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# Foreign banks in Bulgaria, 1875-2002


## Abstract

We use the analogy of ecological succession as our conceptual framework. We apply this analogy to the history of foreign banks in Bulgaria and argue that the current predominance of foreign banks is unlikely to be permanent, even without government action. Foreign banks have entered Bulgaria several times—before World War I, again after that war, and after the fall of Communism in the early 1990s. The same source countries and even some of the same banks that were present before World War II or even World War I, reappear in the 1990s. Government concern with retaining control over credit limited the foreigners' role in the banking system. However, since 1997 the government has privatized almost all the major banks with the result that foreign banks now control over 80 per cent of the banking system's assets.


**Keywords:** International-banking, Bulgaria, Foreign-Banks, transition, succession

**JEL Codes:** N34, L13, G21

## Introduction

In Bulgaria, as in a number of other transition economies, foreign banks now account for the majority of total banking system assets. Historically, foreign banks have played only a limited role in Bulgarian banking. However, economic problems in the mid-1990s led the Bulgarian government to permit foreign banks to acquire Bulgarian banks, especially in privatizations. The result was the present state of affairs, with foreign banks controlling over 80 percent of assets.

Foreign domination of the banking system is a novel experience for Bulgaria. A question troubling many observers is whether this state of affairs is likely to be permanent or not, at least absent government intervention. To offer an answer to this question we introduce the analogy of ecological succession from the literature on forest evolution. We interpret the history of foreign banks in Bulgaria in light of this analogy.

## Ecological succession

The classical narration of primary succession posits that pioneering species first colonize previously uninhabited landforms. As these pioneering plants increase in size and influence, competition between them and the changes they cause in soil and light conditions facilitates secondary succession, the establishment of succeeding organisms that are better adapted to the emerging conditions. Eventually there emerges a final self-maintaining community (Collier et al. 1973). Secondary succession may also follow the abandonment of once cultivated land or major or minor disturbances such as fire, flood, landslides or tree-falls that have left some trace of earlier organic activity (Bormann and Likens 1979). Succession culminates in a climax forest—in a steady-state in which the forest is self-replicating.

Further research has specified the mechanisms involved. Tolerance, facilitation and reverse interference mechanisms support succession. The competitive hierarchy mechanism slows down or prevents succession. These mechanisms are not mutually exclusive and their relative importance in particular cases depends on the climate (Botkin 1993).

In tolerance early succession species do not affect the rate of recruitment, growth or survival of later species. The early species simply arrive and grow more quickly. Later species can grow during the early succession phase but are more tolerant of the more limited resources that prevail when competition is well established.

In facilitation one species prepares the way for the second. An extreme case of facilitation would have the early species as a necessary condition for the survival of the later species. A less extreme case would have the presence of the early species leading to earlier arrival or greater success for later species.

In reverse interference late succession species interfere with the continuation of early succession species. This contrasts with the competitive hierarchy mechanism in which early succession species impede the growth of late succession species. With competitive hierarchy late succession species start to arrive as members of the early succession species reach the end of their life-cycle and die out.

Among pioneering species weeds are prominent. Weeds are opportunistic plants that invade disturbed soil (Elton 1958). Plants that we consider weeds typically evolved to fill the minor role of secondary succession. As succession proceeds, weeds lose ground but some remain in place here and there, ready for the next disaster. More recently, ecologists have broadened the concept of weeds to include plants that appear in or are transplanted to a new environment that is far from their original one. The transplants thrive in the new environment because they have left their enemies behind and face no new ones.

The ecological succession model has several striking characteristics. First, the logic of the process means that species that are most prevalent in the early stages of the process become far less prevalent later. Until the system has reached the steady-state one cannot treat any snapshot in time as an unbiased estimate of the future state of the system. Second, facilitation and reverse interference mean that it is the very success of the pioneering species that brings about their displacement. As they succeed they change soil and light conditions that permit other species to gain a foothold and in time to dominate.

Like all biological analogies and metaphors, ecological succession has its limitations. The most important is that organizations are not organisms. With organizations, the process of variation and selection is Lamarckian (opportunity pull) as well as Darwinian (competition push). Furthermore, organizations can merge and acquire each other. Still, we believe that the analogy can facilitate understanding of the role of foreign banks in Bulgaria.

There have been four eras in banking in Bulgaria. In the first, second and fourth we see the same pattern of succession, one that consists of three phases. The first phase is a partial opening with the government hesitant about foreign entry. Only a few foreign banks appear and these have a limited role. One can think of this as the arrival of the first weeds that facilitate the later entry of others. Second, further opening leads to the entry of a number of foreign banks. In the third phase competitive turmoil emerges, with some foreign banks closing down and others merging with each other or with domestically-owned banks. Unfortunately a fourth phase—steady-state climax—has not yet occurred.

World War I terminated the first (1875-1918) of the four eras. An increasingly nationalistic government, World War II and the arrival of a Communist regime terminated the second era (1919-1944). The third era (1944-1989) was one of a Communist regime that barred entry to foreign banks. The fourth era (1990-to date) began with the fall of

Communism and is still underway. It is our argument that in this present fourth era the Bulgarian banking system, left to itself, will eventually achieve a steady state with a foreign presence that is much reduced from its current situation in which foreign banks own over 80 per cent of the assets in banks.

## 1875 – 1918: The arrival of the Europeans

To the best of our knowledge, the first bank in Bulgaria was the Imperial Ottoman Bank, which entered in 1875 (see below), while Bulgaria was still under Ottoman control. Then in 1877-78 the Russo-Turkish War resulted in the expulsion of the Ottoman army from what is now Bulgaria. Bulgaria subsequently achieved the status of a principality under the suzerainty of the Ottoman Empire. In 1879 an assembly of notables gathered in Turnovo, the medieval capital, to resurrect a Bulgarian state. One of the new government's first activities was to establish the Bulgarian National Bank (Bulgarska Narodna Banka; BNB) in 1879 under its ownership (Avramov 1999).[1]

From then on the BNB became the key Bulgarian bank. The government used the BNB as the bank of issue and as a commercial and development bank (Avramov 1995). This is parallel to the situation in Latin America, especially in Argentina, Brazil, Chile and Mexico, where government-owned banks with mixed central, development and commercial banking functions have dominated from the 19$^{th}$ century (Marichal 1997). The St. Petersburg banking house of Poliakov and Ginsburg apparently tried to found a joint-stock bank of issue in 1880 but the government blocked the attempt. Later, when the BNB suffered difficulties, the government still rebuffed Austrian, French and German offers to

[1] The Bank translates "narodna" as "national" but the word carries the connotation of Nation or People as in the "Bank of the Bulgarian Nation" or "Bank of the Bulgarian People".

recapitalize the bank by taking shares in it. The state also owned or managed the other major financial intermediaries: the Poshtenska Spestovna Banka (Postal Savings Bank; est. 1896), the Bulgarska Zemedelska Banka (BZB; Bulgarian Agricultural Bank), and the Bulgarska Centralna Kooperativna Banka (BCKB; Bulgarian Central Cooperative Bank).[2]

The Imperial Ottoman Bank (IOB), despite its name and role as the premier bank of the Ottoman Empire, was Anglo-French in ownership. The IOB established branches in Rousse (Rus or Rusçuk; 1875-80 & 1892-99), Varna (1880-82), Plovdiv (Philippopoli; 1878-99), and Sofia (1890-99). Turkish speakers represented about 19 per cent of the population of Bulgaria (Popoff 1920) but the IOB did not limit its clientele to them. By the end of the 1880s the IOB's lending exceeded that of the BNB, its only competitor (Berov 1999).

