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THE EVOLUTION OF THE BANKING SYSTEM IN ROMANIA

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Introduction

This paper describes the evolution of Romania's banking system over the last decade. The first part is a short description of the banking system and highlights some of its characteristics such as the type of organization, quality and range of banking products, and competition.

The second part assesses the performance of banks in the Romanian economy. The third part is focused on actions aimed to promote the stable expansion of banking in Romania.

I. A Description of Romania's Banking System

Banking system reform in Romania started at the end of 1990 when a two tier banking system was implemented.

The National Bank of Romania (NBR) is the central bank of Romania. NBR is an independent central bank[1], its main goal being to ensure the stability of the domestic currency in order to contribute to price stability. NBR draws up and implements the monetary policy and foreign exchange, credit and payment policies. NBR has the role of licensing and supervising the banking system.

In 1998, 47 commercial banks were registered in Romania, of which 36 as Romanian entities. Eleven were branches of foreign banks. Of the total number of banks, seven were state-owned, five were owned by private domestic capital, eight were founded with private foreign capital and 16 were private with foreign and/or domestic capital. A special position is held by CEC, a savings bank, which is organized as a public limited company and regulated by a special law[2]. Although CEC is entitled to carry out the whole range of banking activities, this institution has a large degree of autonomy with regard to central bank powers of supervision and control.

Also, since 1996, other institutions already can provide banking services - the so-called credit cooperatives[3]. The activities of these institutions are not yet supervised by NBR, but according to a law adopted in 1998[4], the existing legislation shall be modified so as to allow NBR to supervise the activities of these institutions, as well as CEC's activity.

Although the number of banks has increased by almost six times in eight years, the quantity and quality of banking products are low as compared to Western practice. The total number of bank entities (branches, offices) is about 1500. Taking into consideration that

[1] The independence of NBR is laid down in the Law on the Statute of the National Bank of Romania.
[2] Law No.66/1996
[3] The organisation and functioning of Credit Cooperatives are allowed by Law No. 109/1996.
[4] Law No. 58/1998

Romania has an estimated population of about 22.5 million people, on average, a bank entity provides services for 15,000 inhabitants.

The range of services provided by banks is not very large and this is explained by several factors.

1. Although the number of banks rapidly increased and some of the state-owned banks were privatized at the end of 1998, the Romanian banking system still has a high degree of concentration and segmentation.
2. The weakness of some state-owned banks and the authorities' hesitation to resolve banks failures created an excellent profit-making opportunity for lending to banks with chronic liquidity problems.
3. The government has ensured, mainly after 1996, another profit opportunity for banks by issuing huge volumes of Treasury bills and offering high interest rates.
4. Romanian financial markets have a lack of maturity. Banks are not significantly involved in the insurance market or in the capital market, and even now there is no mortgage market.

All these factors explain the lower degree of competition in the banking system and show why banks are not yet oriented to serve the customer. Card-based schemes are new in Romania since 1992. Domestic currency-denominated cards have been issued since 1997 by a small number of commercial banks, under the VISA or Europay logo. At present, these are only debit cards. Also, in Romania there are no interbank networks or service providers for ATMs--they only have cash dispenser functions.

Recently, some commercial banks improved their current activity by introducing some modern instruments, such as Internet banking.

Concentration and Segmentation

During the last decade, the main characteristics of the banking system have been concentration and segmentation. At the end of 1998, four state-owned banks and CEC were still dominant on the market. The four banks (Bancorex, Romanian Commercial Bank, the Romanian Bank for Development, and Agriculture Bank – see Table 1) held 62% of the market share and CEC held 9.8%. Also, these five state-owned banks held 56% of the total social capital and 72.3% of total deposits.

