

INAUGURAL LECTURE FOR OPENING THE ACADEMIC YEAR 1998/1999

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**THE BANKING SECTOR IN THE CONTEXT
OF POLAND'S INTEGRATION IN THE EU**

In the paper there are discussed problems concerning the adjusting processes in our banking sector in the context of Poland's adherence to European structures. In the introduction an attention is paid to the negotiations currently ongoing between the experts from Poland and from the EU, during which several sections of the EU law are examined. The results of these negotiations will determine the pace of our integration in the EU. The next section presents the scope and the object of the adjusting processes occurring in the Polish banking sector. They generally reduce to the three groups of problems, that are: 1) defining the position of a central bank within a state structure, its aims, conditions and possibilities of effective functioning; 2) harmonizing banking law and supervisory security regulations in conditions of liberalizing flow of capital and increased possibilities of supplying transborder services; 3) increasing the effectiveness, efficiency and security of the banking sector. At the present stage of realizing the adjusting processes the actions undertaken in the area of the third group of problems are of key importance for constructing in Poland a modern banking system comparable to the banking systems functioning in the EU countries. The third part of the paper deals with this group of problems.

1. INTRODUCTION

On 1 February 1994 the formal association between the Polish Republic and the European Union and its member states came into force. Shortly afterwards, on 5 April 1994, Poland made an official application to become a member of the EU. At present our country, together with other six selected countries, is a candidate for EU membership, and the official negotiations leading to admission began this year.

During the period from 27 April to 17 July 1998 EU and Polish experts reviewed nine sections of the EU laws and assessed the compatibility of Polish State regulations with them. They dealt with the following areas: science and research, telecommunications and information technologies, education and schooling, culture, audio-visual policy, industrial policy, joint foreign policy and security, company law, consumer and health protection, fishery, and statistics.

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This autumn further negotiations will take place, dealing with further 19 aspects of EU laws including those extremely controversial for us like the unrestricted flow of goods, agriculture and environmental protection. With reference to every act of the EU law contained in the so-called A list, therefore compulsory, Poland will have to declare whether the introduction of any of such laws and their implementation:

- 1) will not create any problems,
- 2) will create some technical problems which can be resolved quickly,
- 3) will create a problem difficult enough to warrant the necessity to discuss it bilaterally.

It is difficult to say how long these negotiations will take. Undoubtedly, their positive outcome will be a decisive factor in setting the date for Poland to join the EU. The final result will also depend on the political will of the EU member states, the state of Poland's adjustment to the EU laws, and the acceptance of our membership by the majority of the Polish population.

The results of the latest opinion polls in Poland show a significant fall in the acceptance of Poland's EU membership. A year ago it was still at 70%, now it is 58%. All the serious analyses show explicitly that entry to the EU will bring Poland enormous benefits in economic, political and civilizational terms. There is not a better future prospect for the development and modernization of the Polish economy other than integration with the countries of western and central Europe. Here we have a unique chance to establish our place in Europe in a permanent and effective way and create the conditions for successful long-term development.

We can assume that the latest political and financial crisis in Russia will weaken the activities of those opposing Polish integration. Poland is not threatened by the Russian crisis because in recent few years our main trading partners are the member states of the EU. It was a result of implementing a few years ago a commercial part of the EU liberalizing Polish industrial exports to the member states. However, I think also that the specialist economic press should become more active at this point and show clearly the potential benefits resulting from Polish membership while at same time presenting the costs involved and ways to limit them.

As I have already mentioned, the pace of our integration in the EU will also depend on the degree of advancement in the processes of adjustment to EU regulations within all sectors of the economy. The list of necessary moves is rather extensive, therefore in my lecture I would like to concentrate on the most significant adjustments in the Polish banking sector.

2. THE SCOPE AND SUBJECT OF ADJUSTMENT PROCESSES IN THE BANKING SECTOR

A significant part of the recommendations related to the functioning of the banking sector in Poland is contained in the above mentioned European Union act which Poland signed on 16 December 1991. At their basis there is the so-called Second Banking Directive accepted by EU countries in 1989. Its main provisions relate to the introduction of a principle of freedom in supplying banking services and establishing branches of banks in other member states and a uniform banking licence enabling the functioning of banks in the whole of EU territory. By signing the EU convention, the Polish side undertook to fulfil several obligations also in the banking sector. They are related mostly to harmonizing broadly understood banking laws with EU standards. It implies not just aiming at compatibility of Polish regulations with the Europeans counterparts, but also the acceptance of a certain way of creating laws, interpreting them and controlling their implementation. These undertakings should be fulfilled during a ten-year transition period (starting from 1 February 1994).

