35.2%	37.3%	39.9%	42.8%	42.7%

Source: The Central Statistical Office, Yearly Reports, Various Years

Figure 1: Bed Debts in the Polish Banking Sector, 1993–2000 (%)



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