Table 1: Concentration of the Romanian banking system – 1991-1998

Year	% in			Year	% in		
	Total Assets	Total Credits	Total Deposits		Total Assets	Total Credits	Total Deposits
1991	83	94	68	1995	64	76	56
1992	76	93	60	1996	66	76	62
1993	76	87	61	1997	61	63	61
1994	69	82	61	1998	62	73	59

Source: NBR Annual Report, 1999

The segmentation of the banking system is obvious. Three main segments could be identified:

- big state-owned banks;

- foreign banks and;
- small banks with foreign and/or Romanian capital.

The leading state-owned banks were particularly engaged in the financing of state-owned companies and the public sector. Foreign banks are focused on financing major foreign companies operating in Romania and the banks from the third segment are more oriented towards lending to private companies.

Table 2: The Segmentation of the Romanian Banking System as of 31.12.1998

Banks/Segments	Lei deposits by customers (%)	FX deposits by customers (%)	Lei loans to non-Govt (%)	FX loans to non-Govt (%)	Total assets (%)
State-owned Banks*	70.8	52.6	59.9	61.4	64.2
Private Banks	29.2	47.4	40.1	38.6	35.8
Owned by Romanian Capital	13.1	14.7	17.3	18.4	15.7
Foreign Banks and Joint Ventures**	16.1	32.7	22.8	20.2	20.1

* Romanian Commercial Bank, Bancorex, Banca Agricola`, Banc Post, Saving Bank and Eximbank.
** Domestic and Foreign Capital
Source: The World Bank, Romania Financial Sector Review, March 1999

It is very likely that as important events occurred in 1999--the privatization of Romanian Development Bank and Banc Post, the merger between RCB and approximately 10% of Bancorex and the banktruptcy of Banca Albina--they will create significant changes in the segmentation of the banking system. Currently, there is no data available about the effects of these events on segmentation.

II. The Performance of the Banking System

The performance of the banking system reflects the efficiency to which banks can mobilize and allocate capital. Banks have to mobilize domestic savings in order to fund investment and to sustain growth. They must allocate funds for investment that contribute to structural change and increase productivity. Also, banks must provide monetary payments so that markets can operate at a lower cost.

Usually there are two ways to assess performance of a banking system. One approach is to focus on the overall economy, starting from the following assumption: the extent to which banks in a country can mobilize and allocate capital efficiently and prudently is an important determinant of how well its real economy performs[5].

The second approach is based on the observation of bank performance in order to assess how they are performing as financial intermediaries. This analysis is focused on the following measures: (1) the scale of deposit taking and lending and the growth of this

[5] This approach is often difficult because economic growth is not influenced solely by the performance of banks--there are other factors that can influence it. Major problems arise because it is not possible to identify the influence of each factor.

activity, (2) financial performance or profitability, (3) risk-taking (the depth and breadth of banking activity) and (4) customer orientation[6].

The measures of scale in the banking industry are the levels of deposit taking and lending to the size of the overall economy. These activities embody all the services provided by banks. The qualitative dimension in banking is also important. Usually, this is attributed to the maturity structure of lending. Measures for bank financial performances are *profitability* (net income before taxes relative to total assets), *net interest margins* (interest revenues less interest expenses, scaled by total assets) and *capitalization* (equity relative to total assets).

The growth rate of a bank's lending shows the risk-taking, as loan growth also means accepting higher risk. Also, a bank's capitalization significantly influences its incentive to take risks in the sense that a less-well-capitalized bank is more likely to engage in risky activities because it has less of its own funds at risk.

1. Scale in the Banking Industry

The scale of banking in the Romanian economy is significantly lower than in Western economies and it is also lower than in most advanced economies of Central and Eastern Europe. This is true regardless of whether the scale of banking is measured in terms of broad money (which shows the deposit taking) or in terms of total domestic credit to the private sector (which shows lending).

Also, concerning lending to the public sector, banks in the Romanian economy are above their benchmark from Western economies. From this perspective, the Romanian economy suffers from an under-provision of bank intermediation and a lower efficiency in mobilizing savings and in allocating credit to the private sector. The under-provision can be explained at least in part by the macroeconomic instability that has existed in the Romanian economy[7].