The Maastricht Treaty that came into force on 1 November 1993 also dictates the scope of adjustment procedures. It defined the principles of the functioning of the homogenous internal market and the freedom of capital and labour flow; it also announced the creation of a monetary union based on the European Central bank and a common currency – the euro.

The expectations in relation to the countries applying for membership of the EU were stated in a detailed way in the so-called White Book approved by an EU conference which took place on 26–27 June 1995. The issues connected with banking are contained in the appendix to this document, concentrating on regulations and undertakings accepted as an integral part of a properly functioning banking sector. They are divided into two groups and intended to be implemented in two subsequent stages, without however outlining the timetable or the order of the adjustment procedures. The first phase deals with matters relating to the establishing of banks and ensuring the stability of the banking sector, the second concentrates on the strengthening of precautionary measures in order to comply with international standards.

Those three documents define the basic scope and subject of the adjustment processes that should be introduced into the Polish banking sector. They relate to three main issues (Daniluk 1996):

1. Defining the position of a central bank within a state structure, its aims, conditions and possibilities of effective functioning;
2. Harmonizing banking law and supervisory security regulations in

conditions of liberalizing flow of capital and increased possibilities of supplying transborder services;

3. Increasing the effectiveness, efficiency and security of the banking sector.

In accordance with EU regulations the fundamental duty of central banks is to maintain stability of prices; this aim should be realized in conditions of independence, and with explicit ban on financing the deficits of the public sector.

Defining the new position of the Polish National Bank (NBP), in agreement with EU regulations was largely influenced by the relevant articles of the new constitution and the Decree on the NBP, which came into force on 1 January 1998. The appropriate statutory regulations allowed for:

- creating the Monetary Policy Council and Banking Supervisory Board,
- limiting the powers of the chairman of NBP and transferring them to its board which is responsible to the Monetary Policy Council,
- closer co-operation between NBP and the state, especially the Finance Ministry responsible for the major part of governmental economic policy, including banking sector policy.

The Monetary Policy Council is, alongside the chairman and the board, the third organ of the Polish National Bank. Its role is not advisory, but decisional, and it has a monopoly on decision-making in the matters of monetary policy. The main task of the council is to maintain the macroeconomic equilibrium, in particular through reducing inflation, extending the convertibility of the Zloty and increasing Poland's credibility in international transactions. Its effectiveness should contribute to an increase in the autonomy of the NBP and an improvement of credibility of monetary policy. The rational definition of the parameters and instruments of such a policy of the Council will create the conditions for Poland's integration in the European Monetary Union.

Also the creation of the Banking Supervisory Board, made up of the representatives of institutions responsible for the functioning of various parts of the financial market, financial and monetary policies, created the premise for the integration of financial regulations and supervision in conditions of overlapping activities of the various parts of the financial sector.

An important part of the issues of the adjustment of the Polish banking sector relates to the harmonization of banking law and the supervisory security regulations. One should stress that according to EU rules the harmonization of the law does not equal its unification since every country is presented with certain aims which have to be reached, but is left with the freedom of choice of the right procedure.

The security regulations issued by the organs of the EU aim at establishing minimum standards helping to restrict excessively risky activities of financial institutions and to increase the levels of security and stability in the banking,

insurance and stock market sectors of the member countries. The existence of such norms is a necessary condition for the correct functioning of a homogenous market of financial services.

The introduction of the new banking law on 1 January 1998, and several executive decrees to it resulted in significant progress in the process of the harmonization of law and security measures. Poland implemented to a large degree in its regulations the European standards concerning the terms of issuing of banking licences, determining the level of concentration of banking risk, measures preventing money laundering, ways of calculating the coefficient of solvency, a system for insuring bank deposits, adjusting the accounting system and principles of bookkeeping. Some Polish regulations set more stringent requirements than the EU norms, for example the norms of acceptable credit concentration and the system of measures used to calculate a coefficient of solvency.

The realization of the first two groups of issues connected with the adjustment processes of the banking sector to EU requirements remains the responsibility of the state authorities and the NBP. As previously suggested, their implementation is running smoothly and should be accomplished in the near future.

A more complex situation remains in the third group of these issues, those relating to the increase of efficiency, effectiveness and security of the banking sector. The relevant steps and procedures must be taken by the whole of the banking sector and should be aimed at increasing the standards of management, strategic planning and making decision on restructuring and consolidation. As their result there should be a rapid progress in technology and education, the standardization of banking products and a steady development of financial services offered, as well as improvement in their performance. The present initiatives undertaken in this area of issues have a paramount importance for the creation of a modern banking system in Poland, comparable with the banking system in the EU countries. I shall return to this problem in the final part of my lecture.