Despite its earlier success, in 1899 the IOB withdrew from Bulgaria. In 1897 a more xenophobic government had replaced the Stambolov regime, which had sought an independent path between Russian and Turkish hegemony. Subsequently and consequently, the Bulgarian government passed a new commercial code in 1898 that imposed numerous burdensome restrictions on foreign firms (Clay 1990).[3]

[2] In 1862-3, Midhat Pasha, a Bulgarian Moslem serving as governor, founded a large number of autonomous rural credit associations known as "Manafi Umoumie Sandyklar" (credit associations of public utility; Popoff 1920). The credit associations served as treasuries for the local administration, accepted deposits at interest and made loans to peasants on mortgages or against the guarantee of two solvent landowners. In 1894 the government nationalized the associations and put their administration into the hands of the Ministry of Commerce and Agriculture. Banque de Paris et des Pays-Bas arranged financing for the associations. In 1903 the government reorganized the credit associations by combining them to create the Bulgarska Zemedelska Banka. In 1910 the bank spun off its cooperative activities to form the Bulgarska Centralna Kooperativna Banka (Popoff 1920).

[3] Lampe and Jackson (1982), however, report that the Imperial Ottoman Bank closed its Bulgarian branches in 1895 in response to problems elsewhere in the bank. Berov (1999) agrees with Lampe and Jackson on the reasons in that he cites losses on Turkish and South African securities. However he correctly agrees with Clay that it was in 1899 that the BIO finally left. Kostov (1999) argues that the BIO left because of poor profitability due to a series of poor harvests and the decline of grain exports. He adduces other evidence to suggest that the BIO had good relations with the National Party of Bulgaria.

The instability in the Balkans and in Bulgaria itself and government opposition discouraged extensive and sustained economic foreign investment until the mid-1890s or later (Flaningam 1961). The Norddeutsche Bank, the Banque de Salonique and several German companies helped found the Bulgarian Lottery Bank (Bulgarska Lottarina Banka) in 1895 to organize and profit from a lottery (Avramov 1998).[4] This Sofia-based bank was the first foreign company to incorporate in Bulgaria. In 1897 the Industrial Bank [of Russia] (Popoff 1920), which may have had its headquarters in Kiev, had a branch in Sofia that closed very quickly.[5] After the Revolution of 1905-6 Russian interest in the Balkans waned. The next entrant was the Hungarian Commercial Bank of Pest (Pesti Magyar Kereskedelmi Bank; PMKB) which entered Bulgaria in 1898 where it established the Targovska Banka (Commercial Bank), which in turn established four branches.[6]

Although German banks had no direct operations in Bulgaria, from 1889 on they were active in underwriting Bulgarian government debt (Tilly 1991 and 1994; Reisser 1911; Strasser 1925; Flaningam 1961). In 1905, Germany and Bulgaria signed a definitive commercial treaty, including a tariff agreement. This triggered an influx of foreign investment in the financial sector. That year Disconto-Gesellschaft (37 per cent), S. Bleichröder (28 per cent), and the Norddeutsche Bank (13 per cent) joined with some Bulgarian firms to form the Kreditna Bank in Sofia with a capital of FFr 9mn. Despite its location and political ties the bank was conservative in its operations and remained small.

[4] After a hiatus in World War I, the bank recommenced operations and was still operating in 1925 (Avramov 1998), though probably without foreign ownership.
[5] Popoff does not make clear whether the bank's name included a reference to Russia or whether the reference to Russia is simply an identification of its origin.
[6] Berov (1999) gives the year of founding for the Targovska Banka as 1901. Avramov (1998) says 1903. This bank apparently began as a limited partnership (komanditno drujestvo). The various dates may reflect reorganizations or changes of status.

In 1906 the Wiener Bank-Verein, an affiliate of the Deutsche Bank, too entered Bulgaria where it established the Balkanska Banka (Banque Balkanique) with a capital of FFr 4mn. At some point, the Wiener Bank-Verein provided 40 per cent of the capital for the Balkanska Banka; the Crédit Anversois, the Banque de l'Union Parisienne (BUP) and the Anglo-Österreichische Bank provided most of the rest.[7] The Balkanska Banka proceeded to open seven branches around the country. The PKMB (29 per cent) collaborated with Banque de Paris et des Pays-Bas (Paribas; 59 per cent) and the Allgemeine Österreichisches Bodencreditanstalt (13 per cent) to transform the Targovska Banka into the Generalna Banka (Banque générale de Bulgarie; Barcsay 1991 and Kövér 1991). The bank was capitalized at FFr 2mn, and so was substantially smaller than the Kreditna and the Balkanska.

In 1908 Bulgaria declared itself an independent kingdom and no longer subject to the Ottoman Empire. This led to a number of changes in the railroad system and to improved prospects for German firms after Germany gained an almost exclusive position in placing government contracts (Flaningam 1961).

Several specialized banks commenced operations between 1905 and 1911. Austro-Hungarian capital founded the Bulgarska Ipotekarna Banka. In 1910 the Balkanska Banka founded the Crédit Foncier Bulgare to take over its mortgage operations. The next year the Generalna Banka, the Berliner Handelsgeselschaft and the Banque Internationale de Bruxelles together founded the Generalna Ipotekarna Banka na Tsartsvo (Banque générale hypothecairé du Royaume de Bulgarie; Kövér 1991). Apparently Commerz- und Diskonto Bank participated in establishing the Banque Danubienne (Russe), and the Ungarische Bank- und Handels opened an affiliate in Sofia under the name Bulgarische Bank- und Handels

[7] Bonin (1991) says the Wiener Bankverein entered in 1905 and that the BUP and the Société Générale took over the bank between 1908 and 1910. Bussière (1983) reports that the

(BBH). Lastly, the Prague Credit Bank's (Pražská úvěrní banka) Sofia branch also appears to have been of some importance.

In 1911 the Generalna, Kreditna, Balkanska, BBH and Prague held 12 per cent of Bulgarian banking assets, the BNB, BZB and BCKB held 74 per cent, and 53 local private banks held the rest (Lampe and Jackson 1982). However, the national banks were slightly less profitable in terms of ROA (1.8 per cent) than the private banks (2.0 per cent).

In 1912 the mortgage-lending sector saw consolidation. Crédit Foncier Bulgare and Generalna Ipotekarna Banka na Tsartsvo merged their operations into the Franco-Bulgarska Ipotekarna Banka (Credit Foncier Franco-Bulgare; Kostov 1999).[8] A Russo-Bulgaro-French bank, the Banque Commerciale et Foncière des Balkans (the Commercial and Mortgage Bank of the Balkans; Avramov 1998) also opened its doors (Anan'ich and Bovykin 1991). Originally Crédit Français owned 50 per cent of the bank, the BNB owned 25 per cent, and four Russian banks shared 25 per cent. The intent was for the bank to work under French and Russian protection to serve the Bulgarian population in the European part of Turkey (Avramov 1998). Within a year the Russian banks reduced their share to 15 per cent and Crédit Français increased its share to 60 per cent. Lastly, a Belgian company, the Crédit Hypothécaire Agricole et Urbain d'Egypt opened a branch in Sofia. However, between conflicts with the Bulgarian government over the right to issue mortgage bonds and the onset of the Balkan Wars little came of these ventures.

During the period from the Balkan Wars (1912-13) through World War I (1914-18), the government froze the activities of all foreign-controlled banks (Berov 1999). Because Bulgaria joined the First World War on the side of the Central Powers, the French banks

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Banque de l'Union Parisienne only became involved in 1908. See also: Lampe and Jackson (1982), Berov (1999) and Kostov (1999).

were forced to withdraw. At the time the French held a quarter of the capital of four of the main banks in the country, the Generalna, the Balkanska, the Crédit Foncier Bulgare and the Banque Commerciale et Foncière des Balkans (Plessis and Feiertag 1999).