Countries that have reached a more advanced stage of transition experienced growth in both deposit taking and lending to the private sector beyond that of nominal GDP. Also, these countries have achieved a higher degree of macroeconomic stability and a higher rate of growth (See Tables 3 and Table 4).

Table 3: Ratio of Broad money to GDP (in Percent)

Country	1991	1992	1993	1994	1995	1996	1997	1998	Average*
Romania	47	30	22	22	25	28	25	27	28
CZ. Rep.	-	-	70	73	81	75	71	-	74
Poland	-	-	36	37	36	38	40	-	37
Hungary	-	-	50	46	43	42	42	-	45
Bulgaria	-	-	78	78	66	75	34	-	66
Russia	-	-	24	21	17	16	17	-	19

[6] This approach is used by the EBRD – see EBRD *Transition Report 1998, Financial Sectors in Transition*, pp. 117-130.
[7] See Lucian Croitoru, *Liberalizarea financicar` [i func]ionarea sistemului bancar romnesc 1991-1993*, Oeconomica nr.1/1994, Bucharest.

Ukraine	-	-	32	27	13	12	14	-	20

*Except for Romania, the country average only reflects the 1993-1997 period.
Source: Calculated from NBR *Annual Report* 1998 and EBRD *Transition Report* 1998

Table 4: Ratio of Private Sector Credit to GDP (%)

Country	1991	1992	1993	1994	1995	1996	1997	1998	Average*
Romania	8	7	8	7	12	16	12	15	11
CZ. Rep.	-	-	51	60	60	57	68	-	59
Poland	-	-	12	12	13	16	18	-	14
Hungary	-	-	28	26	23	22	24	-	25
Bulgaria	-	-	4	4	21	37	13	-	16
Russia	-	-	12	12	8	7	8	-	9
Ukraine	-	-	1	5	1	1	2	-	2

* Except for Romania, the country average only reflects the 1993-1997 period.
Source: Calculated from NBR *Annual Report 1998* and EBRD *Transition Report 1998*

The Qualitative Dimension of Banking

Bank lending in the Romanian economy is more short-term oriented. This tendency reflects the instability of the economic environment and the weakness of the legal and accounting framework in supporting long-term, secured lending. It also shows the need to develop credit skills and practices necessary for lending decisions. Evidence shows that banks in the Romanian economy have achieved only modest progress in expanding the maturity of their lending (See Figure 1).