3. INCREASING THE EFFECTIVENESS, EFFICIENCY AND SECURITY OF THE POLISH BANKING SECTOR

To start with I would like to briefly characterize the present day banking system in Poland. This will allow for a more precise presentation of proceedings necessary to improve the effectiveness, efficiency and security of commercial banks.

The Polish banking sector is among the most dynamically developing branches of our economy. Anyone who has knowledge of Polish banking ten years ago and the present state can confirm the progress amounting to at least

one generation in terms of banking procedures and technologies. However, the distance dividing Polish banks from the developed market economies is still significant. Comparing them one should point out the following aspects (Jaworski, 1998; Kosiński 1998):

1. Low amounts of capital of Polish banks; among the 1,000 biggest banks in the world as far as their capital is concerned, there are only four Polish banks: Bank Handlowy S.A., PeKaO Group S.A., BGZ S.A. and PKO BP, all of them far from the top;

2. In the ranking published by "The Banker" among the 500 biggest European banks there are only 13 Polish ones; as the highest Group PeKaO S.A. ranking 131, second Bank Handlowy (158);

3. An important feature of the Polish banking sector is its low productivity; the ratio of costs to revenue in 1997 was in Poland 0.84 and in the EU 0.69;

4. The unfavourable relation between the costs of labour and value of assets; in the case of Polish banks in 1997 it amounted to 1.29% and in the EU countries it was much lower, e.g. in France 0.78%, Germany 0.80%;

5. Weakness of distribution network of banking services; in Poland the number of bank branches per 10,000 population is a few times lower than in the EU, although recently there has been some improvement. In 1997 the number of branches of the 15 largest banks grew by 15%, however the staff numbers are still excessive: in Poland it is on average 70 employees, while in Austria 15 and in Sweden 11;

6. The majority of Polish banks lack modern computer system allowing improving the quality of services rendered and ensuring effective strategic and operational planning. The banks also lack efficient means enabling the current monitoring of profitability of particular products and setting negotiable limits;

7. There is a shortage of specialized banking in Poland – banks are mostly commercial and of a general nature. The EU countries have apart from such banks several institutions specializing in particular banking services.

In outlining the characteristics of banks present in the Polish market one should also touch upon foreign banks. Discussing the latter can be problematic as there are varying definitions even of the term "foreign bank". According to article 4 of the Banking Law it describes banks with head offices abroad. Ownership capital of banks so defined constitute 15% of the ownership capital of the Polish banking sector. The General Inspectorate of Banking Supervision when publishing data related to banks with a majority share of foreign capital, includes in this group banks with foreign investment exceeding 50% of capital. Foreign banks defined in such a way had in March 1998 16.3% of assets and 23.3% of ownership capital in the Polish banking sector.

Such a definition of a foreign bank does not allow for the situation when several medium-size foreign investors own jointly over 50% of the bank's shares. If we accept such a broad definition, according to which a foreign bank is any bank with more than a 50% share of foreign owners, then foreign capital in the Polish banking sector amounts to around 40% of the share capital of commercial banks. This indicator is frequently quoted in evaluating the position of foreign banks. Bearing in mind the value of foreign involvement some bankers, some banking experts and politicians maintain that the Polish banking sector is already in foreign possession.

It seems that a percentile share of foreign capital in the banking sector does not constitute a sufficient criterion for evaluating whether the sector retains the national character and remains able to meet national priorities, and if it allows Poland to pursue an independent economic policy. Such an analysis should also include other characteristics, like for example the share of foreign banks in the assets of the banking sector. It is important whether banks with a majority of foreign capital retain the functions of a bank, the so-called good citizen, or become the instrument of strategy for the whole group of foreign investors. One should also consider the status and part played by Polish management in such banks.

Discussion about the place and role played by the foreign banks, particularly in recent times, has a growing tendency to stress dangers arising from their existence rather than the positive side. Undoubtedly in evaluating the situation one should conduct a thorough and honest analysis and consider all the important aspects of it.

Taking into consideration the above mentioned main weaknesses of the banking sector in Poland I would like to present here some initiatives which should be introduced in order to raise its effectiveness, efficiency and security. They relate to the following issues:

1. A considerable strengthening of the capital of Polish banks through, on one hand, their privatization, and on the other, by the significant decrease in taxation and reserve requirements;
2. Increasing the competitiveness of Polish banks through their consolidation, lowering costs, improved management;
3. Increased investment in computer and telecommunication systems;
4. Rationalizing the state and structure of workforce.

The condition of development of the banking system is its further privatization. The complete privatization of the Polish banking sector seems to be beyond discussion as only a totally private bank is able to locate financial means on the basis of purely economic criteria. Further privatization with the participation of foreign capital is indispensable since Poland does not have sufficient own capital. Also the considerable presence of financial institutions on the Warsaw Stock Exchange should be taken into consideration.