The Austrian and Hungarian banks benefited from the withdrawal of the French by increasing their stakes. The PUC and Allgemeine Bodencreditanstalt took control of the Generalna. The Weiner Bankverein, together with other Austro-Hungarian banks, took control of the Balkanska. In 1917 French and Bulgarian investors established the Franco-Bulgarian Bank for International Trade and British and Bulgarian investors established the Lozarska Banka (Winegrowers or Viticulture Bank) but how meaningful these were is questionable.[9] Kreditna Banka benefited from the war and opened branches in Varna and Rousse, and a short-lived one in Ueskűb (Skopje) in Occupied Serbia (now Former Yugoslav Republic of Macedonia). The Deutsche Bank opened a branch in Sofia in 1917. In 1918 the Bulgarische Bank- und Handels received a capital infusion and changed its name to the Banque Hongroise-Bulgare. The Allgemeine Depositenbank led another Austro-Hungarian group to found the Banque du Credit Austro-Bulgare (Kostov 1999).

One foreign country is notable for its absence during the pre-War period. Throughout the Ottoman period Greeks acted as a middleman minority in the Balkan provinces and elsewhere in the Ottoman Empire (Kourvetaris 1988; Dritsas 1994). Though kinship-based networks of merchants, ship owners and bankers tied the Greek Diaspora together and Greek merchants established private banks in Odessa (Mingolou and Louri 1997), Greek

[8] Berov (1999) reports that the Bulgarska Ipotekarna Banka merged with the Banque Générale Hypothécaire du Royaume de Bulgarie to form the Crédit Foncier Bulgare.
[9] Bulgaria was allied with Germany and Austria in the war and banking business was at a standstill.

merchants apparently did not establish any private banks in Bulgaria.[10] The Greek presence in Bulgaria lasted until the ethnic cleansing that followed the end of World War I. The Treaty of Neuilly-Sur-Seine (1919) and the Kafantaris-Moloff Accord (1926) provided for the voluntary and compensated exchange of Bulgarians from Thessaloniki and surroundings for Greeks from Bulgaria (Zerriffi 1999).

**1918 – World War II: Return and retreat**

The disintegration of the Austro-Hungarian, Ottoman and Tsarist Russian empires provided an opportunity for banks based in the countries of the victorious Allies to penetrate the Balkans, Central Europe, and even further afield. The war and its aftermath created disturbed soil in many places. In Bulgaria, where law and regulation, and banks were already in place, the result was a situation of secondary succession, unlike the situation of primary succession before the war. The scenario of opportunistic entry, consolidation and shake-out, and increasing dominance of domestic institutions repeated itself before the onset of the Great Depression and the rise of Fascism in Europe changed the environment again.

The end of the war brought a rush to establish banks including a number of banks with foreign interest. After the War, the German owners handed over the Kreditna Bank to the Bulgarian owners. However in 1921, a German manager from the Disconto-Gesellschaft joined the board. The Deutsche Bank's branch had cut back operations and was supposed to be liquidated but in 1921 it resumed its operations (Strasser 1925).

The Banque de l'Union Parisienne (BUP) re-involved itself with the Balkanska Banka and increased its shareholding. With the agreement of the other shareholders the BUP took a dominant position on the executive committee (Bussière 1983). (The other major

[10] These authors discuss Greek private banks in Odessa but have no mention of Varna or

shareholders in the Balkanska Banka were the Hungarian General Credit Bank (Magyar Általános Hitelbank; itself heavily foreign-owned), the Creditanstalt, Société Générale de Belgique and the Weiner Bank-Verein.

One of the most important entrants was the Banca Commerciale Italiana e Bulgara (BCIB; Bulcomit), which the Banca Commerciale Italiana (BCI) and the Assiccurazioni Generali established in 1919 to finance trade between Italy and Bulgaria (Di Quirico 1999; Stanciu 2000). BCIB had a head office in Sofia and branches in Burgas, Varna and Plovdiv. It financed the tobacco industry and was the main non-governmental bank in Bulgaria.

The Czech investors who had started to establish the Prague Credit Bank in 1914 reorganized the bank in 1920 and registered it as a joint-stock company in 1922. This became the center of an industrial group (Berov 1995 and 1999; Kostov 1999).

The Franco-Bulgarian Bank for International Trade too was reorganized in 1920. Apparently the French investors were the Crédit Français, the Caisse Commerciale et Industrielle de Paris, the Crédit Foncier du Brésil et de l'Amérique du Sud (in Paris), and the Banka Franco-Romana (in Bucharest). The bank created an industrial group that played an important role in the Tobacco Cartel.

In 1920, Crédit Foncier d'Algérie et Tunisie (60 per cent), Banque Belge pour l'Etranger (35 per cent) and Angel Kujumdgiiski (5 per cent) established the French-Belgian Limited Joint-Stock Company. The company formed a group of some nine industrial and commercial companies. In 1923 the company became the Banque Franco-Belge de Bulgarie. This bank established three subsidiaries: Banque de Plovdiv, Banque Bulgare du Nord in Rousse, and Banque Bulgaro-Belge in Burgas (Kostov 1999).

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other Bulgarian ports.

In 1921 Banque de Paris et des Pays-Bas took a stake in the until then entirely Bulgarian Bulgarska Targovska Banka (Bulgarian Commercial Bank).[11]

There were some other small foreign banks in Sofia that did not last out the decade (Berov 1999; Kostov 1999). These were the Bulgarian-American Bank (est. 1911; reorganized 1920); the Banque Hongroise-Bulgare (re-est. 1921; reorganized 1922); the Lozarska Banka (re-organized in 1922 with a small amount of British investment and in liquidation in 1925); and the Austria-Bulgarian Credit Bank. The Banque Internationale de Bulgarie also had some minor foreign ownership.

The Allgemeine Österreichische Bodencreditanstalt acquired an interest in the Banque Générale de Bulgarie through the PMKB and Paribas played an important role in stabilizing the bank. The Bodencreditanstalt itself had amongst its foreign shareholders the Amsterdamsche Bank, which now is part of ABN AMRO (Cottrell 1983). In 1925-26 the Banque Générale de Bulgarie absorbed the Banque Hongroise-Bulgare, which had had as its principal shareholder the Anglo-Hungarian Bank (Kostov 1999).

As it withdrew from commercial banking after 1926, the BNB spun off its mortgage operations into a new Bulgarska Ipotekarna Banka. This bank had mostly foreign owners but at the time the government retained the option to buy the bank in ten years.

In 1928 the Kreditna Banka took over the business of the Deutsche Bank's branch. In the same year, its owners reorganized the moribund Credit Foncier Franco-Bulgare. The Balkanska Banka merged with the Banque Franco-Belge de Bulgarie to form the Banque Franco-Belge et Balkanique (Bussière 1983). The Banque Franco-Belge was a subsidiary of the Belgian Banque pour l'Étranger, which was a member of the Société Générale de Belgique group and an owner of Balkanska.

[11] Kostov (1999) says 33% and 1921. Berov (1999) says 25% and 1926.

By 1929, the foreign banks accounted for 45 per cent of the assets of Bulgarian private banks (Avramov 1995). The foreign banks dominated the four Bulgarian non-government banks in Sofia and foreign banks accounted for 31 per cent of bank capital in Bulgaria as a whole (Lampe and Jackson 1982). Still, a small number of other state and quasi-public banks dominated the banking system even though during 1926-28 the BNB had withdrawn from commercial banking and become solely a bank of issue.

In 1930, the Franco-Bulgarian Bank for International Trade and the Banque de Crédit Nationale merged into the entirely Bulgarian-owned Bulgarska Banka (est. 1918), which also acquired several other small Bulgarian banks and re-named itself Saedineni Bulgarski Banki (Union de Banques Bulgares).