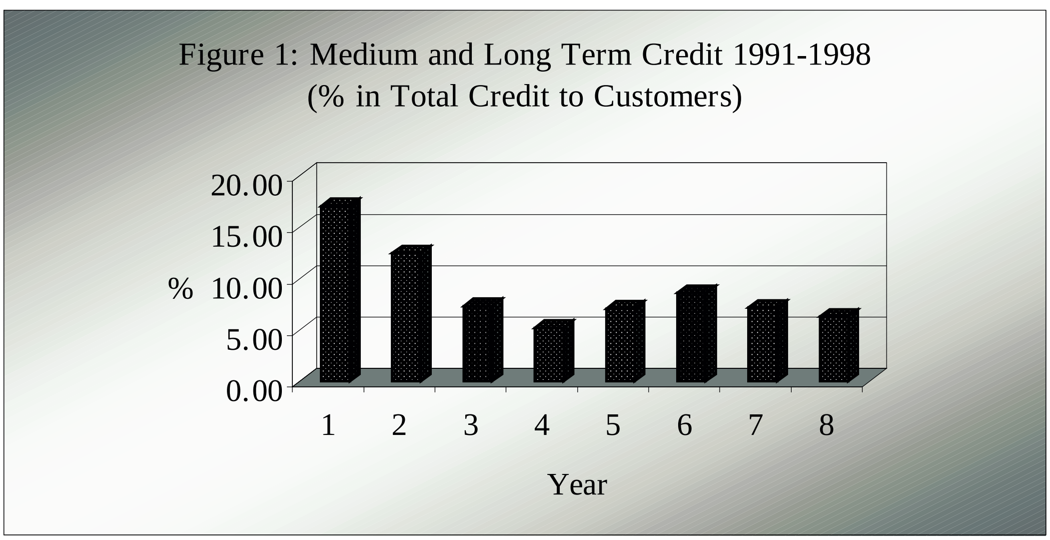


Figure 1: Medium and Long Term Credit 1991-1998
(% in Total Credit to Customers)

2. Profitability

The profitability of Romania’s banking system can be summarized as follows:

- ✓ in a market with poor competition, banks with a large share of the deposit market had an advantage over competitors in the absence of a competitive interest rate;
- ✓ customer loans have not been very profitable investments for banks. Many banks have been the captives of poor depositors or recalcitrant borrowers;

- ✓ the main source of profit has been the holding of government securities and the high returns they have yielded on the interbank market and through foreign exchange operations (mainly during the last three years);
- ✓ state-owned banks have earned lower net revenues than banks that are new private or privatized banks; macroeconomic factors significantly influenced the net revenue of banks. Periods of high inflation and nominal interest boosted banks' profits, but much of these profits serve to preserve the real value of the banks' capital.

Net Profits

Profitability of banks is measured as the ratio of net profits before taxes to total assets. Banks in the Romanian economy used to have profitability above the average of those in transition and OECD countries (See Table 5). For the 1991-98 period, the average profitability in the Romanian banking system was 4.4%. In comparison, the average profitability of banks in transition countries for the years 1993-97 was 2.6%, while profitability in OECD countries for the years 1993-95 averaged 0.7%. This fact reflects the big profits that banks can earn in an unstable macroeconomic environment by investing in high yielding government debt and trading in the foreign exchange market.

Table 5: Average Ratio of Net Income Before Taxes to Total Assets of Banks in the Romanian Economy, 1991-1998 (%)

1991	1992	1993	1994	1995	1996	1997	1998
1.2	4.3	6.9	3.8	6.2	4	4.9	3.6

Source: Calculated from Ministry of Finance Statistics and NBR *Annual Report* 1998

Interest Margins

Another measure for profitability of banks is the net interest margin (the difference between interest revenues and interest expenses, scaled by total assets). The net interest margins generate the revenues of banks from which operating expenses and loan loss provisions are paid. The evolution of net interest margins between 1994 and 1997 (see Table 6) shows two important aspects.

Over time, there was a slow decline average margins, from 6.31% in 1994 to 3.72% in 1997.In 1998, net interest margin was negative and this could be explained by the chronic liquidity problems of two state-owned banks (Bancorex and Banca Agricola) that had borrowed significantly from the interbank market. So, for the whole banking system, the amounts paid for interest exceeded the amounts gained from interest.

Table 6: Average Ratio of Net Interest Income to Total Assets of Banks, 1994-1998 (%)

