

## **Policy Paper**

**Re:** Mission on Bank Privatization to Belarus

**From:** Slovakia-Belarus Task Force on Economic Reforms (implemented by the Pontis Foundation's Institute for Civic Diplomacy)

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### **Introduction:**

On April 25 – 27, 2005 the Institute for Civic Diplomacy at the Pontis Foundation organized a mission of Slovak economic experts to Belarus. The mission consisted of Juraj Renčko, former advisor to Minister of Finance of the Slovak Republic (1998-2002) responsible for re-structuralization and privatization of the banking sector, and Karol Hirman, Public Relations Manager of the Slovak Gas Company (SPP) and former Slovak journalist covering economic affairs of the CIS. The goal of this visit was to review options of banking sector privatization in Belarus, space for expert cooperation, and the transfer of experience with economic reforms between Slovakia and Belarus. During their stay Slovak experts attended series of meetings with representatives from the government administration, central bank, private banks, Beltransgaz, as well as with non-governmental “think-tanks.” This report summarizes the observations of the mission.

### **Main Conclusions:**

Local non-governmental and independent economic groups, as well as official representatives, are well aware of the current dynamics of the economy in Belarus. The present economic development will soon pique and prove to be unsustainable in the long-term without extensive investments. The failure to move towards a more free-market orientation is generally recognized by state officials, which could create a good base for reforms that would improve the attractiveness of Belarus for foreign investors. Despite the well-known political conditions, it seems that the public sector is looking for greater foreign investments, especially, but not exclusively in the banking sector, and informal meetings suggested that this capital should come from the West, not from Moscow. This interest to secure investments could contribute to overcoming some of the dogmas that form the basis of Belarusian economic policy. Minimally, it is possible to imagine that the environment would standardize a sphere for private enterprise and capital and that the state would “withdraw” to select segments of the economy. *This is the area where international aid could initially be focused, despite the existing political situation.* The Pontis mission concluded that the ability of the Belarusian administration to receive consultation in the above mentioned extent and direction is presumably sufficient. At the same time, there is a reasonably developed NGO sector (mainly think tanks) that understands the problems of the country, including the extent of economic difficulties, and with external assistance it is capable of preparing a feasible and comprehensive reform program.

### **Banking Sector Review:**

As of today, there are 32 commercial banks in Belarus, of which 27 have foreign capital shares, and 8 of these are owned fully by foreign sources. These investors are mainly from the Commonwealth of Independent States, but in one of the banks the majority share is owned by a significant European bank (Priorbank with 58,2% interest of RaiffeisenBank, 13,5% EBOR belongs to the Raiffeisen Group).

Despite the large number of banks with partial foreign ownership, the Belarusian bank sector is a de facto state sector. The state share (usually through the Ministry of Economy) in the basic capital of a bank is as much as 81%, with the share of foreign sources at 9%, domestic sources (especially industrial corporations) 7,6%, and the National Bank of Belarus (NBB) 2,8%. The NBB share is not considered part of the state share, however, even though the central bank is practically subordinated to the President.

The Belarus banking sector is characterized by a high rate of concentration. The largest bank, Belarusbank, represents 41% of the banking sector assets, and overall the first five largest banks control 80% of the assets. Four of these five banks are owned by the state, with the third largest bank being owned by Priorbank.

Financially, the banking sector is considered under-capitalized, suffering from a lack of liquidity, and pressured by the imbalance of its short-term and long-term assets and liabilities.

### **State Policy toward the Banking Sector:**

The NBB is the vehicle for state policy toward the banking sector. Several years ago, the NBB prepared "The Concept of the Banking Sector Development of the Belarus Republic for the years 2001 – 2010" (<http://www.nbrb.by/publications/crrb.pdf>) which established goals for seeking foreign capital interest in the banking sector. Nowadays, the state hopes to reach a 25% share of foreign capital that should represent an additional \$250 mil. USD in basic stock within the whole bank sector by securing a majority share in the four largest banks. The NBB sees the space and it is ready to suggest achieving as much as a 50% share by foreign investors. The government also intends to secure an additional \$750 mil. in credit sources to alleviate the issue of under-capitalization.

During discussions our representatives recognized several signals indicating that state activity in relation to the banking sector does not comply with basic principles of business practices and ethics.

- First, the state exerts tremendous administrative pressure on banks, including private banks. We were informed that some banks were forced to capitalize their claims towards some corporations to secure their funding and to restructure. Subsequently in such cases, banks become owners of corporations to which they give loans.
- Second, the state tries to concentrate investments of state corporations into banks owned by the state to secure their liquidity and the ability to fund state programs and projects.
- Third, the central bank provided resources, by grossing up capital stock in cash, to some banks that have problems with liquidity. Through this, the NBB became

a co-owner of these banks (see the above mentioned 2.8% share on capital stock within the whole banking sector).