During the Depression the foreign banks shrank their operations and repatriated capital, especially in advance of the imposition of exchange controls in 1931. The Balkanska Banka closed six of its seven branches and withdrew from its subsidiaries, especially the Fabriques des Tabacs Reunies (Plessis and Feieretag 1999). The foreign banks' share of deposits in private banks fell to 20 per cent by the end of 1931 and 7 per cent by 1934 (Avramov 1985).

After 1933 the non-German banks' withdrawal was also a consequence of Bulgaria's increasing political and economic orientation towards Nazi Germany (Berov 1995). Bulgaria entered into bilateral trading agreements with Germany covering 88 per cent of its agricultural exports (Hunter 1993). The result was to skew the Bulgarian economy towards Germany and away from the European free trade zone and to reduce greatly the scope for trade financing by non-German banks (Plessis and Feiertag 1999). During the 1930s, the owners of the Generalna Banka and the Crédit Foncier Franco-Bulgare followed a policy of reducing their capital commitment.

In 1934 the Bulgarska Zemedelska Banka merged with the Bulgarska Centralna Kooperativna Banka to form the Bulgarska Zemedelska i Kooperativna Banka (BZKB). The government, with the support and participation of the BZKB, formed the partly state-controlled Bulgarska Kreditna Banka (Bulgarian Credit Bank) by combining numerous smaller banks including the Saedineni Bulgarski Banki.[12] By 1936, state financial institutions accounted for two-thirds of all deposits and three quarters of all new credit (Lampe and Jackson 1982).

In 1937 the government exercised its options and acquired the Bulgarska Ipotekarna Banka, buying out its foreign and domestic owners.[13] Paribas, which had a stake in both the Generalna Banka and the Bulgarska Targovska Banka, tried unsuccessfully to promote a merger between them. In 1938 Generalna Banka merged with the Banque Franco-Belge et Balkanique. The BUP and the Banque Belge pour l'Etranger withdrew and the merged bank took on the name Banque Franco-Bulgare.

Shortly before the *Anschluss*, German groups developed an interest in Austrian companies and banks with a view, *inter alia*, to using Austria as a bridge to the Balkans (Matis and Weber 1992). The Creditanstalt in particular revived the interest and involvement in Bulgaria that had waned during the 1930s.[14] Thus at the onset of the war, the primary banks with foreign ownership were the Kreditna Banka, the Banque Franco-Bulgare, the Italian-

[12] Some of the others included the Banque Internationale de Bulgarie, the Banque de Bourgas, and the Banque de Crédit et Commerce de Tirnovo.

[13] At the time of the bank's founding in 1927, the government retained an option to acquire the shares in ten years.

[14] The Creditanstalt took over the Austrian business of the Anglo-Austrian Bank in 1926. It then took over the Bodencreditanstalt in 1929. Lastly, it took over the Weiner Bankverein and the Niederösterreichische Escompte-Gesselschaft in 1933. These acquisitions made the Creditanstalt almost a monobank within Austria (Cottrell 1998).

Bulgarian Commercial Bank and the Anglo-Prague Credit Bank.[15] However, by then the foreign banks' share of commercial bank assets had fallen to 34 per cent (Kostov 1999).

Bulgaria, partially for irredentist and partially for precautionary reasons, allied itself with the Axis powers. But for philo-Russian reasons it refused to declare war on Russia or to deploy troops outside the Balkans. Lampe and Jackson (1982) report that during World War II all the foreign banks other than Banque Franco-Bulgare were German or Italian.

On 5 September 1944 the USSR declared war on Bulgaria and the Soviet Army invaded the country. A coup by the domestic Communist movement and the Military League on 9 September 1944 enabled the Fatherland Front Government to come to power before the Red Army reached Sofia. A 1946 referendum abolished the monarchy; the seven-year-old Tsar Simeon II left Bulgaria for Egypt via Turkey. (He eventually settled in Spain but became Prime Minster of Bulgaria in 2001.)

During 1944-47 the government started to buy all the banks. Then the 1947 Banking Law nationalized all the banks, with the exception of the Kreditna Banka. The Bulgarian government exempted from nationalization all former German property expropriated and transferred to the Soviet Union as reparations, which included Kreditna (Sipkov 1958). The Bulgarian government completed its takeover of the Banque Franco-Bulgare by formally buying out Paribas. Among the foreign-owned banks that it also took over were the Prague Credit Bank's branch, the Italian-Bulgarian Commercial Bank, the Macedonian National Bank and the Bulgarian Discount Bank.

[15] In 1930 the Prague Credit Bank merged with the Anglo-Czechoslovakian Bank (Anglo-československá banka) and the Czech Commercial Bank (Česká komerční banka) to form the Anglo-Czechoslovak and Prague Credit Bank. In 1938, the bank changed its name to the Anglo-Prague Credit Bank. In 1940, after Germany declared the Protectorate of Bohemia and Moravia, the bank changed its name to Prague Credit Bank. Although Germany did not take over the bank, like all other banks in the Protectorate it came under

The arrival of a Communist regime meant the end of any role for foreign banks. All banking functions became the responsibility of the BNB (Miller and Petranov 1996). In 1951 the Government changed the BNB's articles of association, making the BNB a government agency subordinated to the Council of Ministers and without ministerial status. The Government also established the State Savings Bank (DSK), which received a monopoly over accounts for individuals.

In terms of our ecological metaphor, the system went into secondary succession immediately after World War I and was well on to its way to a steady-state situation with dominance of domestic banks by the late 1930s. However, from the mid-1920s on, successive governments imposed acted to create what one might call a plantation system (monoculture), a process that reached its full extent under the Communists.

## The Communist Era

As one would expect, during the Communist Regime (1944-1989) domestic private banks did not exist and the regime excluded foreign banks. Amongst Satellite states, the Bulgarians applied the Soviet model too faithfully (Šević 2000). Bulgaria had a typical, Soviet-type "monobank" system (Pindak 1973). In the ecological succession metaphor, the banking system was a mono-crop plantation. Variety was suppressed and so were weeds.

The mid-1960s saw some changes. In 1964, Bulgaria established the Bulgarian Foreign Trade Bank (BFTB) out of the foreign operations of the BNB, as the regimes in Poland, the USSR, Czechoslovakia, and East Germany created similar institutions. As Bulgaria's foreign trade bank, BFTB established representative offices in London (1964), Frankfurt (1980) and Vienna (1986). It incorporated the Litex Bank (Lebanese International

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Nazi control. In 1948 it merged into the by then state-owned Zivnostenska banka (Trade

Trade & Exchange) in Lebanon as a subsidiary. In 1987, BFTB (49 per cent) and the Bayerische Vereinsbank (51 per cent) established the joint venture Bayerisch-Bulgarische Handelsbank GmbH, with its head office in Munich. In 1988, BFTB (61 per cent) and the Soviet Union's Vnesheconombank (39 per cent) established Bulgarsovinvest Bulgarian-Russian Joint Finance Company.

Some further abortive reforms and changes followed. Bulgaria combined the state investment bank with the BNB, but then in 1968, decided to convert the BNB's commercial banking operations into two branch banks, the Bank for Industry, Transport and Building, and the Bank for Agriculture and Trade. The two banks opened no branches and in 1971 the BNB re-absorbed them.

In 1980 (and possibly for some years around that year) Banco di Napoli maintained a representative office in Sofia. Unfortunately we know no more about this.