1994	1995	1996	1997	1998
6.31	5.93	5.06	3.72	-2.21

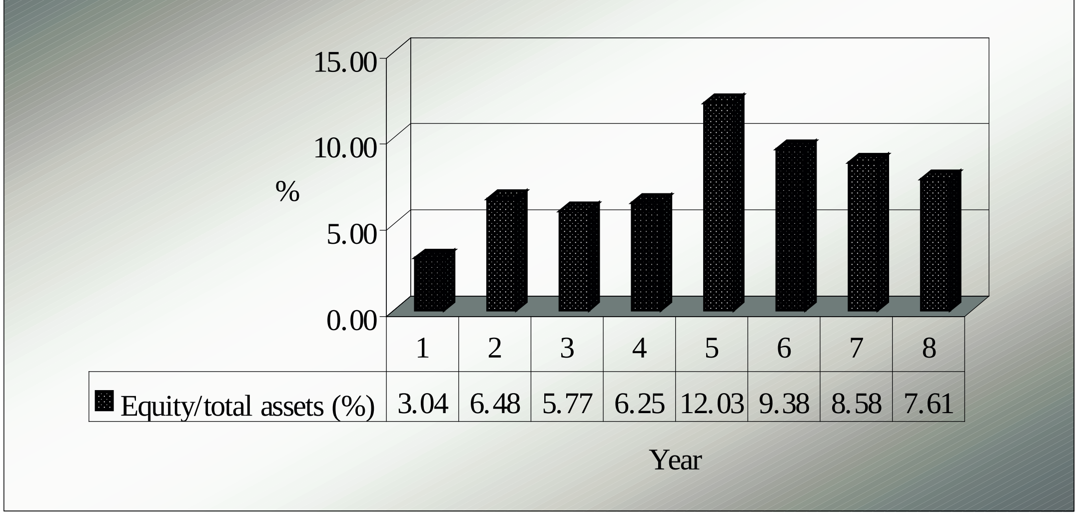
Source: Calculated from Ministry of Finance Statistics and NBR *Annual Report* 1998

The decrease in net interest margins can be explained by the progress in macroeconomic stability (first of all, a decrease in inflation) and it also shows the beginnings of structural reform in Romania. In terms of the evolution of net interest margins, Romania recorded better results than Russia, Ukraine, Macedonia, and Belarus, but is still behind the performances recorded in the Czech Republic, Poland, Hungary and Slovenia.

Capitalization

The financial strength of banks is reflected by the ratio of equity to total assets (See Figure 2).

Figure 2: Average Ratio of Equity to Total Assets of Banks, 1991-1998



There was a winding trend over time in this average ratio in the Romanian banking system. Starting from 6.5% in 1991, it reached a peak of 12% in 1995 and fell down in the following years to 7.6% in 1998. For the years 1991-98, this ratio averaged 7.4%. By comparison, for the years 1993-97, the average ratio in transition countries was 9.6% and, in general, over time across transition countries there was an upward trend. Therefore, the banking system in Romania is an exception, alongside Belarus, Hungary, Kazakhstan, Lithuania and the Slovak Republic.

3. Risk-Taking

An indicator of loan quality is the growth rate of lending (adjusted for inflation) of a banking system as a whole. It is widely accepted that for a bank, but also for an entire banking system, there is a trade-off between the volume of lending and the undertaken risk. In most cases, higher growth of lending shows greater risk[8].

For a bank, the rate of loan growth is negatively correlated with the bank's capacity to evaluate lending opportunities and monitor loans. That is why, in most cases, the higher the

[8] See M. Goldstein and P. Turner: *Banking Crises in Emerging Economies: Origins and Policy Options*, BIS Working Paper, No. 46, 1996

rate of loan growth is, the more rapid the deterioration in the quality of new loans. This assumption also holds for the whole banking system because of decreasing returns to investment.

Banks are more likely to make risky loans when less of their equity is at risk. In Romania's case, this fact is exacerbated by two additional elements. First, at least two of the biggest banks with chronic liquidity problems were state-owned and there was a misty circle of interest around them. Secondly, until 1999, Romanian authorities didn't accept bank bankruptcy, regardless of whether state-owned banks or private banks were de facto bankrupt. Therefore, moral hazard expanded in the banking system, as always when "somebody else" is paying for the bad decisions that are taken.

There is a positive correlation between the real rate of loan growth and ratio of equity to total assets (See Figure 3). This could suggest that loan growth is not necessarily based on the government guarantee, except for 1997 and 1998. However, this evidence has to be interpreted with caution because the accounting measure of equity can overstate the strength of a bank when non-performing loans have not been classified and provisioned against. In the Romanian economy, details on banks' of-balance sheet exposures are not disclosed in their financial statements.