The issues related to the state budget will continue to influence the decisions about the way of privatizing Polish banks. The final evaluation of the positive and negative results of the privatization of the banking sector will be possible after some years. However we should remember the already existing serious investors who fully appreciate the value of Polish banks and are prepared to secure an effective program for their development.

In the next few months there will take place a privatization of three banks which jointly own 25.7% of the assets of the Polish banking sector, i.e. Group PeKaO S.A., Bank Przemysłowo-Handlowy from Kraków and Bank Zachodni from Wrocław. Their privatization will largely determine the shape of Polish banking for the next few years.

The strengthening of the capital of Polish banks can also succeed through a reduction in tax burden and the rate of legal reserve. It would be useful in such a case to introduce tax relief for banks on profits directed to increase their ownership capital. The lowering of reserve requirements would result in the lowering of interest rate charged by commercial banks, and perhaps also increase their profitability. The best solution from the point of view of banks would be also the change of tax regulations to treat the total of appropriated reserves as costs of obtaining income. At present, the introduction of the proposed changes in the taxation is not likely, mainly due to the state of public expenditure: it would result in a significant fall in tax revenue income.

The effectiveness and efficiency of the banking sector can be greatly improved through its consolidation, lowering operational costs and improved management. Consolidation is usually understood as a merger, take-over or co-operation of two or more banks in order to maintain or increase their competitiveness. It is assisted by privatization. The growing competition among European and American banks resulted in a recent wave of mergers. The liberalization of Polish currency laws and the full opening of our country in 1999 for foreign banks and increasing competition will definitely speed up changes in the banking sector. There should be a concerted effort to create in Poland in the next few years two to three strong financial groups offering a full range of services in all the areas of the financial market controlled by domestic capital. Such consolidation could be aided by the take-over, within the privatization process, of some still state-owned banks by the banks with a majority stake of Polish capital. In this way there could be created a part of Polish banking system sufficiently strong to compete with foreign banks.

The necessary condition enabling Polish banks to compete effectively is to rationalize their operational costs. It is particularly important now when there is a definite downward trend in net profit margins. In 1997, despite the fact that the majority of banks recorded profits, their general profitability fell in comparison to the previous year. This was caused by growing operational costs,

namely higher costs of maintaining their branches, staff remuneration, purchasing new computer systems, high legal reserves and premium paid into the Bank Guarantee Fund.

In the situation of failing net profit margins, particular importance rests on the issue of correct management of bank risks, meaning the use of advanced methods of appraisal and control of the risk based on the accepted quantitative methods aided by computer technology. Also there should be implemented some organizational changes at the basis of which there are profit centres built around basic groups of products, clients, or the location of their users.

In Polish conditions the improvement of the quality of services rendered remains of paramount importance. This can be achieved through the extended application of computer and telecommunication systems. Banks should offer more and cheaper services based on electronic banking, both for individuals and companies. Every bank should possess an integrated information system including all its branches. This would allow lower unit costs of particular banking products and better and more effective decision-making at all management levels. The delays in implementing computer systems in Polish banking could be its chance to make a leap reaching for the world's latest technological solutions.

The last group of issues related to increasing the effectiveness and efficiency of Polish banks is related to the rationalization of the state and structure of the workforce. At present 33% of bank staff are university graduates, 58% completed secondary education; such a structure corresponds with the present level of development in Polish banking. In the near future, due to the wider application of computer technologies, the number of simple routine operations will fall. At the same time newly introduced banking products will require higher qualifications on the part of the personnel offering them. It will require changes in the staff professional structure, which can be conducted through transfers, changes in job description and directing staff development. Our banks still suffer high levels of fluctuation among the best qualified personnel; their leaving is usually a big loss for their employers. Therefore special program should be created giving them opportunities of further professional development and offering earnings compatible with their abilities.

It should be mentioned that Polish banks employ a high number of British people of Polish origin. Banks should actively seek highly-qualified staff among Polish communities abroad which would accelerate access to the most advanced banking technology for our banks.

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4. CLOSING REMARKS

The Polish banking sector faces positive development perspectives. The adjustment processes connected with our future membership in the EU are conducted in the banking sector in a satisfactory way. Undoubtedly it is strongly influenced by pressures of competition, new capital and organizational solutions. The Polish banking market becomes more open as we implement our obligations from the agreement with the OECD and the EU. All these will contribute to the speedy introduction to Polish banking of the tendencies existing in the world financial markets.

Naturally there remain some dangers to the realization of the adjustment processes. I think however that they will be noticed in good time by the state and banking authorities as well as the banking world, and the right measures to counteract negative aspects will be introduced.

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