In 1981 the government established Mineralbank to lend to small and medium enterprises. Then in 1987 it established several new banks to specialize in lending to different sectors of the economy.[16] The intent was to move towards a two-tier banking system with the BNB becoming purely a central bank, responsible for supervision of separate commercial banks. In 1989 the government converted 59 of the BNB's branches, which were spread throughout the country, into unit banks. The BNB initially owned all the capital of these banks. In time, the other government banks and the major government firms came to acquire shares too.

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Bank). By that time the Bulgarian government had already nationalized the branch in Sofia.

[16] The seven were the Agricultural and Cooperative Bank, the Biochemical Bank, the Construction Bank, the Economic Bank, the Electronics Bank, the Transportation Bank, and the Transport, Agricultural, and Building Equipment Bank, which was also known as Balkan Bank.

## The Post-Communist Era to the Currency Board

The regime of Todor Zhivkov, Bulgaria's totalitarian ruler since the mid-1950s, ended on November 10, 1989, just one day after the fall of the Berlin Wall. However, Bulgaria's "revolution" was essentially an internal coup within the Communist Party, not a popular revolt like those that brought down the other European Communist regimes. Zhikov was an acute pragmatist, for instance Stalinist during the Stalinist regime, but not in sympathy with those in the Party who wanted liberalization. The Communist Party renamed itself the Bulgarian Socialist Party and won the subsequent election after Bulgaria became a parliamentary democracy in 1990. The new government only nominally embraced a liberal agenda; not understanding free markets, it made only those changes it was forced to make.

Still, the transition governments of 1989-90 passed several banking system reforms. The Law on the Bulgarian National Bank (1991) returned the BNB to the role of Central Bank with monetary and regulatory powers and responsible to Parliament. In 1992 the government enacted the Law on Banks and Credit Activity, which established the current legal framework for the banking system (Ignatiev 1997). The law eased the conditions for the chartering of new banks and the number of private banks grew rapidly. The Act authorized the licensing of subsidiaries of foreign banks but not branches.[17] It also stipulated that acquisition of more than 5 per cent of the total voting shares in a bank required BNB permission (Dobrinsky 1994). Table 1 presents the evolution of the structure of the Bulgarian banking system from 1991 to 2000.

The collapse of the Communist regime resulted in a new period of disturbed soil. Like the period 1878-1905 the period 1990-1997 was one in which the BNB and other government-owned banks dominated the scene and the government itself was only minimally accepting of the entry of foreign banks; it permitted foreign banks to enter only with *de novo* branches, affiliates and subsidiaries. Some foreign banks made trial forays but conditions were not yet propitious for large-scale entry. Consequently, the foreign banks' share of banking system assets remained in the single digits.

The new banks that the government had created in 1987 and 1989 were too small and undiversified either in terms of their sector specialization or geographic scope to be viable. In 1993 the government created United Bulgarian Bank (UBB), Expressbank, Hebros Bank (HB) and Sofiabank to merge some of the sector banks and local banks that it had created. UBB consolidated 22 banks.[18] Varna-based Expressbank consolidated 13 commercial banks.[19] Plovdiv-based HB consolidated 11 banks.[20] Sofiabank merged Hemus, Electronika, Sofia and Kazanlak Commercial Banks. Even so, the new banks were subject to a failure of governance and performed badly (Dilova-Kirkowa 1999). Because other government banks and the major government firms owned these banks the banks were owned by their primary clients and amassed non-performing loans (Minkov 1992).

Raiffeisen Zentralbank (Austria) appears to have opened a representative office in 1989 and to have taken a 33 per cent participation in the Bank of Agricultural Credit in Sofia from

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[17] Authorities permit only subsidiaries when they wish to increase the responsiveness of the foreign banks to the authorities or when they wish to limit the foreign banks' competitiveness vis-à-vis corporate clients (Tschoegl 1981).

[18] The 22 were: Stroybank, Doverie, Iskur Commercial Bank, and the commercial banks of Rousse, Vratsa, Gabrovo, Kurdjali, Lovech, Pazardjik, Pernik, Pleven, Peshtera, Popovo, Montana, Samokov, Sliven, Turgovishte, Haskovo, Shoumen, Nova Zagora, Elhovo and Botevgrad.

[19] The 13 were: Transport Bank of Varna, Vuzrazhdane Commercial Bank of Sofia and the Varna, Gotse Delchev, Devin, Doupnitsa, Kyustendil, Provadia, Razgrad, Silistra, Smolyan and Cherven Bryag commercial banks.

[20] The 11 were: Agricultural and Cooperative Bank, Agrobank of Plovdiv, Commercial Bank Vitosha of Sofia, Commercial Bank Trakia of Dimitrovgrad, and Commercial Banks Plovdiv, Blagoevgrad, Veliko Turnovo, Assenovgrad, Mezdra, Purvomai, Troyan and Chepelare.

which it withdrew when it became clear that it would not be able to acquire majority control. Ionian Bank established a representative office in 1993.

In 1994 the government rescinded its ban on branches of foreign banks and ING Bank became the first foreign bank to establish a branch. Several Bulgarian and Russian institutions came together to found the Bulgarian-Russian Investment Bank (BRIBank) with 50-50 Bulgarian and Russian ownership. (BRIBank also established a representative office in Moscow.) BFTB changed its name to Bulbank, acquired Bourgas Commercial Bank and Stara Zagora Commercial Bank and reincorporated Bulgarsovinvest as Corporate Commercial Bank AD, still with 61 per cent Bulbank ownership.

In 1995 two more foreign banks entered. Xios Bank opened a branch and Raiffeisen Zentralbank established a subsidiary. In the continuing process of domestic consolidation Biochim Bank (Biochim) acquired Serdika Commercial Bank, Sofia Bank and SIRBank (Specialized Insurance and Reinsurance Bank).

In 1996 Ionian Bank and Bayerische Hypotheken- und Wechsel-Bank each opened a branch. The newly founded (1991) Egnatia Bank from Thessaloniki apparently also had a short-lived representative office or branch. Two joint ventures commenced operation. One was the Bulgarian Investment Bank (BIB). The foreign shareholders included the European Bank for Reconstruction and Development (EBRD; 35 per cent), UBB (15 per cent), Biochim (11 per cent), Hebros Bank (5 per cent), Banque Nationale de Paris (BNP; 15 per cent) and others. Commercial Bank of Greece (CBG) took a 20 per cent direct stake in the bank and an 11 per cent indirect stake, as well as the management of the bank. Later, BIB changed its name to International Commercial Bank and then to Commercial Bank of Greece (Bulgaria) as the CBG bought out the other owners. Lastly, Banque Nationale de

Paris and Dresdner Bank formed BNP-Dresdner (Bulgaria) with each taking owning 40 per cent and the EBRD owning 20 per cent.

In March 1997 Istrocapital, a Slovakian investment group, received BNB permission to recapitalize the failed Bulgarian private Mollov Bank, which it renamed Eurobank. The recapitalization, brought foreign ownership in Eurobank to 92 per cent. Allianz Bulgaria Holdings acquired the failed private Yambol Commercial Bank (est. 1989) and renamed it Bulgaria-Invest Commercial Bank. The EBRD took a 20 per cent stake in First Investment Bank. National Bank of Greece and Société Générale each also opened a branch.

During this period, of the six private banks created in 1991, two—International Bank for Trade and Development Bank (IBTD), and International Bank for Investment and Development (IBID)—also had some foreign participation. IBTD is still operating and apparently now has no foreign ownership. IBID began as a 50/50 US-Bulgarian joint venture involving several wealthy investors.[21] In 1995 Bulgarian interests bought out the foreign shareholding but the bank closed its doors in April 1997.

Some other foreign banks may have had representative offices. In 1996 ABN AMRO of the Netherlands, the Agricultural Bank of Greece, Creditanstalt Bankverein from Austria, and Macedonia Thrace Bank from Greece all had representative offices in Sofia.