Figure 3: Real loan growth and bank capitalisation

	1	2	3	4	5	6	7	8
Equity/total assets (%)	3.04	6.48	5.77	6.25	12.03	9.38	8.58	7.61
Real loan growth (%)	0.97	0.68	0.81	3.49	6.82	3.18	1.00	4.22

Bank Profitability: Market Power, Ownership and Country Factors

There are studies that show that the profitability of banks has varied depending on their market share, ownership structure and the economic environment in which they operate. For example, in all transition countries, bank profits were high during years of macroeconomic instability, as a result of high interest rates and foreign exchange trading.

Romania is no exception[9]. Usually, there is a significant variability in profitability with market share. The profitability of banks with small market share is lower than that of banks with a larger market share[10].

Also, profitability has varied depending on the ownership of banks. In a short period of time, foreign banks or banks with foreign participation have proved to be the most profitable[11]. At the same time, newly formed banks obtained higher net revenues than state-owned banks. The explanation is simple: a newly formed bank is strongly motivated to attract customers and to expand its business. In order to do so, such a bank offers better quality service.

Operating Costs

The first determining factor of a bank's operation costs is the scale of its activity (deposit taking and lending). For the very small scale of banking activity in the Romanian economy (as compared to OECD countries and most advanced transition countries), economy of scale is significant.

At the same time, the market structure and ownership variables don't influence cost in a significant way. However, macroeconomic performance and progress in transition don't have a significant influence on operating costs. These conclusions are equally true for all transition economies.

In the Romanian banking system, there is no strong competitive pressure and until now, the ownership structure didn't seem to have a significant influence on operating costs. On the other hand, net revenues in banking activity remained high as compared to other industries. This evidence suggests that much differentiation among banks is determined by the deposit taking and lending activity, rather than by the variation in operating costs and efficiency.

Considering operation costs, the Romanian banking system seems to be better off than in countries with less efficient banks (Belarus, Kazakhstan and Ukraine), but worse off than countries with more efficient banks (Croatia, the Czech Republic, Slovenia, the Slovak Republic and Poland)[12]. This also reflects country differences in overall progress in transformation towards market economies.

4. Serving the Customer

Net Interest Margins

[9] This evidence emphasizes the importance of macroeconomic stability in strengthening the efficiency of intermediation in banking.

[10] The EBRD's Transition Report 1998 shows that in transition economies, banks with market share above 40% have substantially higher profitability then smaller banks. Of course, there are very few banks with such large market shares, but the initial assumption is valid for Romania's banking system.

[11] See Cristian Popa, *Romania's Banking Sector Reform: A Comment*, in The New Banking Landscape in Central and Eastern Europe: Country Experience and Policies for the Future (Eva Thiel Blommestein, ed.), OECD Proceedings, Centre for Co-operation with Economies in Transition and Vienna Institute for Comparative Economic Studies, OECD, Paris, 1997, pp. 217-228.

[12] See EBRD, *Transition Report 1998*, p:126

It can be seen that there is a positive correlation between net interest margins and a bank's share in the retail deposit market. Also, smaller banks have lower margins than leading banks. This suggests that smaller banks exert a downward pressure on net interest margins by setting higher deposit rates and lower loan rates. Also, banks with foreign participation and foreign banks set narrower net interest margins.

An explanation for this result could be that banks with foreign participation, foreign banks and smaller private banks are concentrated to a greater extent on the lower risk borrowers. By contrast, state-owned dominant banks have more risky asset portfolios that can explain their higher interest margins.

Expansion of Customer Loans

The expansion of customer loans by banks with adequate capital should be a priority in Romania's banking system because of the significant under-provision of loans to the private sector. The opportunity for a bank to expand customer lending depends on the degree of macroeconomic stability, the rate of output growth and the overall progress in the transformation process towards a market economy. Banks provide loans if they have an incentive to do so. This incentive comes first from bank owners that normally want to earn the best possible value from shareholdings and from competitive pressures.