- Fourth, the criteria for granting licenses seem to be soft in relation to reviewing the suitability of the owner/owners. The rules of risk management in connection with the provision of loans are not always stipulated clearly or duly enforced. The lax nature of regulations is contributing to questionable ownership, particularly by Russian corporations.

### **Bank Supervision:**

The NBB has established a relatively *functional system of bank supervision*. According to the statements of NBB leaders and its bank supervision, they are trying to implement a modern system of bank supervision based on the Basel II principles. At the same time, the NBB is preparing for implementation of the international accounting standards. Representatives of banks, including Priorbank, also appreciated the progress achieved in the area of quality enhancement of the supervision over banks.

Considering the forms of state interference into the bank sector, it is questionable whether the bank supervision can be more precise and objective. Nonetheless, it seems that the *basic elements of the modern system of bank supervision are present, and bank supervision can be expected to be at acceptable level of quality after the elimination of state interference*.

### **Enterprise Sector:**

To review properly the stability of the banking sector, a more detailed analysis of the general economic situation and development tendencies of the enterprise sector would be needed, which was not possible during the stay of our group. The following statements are therefore based on non-quantitative information and impressions.

A non re-structured state sector prevails in the economy of Belarus. Privatization that started in the first half of the 1990s was stopped, and corporations were again partially taken over by the state. The shift back towards state control was caused by a significant break down of the enterprise sector, manifested in the form of increasing unemployment. In an effort to stop this development, the process of enterprise sector restructuring was frozen, and the preservation of employment became the priority of the state interventions into the economy.

This led to the following characteristics in the enterprise sector in the country:

- There are several large state corporations focused on export profiting due to a special tax relief regime (even though official representatives claim that this approach ended and that these corporations currently operate in the same market conditions as others)
- Special favorable conditions are applied to agriculture, preservation of which is considered to be a social issue.
- Although a private sector exists, it is only surviving and does not show signs of growth or the capacity to provide the space for bank services development.

## **Non – Performing Loans (NPLs)**

According to information from the NBB, the ratio of bad loans reaches 4,5% of general loan volume within the whole bank sector, which is within Western European standards. This ratio, however, is actually several times higher and is caused by the following issues:

- Raiffeisen oversees the evaluation of credit risk according to local standards as well as those of the IAS, according to which the rates of NPLs are twice as high.
- State corporations often benefit from restructuralization of loans and extended time for payments (prolongation of maturity), which masks doubtful loans. More stringent conditions and restrictions would likely lead to higher NPL rates. praxis of restructuring of loans and
- It seems that the state provides corporations in trouble with different types of relief, including tax relief. We also recorded cases when a bank was forced to take over the ownership of a corporation with the goal “to put it in order.”
- Belarus has experienced several consecutive years of huge economic development. Despite some doubts about the quality of basis statistical data, the actual development is undeniable and is related to the boom on the Russian market and with the increase of the price of oil and oil products in the world market. It is not clear how incomes generated through this development are distributed within the economy. This development had a presumably positive influence on profitability and financial stabilization of corporations. However, a reversal of this development can cause significant and widespread financial problems for a number of corporations.

Additionally, the range of NPLs concentration within the banking sector is not clear, nor is the impact such concentration might have on possible privatization.

## **Privatization Opportunities in the Banking Sector:**

Privatization opportunities of some state owned banks by reputable investors with international experience in banking are currently very limited. Ultimately, the government does not have a clear privatization goal. On the one hand it declares an interest to attract strategic investors, but at the same time it does not want to privatize control. The state wants to retain the capacity to implement economy policy, or more precisely individual governmental programs and projects, through banks. Also, it is unclear which banks the state would like to privatize. The risk that the offered price for the share purchase would be significantly lower than that expected by the government is therefore quite considerable.

The effort to keep the state corporations as clients of state banks means that private banks must provide their services to the segment of private non-financial organizations. This segment, as it was already mentioned, has been stagnating and is unlikely to develop under the current conditions. As a result, private banks will not be able to expand their activities and services. Bank privatization is therefore only possible after privatization of the enterprise sector. Without a clear government concept of reducing state intervention into the economy and without a privatization scheme, it is not presumably possible to attract reputable foreign investors into the banking sector. Privatization of banks and corporations should therefore be understood as two sides of the same coin.