Lastly, foreign banks also established a presence and exerted an influence through contractual means. Several acted as consultants to Bulgarian banks through twinning arrangements or other formal or informal contractual arrangements. In a twinning

[21] These included Frank Carlucci (the former a former Secretary of Defense in the Reagan Administration and a Deputy Director of the CIA during the Carter Administration), and a Mr. Ansari, a former Iranian Minister of Finance. Carlucci may have been acting on behalf of The Carlyle Group (est. 1987), a private global investment firm that originates, structures and acts as lead equity investor in management buyouts, strategic minority equity investments, equity private placements, consolidations and buildups, and growth capital financing.

arrangement the foreign bank sends staff to the host-country bank to introduce western banking and technology and to train staff. The incentive for the foreign bank is the possibility that if it wishes to it may be allowed to take a stake in its twin (Mondschaen and Opiela 1997). ABN AMRO twinned with Biochim Bank in a project funded by PHARE and Allied Irish Bank twinned with UBB. The ABN AMRO-Biochim twinning, however, only lasted six months before the Bulgarian government dismissed the foreign managers. Peter Jotev, then Deputy Prime Minister and Executive Director of the BCC, explained that a clause in the management contract stipulated its termination if the government initiated privatization procedures. At least three different subsequent attempts to privatize Biochim fell through before the government finally succeeded in 2002.

Despite the phased liberalization of entry and accumulation of foreign entrants, at mid-1997 foreign banks were a minor part of the banking sector in Bulgaria, at least in terms of their share of the assets in the banking system. Between 1993 and the end of June 1997, the foreign share of the assets of the banking system grew from 0.1 per cent to 4.9 per cent. (These figures understate the foreign share of loans, as they do not recognize loans to Bulgarian borrowers on the books of banks outside Bulgaria.)

In 1995 Bulgaria was well positioned for economic recovery following the shock of the liberalization that had begun in 1989. Instead, in early 1996 problems in the banking system (loans to government companies) led to a bank panic that in turn led to a currency crisis and a brief hyperinflation. In early 1997 the government announced that it would institute a currency board system and other reforms and the crisis subsided. In all, the period from 1991 through the twin (banking and currency) crises caused Bulgaria a loss of about 42 per cent of GDP (Tang *et al.*, 2000).

## After the Installation of the Currency Board

In 1997, Bulgaria finally underwent its Transition. Ivan Kostov, of the United Democratic Forces, became Prime Minister, having defeated the Bulgarian Socialist Party, the successor to the Communist Party. As part of a series of measures aimed at "limiting Leviathan", in June 1997 the Government adopted a currency board, which removed the Government's control over monetary policy and stabilized the currency. The government also pushed forward privatization of the banking system to limit its own power to use the banking system to support bankrupt firms (Koford 2000). Lastly, the government favored the entry of foreign banks because these could draw on their parents for liquidity as the currency board system limited the BNB's ability to act as a lender of last resort (Šević 2000).

In September of 1997, Bank Moscovy purchased 8 per cent of Sofia Bank. In October, the US investment firm Wasserstein Perella (WP) took a 24.7 per cent stake in BRIBank through WP's investment arm Emerging Markets Finance. WP also took a position on the supervisory board. Local legal entities and individuals held the remainder of the bank's equity with no one party holding more than 5 per cent. Lastly, Naftex Oil Trading acquired 25 per cent of International Orthodox Bank Sveti (St.) Nikola. Several offshore companies owned another 54 per cent. Until the Bulgarian government ordered it to change, Naftex had used the name Yukos Petroleum - Bulgaria though it was unrelated to the Russian Yukos oil company.

The government also succeeded in privatizing UBB at the end of 1997. The initial foreign ownership of UBB was 35 per cent Bulbank (the government-owned ex-Bulgarian Foreign Trade Bank), 35 per cent EBRD and 30 per cent Oppenheimer & Co. on behalf of several investment funds specializing in emerging markets. This meant that control de facto remained in the hands of the Bulgarian government.

The 1998 privatization of Post Bank put control of that institution unambiguously in private hands. Alico (the life insurance subsidiary of the AIG insurance group) and Consolidated Eurofinance Holdings (a Swiss firm owned by the Greek Latsis oil and shipping group and the owner of Athens-based EFG Eurobank), acquired 78 per cent of Post Bank (PB) for US$38m after negotiations with Nomura International collapsed. The Bulgarian Posts, Bulgarian Telecommunications Company, State Insurance Institute, DSK Bank and the National Palace of Culture held the remainder of the shares. PB was one of the largest Bulgarian banks with 28 branches and 84 offices and customer services desks. PB also has an agreement with the Bulgarian Post Office for the bank to work through postal system's 2,760 post offices. The purchase agreement committed the owners for the next five years to turn over 10 per cent of pre-tax profits to charities and non-profit institutions in Bulgaria via the Bulgarian government.

That same year, T.C. Ziraat Bankasi, a Turkish bank, opened a branch in Bulgaria. This was the first operation in Bulgaria by a Turkish bank since the departure of the Ottoman Bank. Despite the ethnic cleansing of the Convention of Adrianople (1913) and the Communist regime's encouragement of Turkish emigration (Erhard 1991), Bulgaria still has a large Turkish minority. Also, Turkish firms are starting to set up plants across the border in Bulgaria to use as a base for circumventing European Union and US textile quotas.

The Bayerisch-Bulgarische Handelsbank GmbH became HypoVereinsBank Bulgaria.[22] Piraeus Bank acquired the Macedonia Thrace Bank. Bulbank also wholly-acquired its domestic subsidiary, Corporate Commercial Bank, but sold Litex Bank to local investors in

[22] Bayerische Vereins Bank and Bayerische Hypotheken- und Wechsel-Bank merged in 1999 to form HypoVereinsbank. In 2002, HypoVereinsBank Bulgaria became HVB Bulgaria.

Lebanon.[23] BRIBank changed its name to Bulgarian Reconstruction and Investment Bank – BRIBank – as Russian ownership fell to less than 1 per cent following a crisis there.

In fall 1999, Société Générale (France) purchased Expressbank from the Government for US$39m. After its privatization, the bank took the name SG Expressbank.

Later, Regent Pacific Group acquired Hebros Commercial Bank for US$24m in a privatization. Now iRegent pledged to invest US$ 5m in 2000, US$ 3m in 2001, and US$ 2m in 2002 to help further recapitalize the bank. The iRegent Group is an investment management company specializing in emerging-markets.[24]

Demirbank, the second Turkish bank to enter Bulgaria, established a subsidiary. Oppenheimer sold part of its stake (17 per cent of the total) in UBB to a subsidiary of the American International Group (AIG), Cyprus-based Jodral Enterprises. Piraeus Bank acquired Xios Bank. The International Orthodox Bank Sveti (St.) Nikola bank changed its name to Neftinvestbank. The BNB allowed Refco Capital Markets, part of the Refco Group, to buy 20 per cent of the shares of BRIBank.[25]

In 2000 Bulbank sold its shares in Corporate Commercial Bank (99.9 per cent), UBB (35 per cent) and HypoVereinsBank Bulgaria (49 per cent) as part of its preparation for

[23] It apparently sold Litex, which no longer had a role in the bank's strategy, to raise capital (Dilova-Kirkowa 1999).

[24] The iRegent Group is registered on the Isle of Man and quoted on the Hong Kong Stock Exchange. In 2002 Regent Europe bought back the 20 per cent stake in itself held by iRegent and changed its name to Charlemagne Capital. For an interesting discussion of Charlemagne's activities in Croatia see Hickey (2001). Charlemagne's activities and strategy are similar to those of iRegent and the two continue to collaborate.