III. Actions Aimed to Promote the Stable Expansion of Banking

During the last nine years, the banking system in the Romanian economy provided less bank intermediation of savings and investment than banking systems in more advanced economies in transition. This is why, along with factors outside the financial sector with a significant impact on the development of the banking system (degree of macroeconomic stability, privatization etc.), it is important to consider the specific conditions that are indispensable for promoting its stable expansion. These specific factors are dealing with and resolving bank failures, managing entry into banking, and bank privatization.

Resolving Bank Failures and the "Too Big to Fail" Problem

In the long run, healthy competition in the banking system means that only those institutions that are best able to serve the customers at lower cost will survive. The problem of poorly performing banks exiting the market arises from the fear about spill-over effects that the closure of a bank can have on other banks. Romania has already experienced such a scenario in early 1999, when the second biggest state-owned bank (Bancorex) finally exited the market. After years of debt accumulation (the total losses of Bancorex are estimated to about 2% of Romania's GDP), the authorities decided to close this bank down.

The delay of such a decision is explained mainly by the fact that Bancorex was perceived to be "too big to fail". The delay of such a decision significantly increased the moral hazard problem because the managers and shareholders of several banks (state-owned but also private) had considered themselves protected from the consequences of their investment decisions. A great challenge for the Romanian banking system is to impose more financial discipline and less generous bailouts for troubled banks.

One of the main sources of the “too big to fail” problem is the dimension of banks. The larger the bank, the larger the inter-bank exposures tend to be. Another source is the fact that a large bank has a large number of depositors and can spill over into a banking panic and into creating political pressure for depositor protection.

Another factor that can explain the reluctance of regulators to resolve troubled banks is the lax incentives for the regulatory authority. The economic, political and institutional environment in Romania has made it difficult for regulators to act decisively. For example, there have been and still are strong political pressures placed on state-owned banks to sustain large state-owned companies. This problem can be solved only by the privatization of state-owned banks and state-owned companies.

There are also other factors contributing to the bad loan problem in the Romanian banking system beyond the political pressure on banks and banking regulators. Often banks themselves prefer to simply roll-over bad loans to conceal the extent of their problems and to not seek to recover non-performing assets. Irrelevant order to solve this problem, it is necessary to improve accounting and auditing practices for banks and to encourage banks to become hard creditors.

Corrective Actions and Liquidation

Given the existing obstacles to efficient bank liquidation, a key challenge is to detect troubled banks as early as possible and to deal with them without any hesitation. Immediate intervention needs accurate financial reporting by banks so that the regulators have an ability to find out when a bank is in trouble. If such a bank is identified early, the regulators can impose remedial actions to restore its capital adequacy or to impose a recapitalisation plan. If a bank’s balance sheet is irrevocably deteriorated and no recapitalisation is possible, the regulator must place the bank immediately into conservation for liquidation.

Limiting Forbearance and Political Interference

In order to respond to the problems of regulatory and political interference, Romanian authorities should adopt mandatory corrective action measures similar to those that have recently been introduced in the United States[13] and Japan, or at least close to these. This implies a set of rules for actions that have to be adopted by the regulators in specific unpleasant situations for a bank. In particular, these rules should be based on the Basle Committee’s risk-weighed capital adequacy standard.

These rules must be published so that the public can better understand the significance of the decisions and actions adopted by regulators. The mechanism for regulator interventions can be described in the following manner:

Reducing Concentration

Reducing concentration is a primary condition for avoiding the “too-big-to-fail” problem that is still present in Romania’s banking system. Fortunately, after the Bancorex

[13] For a framework of the original US reform proposal see: G. Benston, R.D. Brumbaugh Jr, J. Guttentag, R. Herring, G. Kaufman, R. Litan and K. Scott – *Blueprint for Restructuring America’s Financial Institutions: Report of a Task Force,* The Brookings Institution, Washington DC, 1989.

case was finally solved, there are no clear alarm signals in connection with other big state-owned banks.

The Moment for Regulator Intervention	Possible Actions of Regulators
A bank's capital ratio drops below its required level (for example 8%).	The formulation of a business plan to restore capital adequacy and mandatory actions aimed to limit risk and reduction in loan exposures.
A bank's capital ratio continues to fall (for example between 3% and 6%).	Impose restrictions, such as the suspension of dividend payments on equity, interest payments on subordinated debt and unauthorized payments to affiliated companies. Enact limits on deposit interest rates and formulate a recapitalisation plan that must be implemented immediately.
A bank's capital ratio falls below 3%.	Take the bank into conservation for subsequent recapitalisation or liquidation.

Policies aimed to curb increases in concentration through mergers of private banks are also desirable in the long-run. This is not in contradiction with the present intentions of NBR to encourage mergers of small banks in order to reasonably increase their social capital and to eliminate the under-capitalized banks, avoiding major shocks.

In the short term, the privatization of Romanian Commercial Bank should remain one of the priorities in restructuring the banking system.

Limiting Deposit Insurance

In spite of the pressures exerted by some powerful groups of Romanian businessman, a system of full deposit insurance is not justified. Such a system is extremely costly and it will also maintain disincentives for market discipline. Large depositors (corporations and other banks) shouldn't be included in a formal insurance scheme. Instead, they should be encouraged to be more preoccupied with bank solvency.

Managing Entry into Banking

From the beginning of banking system reform, the NBR has tried to avoid excessive entry of banks into the market[14]. Nevertheless, maintaining a monopolistic banking system inhibits the development of a competitive market and it maintains the too-big-to-fail problem as well. Indeed, there is a trade-off between the entry of new banks and the quality of banks. But, at least in the short term, given the limited enforcement capacity of regulators, a second-best solution (i.e. restrictions on entry) seems to be welcomed.

[14] A different approach was taken in Poland, the Czech Republic and Russia. In these countries, a greater emphasis was placed on the number of banks, rather than their quality.

The main instrument for regulating entry in banking is the granting of banking licenses. But any assessment of the capabilities of a new bank is inevitably subjective. This inconvenience can be reduced if the licensing authority is closely working with an independent agency. Thus any doubt concerning the transparency and fairness of the licensing process will be eliminated.

During the last few years, foreign bank entry has become more important. This foreign entry contributed to improved performance of the banking sector mainly because: foreign institutions can more easily satisfy capital adequacy ratios, they have access to sources of finance from abroad, they have a good reputation and more transparent financial accounts, they bring better technologies and banking skills and raise the level of investment. Because Romania has already signed the European Union Association Agreement, it is expected that it will continue to open the banking system to non-discriminatory access by foreign banks.

Bank Privatization

The empirical evidence throughout the world shows that the benefits of privatizing outweigh the costs. It is also true that there are significant differences between the privatization of banks and the privatization of non-financial companies. The main difference arises from the fact that in the privatization of a big bank (for example Romanian Commercial Bank), an important constraint is not to disturb confidence among depositors. Also, when the efficiency of the regulatory authority is very poor, delaying privatization may be accepted. This is not the case for Romania.

Recent bank privatizations (in 1998 and 1999) of two important state-owned banks (Romanian Bank for Development and BancPost) show that the important depositors didn't lose their confidence in those banks. Instead, the privatized banks attracted more depositors. In both cases, the main reason is that the new major shareholder is a reputable foreign bank[15].

Obviously, there is a strong case for involving outside interests in privatization and ensuring the participation of strategic investors. Irrelevant importing managerial skills and improving reputations are at the core of bank privatization.

[15] Societe Generale is now controlling the Romanian Development Bank and General Electric has the major share in BancPost.