[25] The Refco Group is named after Ray E Friedman, a former livestock trader who sold the business to his stepson, Thomas H. Dittmer, in 1974. The US-based firm became active in commodity futures trading and is now a diversified financial services firm. In May 1999, Refco entered into alliance with Bank für Arbeit und Wirtschaft-BAWAG, Austria's 4th largest bank. Under this alliance, BAWAG acquired 10% of Refco. Dittmer and senior officers of the firm apparently hold the remainder of the shares. Bayerisches Landesbank owns 46% of BAWAG, which is also closely allied with the Allianz insurance group.

privatization. Then the Bank Consolidation Company (BCC) completed the privatization of Bulbank, selling its shares to UniCredito Italiano (93 per cent) and Allianz (5 per cent).

National Bank of Greece bought UBB from Bulbank, CIBC Oppenheimer, AIG and the EBRD. The EBRD retained a 10 per cent stake, though NBG had a two-year right of first refusal to buy the EBRD's remaining stake if the EBRD wished to sell.

BRIBank acquired the insolvent Stopanska Banka (Economic Bank). Later that year BRIBank changed its name to Economic and Investment Bank (EIBank).

In Turkey, Demirbank Bank failed. Demirbank (Bulgaria) provided the first instance of a foreign institution with operations in Bulgaria undergoing bankruptcy. The news did not cause much of a stir in Bulgaria, though some deposits fled. The BNB investigated and announced that because the Bulgarian subsidiary had sufficiently large short-term deposits in European and American banks, there was no need to liquidate the operation. The Savings Deposit Insurance Fund of Turkey sold Demirbank to HSBC, but retained several of the subsidiaries. Later that year the Fund sold Demirbank (Bulgaria).[26]

In 2001, a consortium of foreign development agencies (IFC, DEG, Internationale Micro Investitionen Aktiengesellschaft and EBRD) joined with Commerzbank to establish ProCredit Bank as a bank specializing in microfinance and lending to small and medium enterprises. The group founded the bank after acquisition talks with Eurobank fell through.

BNP and Dresdner Bank ended their cooperation in Eastern Europe with BNP taking over their joint operations in Poland, Hungary and Bulgaria, while Dresdner took control of their joint operations in Russia, the Czech Republic and Croatia. UniCredito sold minor

[26] The buyers were Mr. Halit Cingillioglu and Mrs. Isil Dogan (50 per cent each). The Cingillioglu-Dogan consortium also bought Demir Halk-Bank N.V., Demir-Kyrgyz International Bank and Demir Kazakhstan Bank for US$95m for the four.

stakes in Bulbank to SIMEST (an Italian company; 2.5 per cent) and the International Financial Corporation (5.3 per cent).

In July 2002 the Bulgarian Bank Consolidation Company was finally able to privatize Biochim Bank. The purchaser was the Bank Austria/Creditanstalt Group (BA/CA), a subsidiary of HypoVereinsBank Group. HypoVereinsBank plans to merge Biochim with its subsidiary HVB Bulgaria. The privatization of Biochim has brought foreign ownership of Bulgarian bank assets to about 80 per cent.

**Discussion**

Many of the foreign banks operating in Bulgaria, especially those operating via branches or small, wholly-owned subsidiaries, are essentially engaging in normal international banking. Examples would include ING, BNP Paribas, Citibank and Raiffeisen. These banks' borrowers tend to be foreign firms or the most creditworthy of Bulgarian enterprises. For instance, in 2000 Citibank provided a US$77mn loan to help Bulgaria modernize two reactors at its Kozloduy nuclear power plant.

Piraeus Bank and Alpha Bank appear to be a classic case of banks following their clients. The Greek banks began by concentrating on trade finance and serving Greek firms in Bulgaria. Greek firms and individuals rushed back into Bulgaria, Romania, and elsewhere in the Balkans and the Black Sea in the early 1990s (Kamaras 2001), reestablishing a presence that began before Christ but that had been obliterated during most of the 20$^{th}$ Century. NBG and CBG began the same way though they have gone on to acquire larger banks in order to benefit from bringing them up to standard.

T.C. Ziraat Bankasi and Demirbank similarly follow Turkish business. Their operations may include an element of ethnic banking as well.[27]

After the collapse of the Hapsburg Empire, several Austrian banks followed a Danubian strategy (that is, they attempted to expand into countries along the Danube), as did Austrian trade generally (Nautz 1994; Preshlenova 1994; Weber 1995). Today the large Austrian banks appear to be trying it again.

In addition, the transition process and especially privatization has created opportunities for opportunistic investors. The investors include everything from various quangos and development banks to banks, investment or private equity firms and individuals betting on the success of Transition. For instance, First Investment Bank (FIB) counts among its shareholders the EBRD (20%) and the Vienna-based European Privatization and Investment Corp (EPIC; 39%). EPIC is an investment vehicle that has been purchasing shares in privatized companies in Central and Eastern Europe. Investors like EPIC do not intend to manage banks or even to invest for the long term. Their involvement is almost purely financial. They acquire a wide range of assets and businesses as they can and hope to create the bulk of the value to themselves through shrewd deal making. In time one can expect them to exit due either to the success or failure of their investments. In the case of FIB the remaining shares are in the hands of Bulgarian individuals and firms, some of whom actually manage the bank. EPIC is relying in part on the EBRD's oversight of FIB as the EBRD is involved in approving large loans and in agreeing strategy.

The banks participating in the privatizations such as UniCredito Italiano, National Bank of Greece and HypoVereinsBank, and the investors and banks such as iRegent, ALICO-CEN, Commercial Bank of Greece, and Société Générale are a different story. They are not

[27] Ethnic banking involves the providing of banking services to home country nationals

just contributing capital. They expect to earn a return on risk capital but also on the management skills, systems and experience that they bring to bear. These are the analogues to the pioneering species and weeds of ecological succession. iRegent hopes to sell out in three to seven years. Even for the others, their own success will ultimately limit their role.

The first mechanism is the analog to the tolerance mechanism in ecological succession in which the later species are more tolerant of the limited resources that prevail when competition is well established. The competition between foreign banks to raise deposits and make loans will reduce the deposit-loan interest spread. When the foreign banks no longer earn rents, this will reduce their incentive to grow, or even to remain. Furthermore, the reduction in spreads should result in an increase the size of the banking sector relative to GDP. In time the nascent Bulgarian-owned banks will be in the best position to benefit from this growth.

The biggest long-run problem for foreign banks is that they have no particular advantage when engaging in general commercial and retail banking in already competitive markets. It is not surprising that researchers have found that in industrial countries foreign banks tend to have lower margins and profits than domestic banks whereas the opposite holds true in developing countries (Demirgüç-Kunt and Huizinga 1999; Claessens *et al.,* 2001).[28] Thus in industrial countries foreign banks tend to avoid the retail market except in the niche market of ethnic banking (Tschoegl 1987).

Furthermore, the principle of comparative advantage implies that economic agents, whether individuals, firms or countries, do best when each specializes in what it does most best or least worst. Thus, even if the foreign banks are better than local banks at both

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resident in the host country.

foreign and corporate banking on the one hand and retail banking on the other, the local banks will have a comparative advantage in retail banking. That is, the local banks will be less worse at that than at foreign and corporate banking.

However, there is good reason to expect that ultimately foreign banks will be less good than local banks at some banking business. Berger et al., (2002) argue, on the basis of theories of incomplete contracting, that small banks may do better than large banks at processing soft information. Bank lending to small firms is one area that relies heavily on soft information even in developed economies and even more so in Transition economies where the infrastructure to produce hard information is still nascent. Berger et al. (2002) find that large banks are less willing than small banks to lend to firms that do not keep formal financial records and are more likely to have impersonal, shorter and less exclusive relationships with borrowers. By necessity the foreign banks that have acquired Bulgarian banks are large. It follows then that the foreign-owned banks will, relatively at least, neglect lending to small firms, leaving open a niche for small, locally-owned banks eventually to enter. Furthermore, deposit insurance will remove a major impediment to the growth of the local banks, the perceived greater safety of large, foreign banks relative to small, local ones.

The second mechanism supporting the erosion of the prevalence of foreign ownership is the analog of the facilitation mechanism in which the presence of the early species prepares the way for the later species. The foreign banks' efforts to improve their acquisitions will increase the competence of the Bulgarian bankers in the banks the foreigners have acquired. In time some of these individuals will leave to found good local banks. Lessard and Tschoegl (1984) found examples of this occurring in Panama in the early

[28] However, one caveat is in order; a cross-country study found evidence that foreign banks engage in relatively extensive profit shifting, making any firm statements about the profitability of foreign banks suspect (Demirgüç-Kunt and Huizinga 2001).

1980s as officers of US banks in Panama quit to found their own banks in Panama. Others will have the credibility to be able to muster the capital to execute a management buyout of the Bulgarian subsidiary for which they work. To do so they are likely to draw on the same deal-oriented opportunists that are active today and that are not oriented towards exercising management control or maintaining a long-term presence.

Banking itself will also become easier in some ways. The activities of the foreign banks will improve the quality of the borrowers. The expansion of credit reporting databases and the improvement of debt enforcement will reduce the prevalence of fraudulent borrowers. Bulgarian lending officers will become more experienced at judging risk. Experience with banks and their demands for information will train borrowers and result in self-selection. Borrowers unable or unwilling to meet bankers' expectations will be driven out of the market. Better borrowers will make it easier for small banks to start. These will grow and in time be in a position to acquire the Bulgarian subsidiary that foreign parents divest.

Selling implies the existence of a buyer and that may seem far-fetched today. However, it will be less so in twenty years. Over the next decades not only will successful domestic firms and banks develop, but again there will be individual Bulgarians with the personal credibility, based probably on their success in foreign-owned banks, to be able to arrange funding for acquisitions and buy-outs.

Already there are banks such as FIB that are Bulgarian-managed though the bulk of the shares are in the hands of passive foreign owners. Also there are several banks—Roseximbank, Corporate Bank, First Eastern International Bank, International Trade and Development Bank and Economic and Investment Bank—that appear to be Bulgarian-owned in fact if not in law. Although the majority of the shares in these banks are in the hands of offshore companies and foreign-registered companies, most observers believe that the ultimate owners of these offshore companies are Bulgarian individuals.[29] In time the more successful among these banks will be in a position to buy the less successful among the foreign-owned banks.

The third mechanism supporting the erosion of the prevalence of foreign ownership is the analog of the competitive hierarchy mechanism in which late succession species start to arrive as members of early succession species reach the end of their life-cycle and die out. Over time, even those foreign-owned banks that are successful in Bulgaria may leave because of problems at home. In the 1980s, eight Japanese banks had retail subsidiaries in California; now three do. Of the five that have disappeared, three disappeared when mergers among the parents resulted in mergers between the subsidiaries. The survivors are the three subsidiaries that still exist. One subsidiary was sold to a French bank and another was sold to a US bank as the parents sought to raise funds to rebuild their own capital bases. The point is that departure did not require the failure or even weak performance of the California operation. Departure just required that the parent have a more pressing or profitable use for its capital.

The last mechanism supporting the erosion of the prevalence of foreign ownership is the analog of the reverse interference mechanism in which late succession species interfere with the continuation of early succession species. This could occur if the domestic banks lobby successfully for restrictions of foreign-owned banks. Bulgaria's accession to the EU is likely to limit the successful pursuit of protectionism masquerading as nationalism and so limit the applicability of this mechanism.

What all this means is that even when one observes cases where foreign banks initially dominate a country's banking sector, one should expect to see them exit retail banking and

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[29] Cyprus is a popular place of incorporation for these sort of operations.

specialize in foreign activities *pari passu* with the emergence of local competitors. This was the experience, for instance, of Cyprus vis-à-vis the British banks (Phylaktis 1988), the foreign banks in Saudi Arabia and Oman (Tschoegl 2002a), the foreign banks in Japan (Tatewaki 1992 and Tschoegl 1988), and the British banks in Australia (Merrett 1990). These cases are all relevant to the case of transition economies because in each case the banking system started out wholly in the hands of foreign banks with domestic ownership emerging later. In Cyprus, the British banks had lost their predominance well before the end of British colonial rule. Only in Saudi Arabia did the government exert much economic nationalism and as Tschoegl (2002a) points out, it is not clear that this had a material effect in speeding up the transition. More generally, in a recent article Dopico and Wilcox (2002) found that foreign banks have a greater share in markets that are underbanked; conversely, foreign banks have a smaller presence in mature markets.

Particularly well-run foreign banks will probably continue the longest. Those foreign banks that are among the largest banks in their home markets may linger also. Unable for anti-trust reasons to grow at home, they will endeavor to grow abroad. This is the motivation for some foreign banks to own retail banking subsidiaries in the US (Tschoegl 2002b). Probably Greek banks will be prominent among those seeking to grow abroad. The Greek banking market is already highly concentrated and the Greek government is unlikely to favor mergers among the large banks. Several of the leading Greek banks have already embarked on a regional strategy in the Balkans and the Black Sea. The parents are building portfolios of banks, partially through de novo entry, partially through privatization and partially through the acquisition of failed banks.

In all this, the role of accession to the EU and the adoption of the €uro have ambiguous effects. Accession will cause Bulgarian law and regulations to converge towards a pan-

European model. The convergence of home and host regulations and practices will make it easier for foreign banks to operate in Bulgaria but to the degree that the new regulations improve the climate for banks over all, they will also make entry easier for Bulgarian banks.

However, adoption of the €uro directly, or even indirectly through a currency board, reduces the foreign banks' need to own a domestic bank. Historically, foreign banks have often faced difficulties when their home country clients or large domestic firms clients have sought host-country currency loans. In many countries the thinness of local inter-bank money markets has constrained the foreign banks' lending. Furthermore, Berlin and Mester (1999) argue that access to stable deposits permits banks to offer loans that insulate borrowers from exogenous interest rate shocks. To deal with these issues some foreign banks have responded by buying a local bank as a source of local currency deposits. The advent of the €uro means that foreign banks can lend locally without a local subsidiary as a source of deposits. Instead they can simply lend through a branch in the host country.

Lastly, the development of the banking systems in neighboring countries too will have ambiguous effects. Currently many of the same foreign banks that are active in Bulgaria are also active in Rumania, Hungary, Serbia, Albania, and Macedonia. When a foreign parent such as the National Bank of Greece owns banks in several Balkan countries it provides an indirect bridge between any two countries in which it has a presence. Should it leave one of the pair, perhaps by selling its subsidiary to local owners, the new owners are likely to re-establish the bridge by opening their own branch in the other country. Thus the process of withdrawal by some foreign banks may result in the replacement of the withdrawing party by another foreign bank, this time from a neighboring country. Whether this will result in a net increase in a percentage increase in foreign ownership rather than just an increase (if that) in the number of foreign banks is an open question.

**Conclusion**

The history of foreign banks in Bulgaria suggests one lesson and one forecast that one can combine in a metaphor. The lesson is that foreign banks are opportunistic, flooding into newly opened environments. The forecast is that over time any domination by foreign banks will wane. The metaphor is that foreign banks are weeds in a domestic banking system; they are opportunistic plants in a process of succession.

After the liberation from Ottoman rule and again after World War I, foreign banks entered Bulgaria in some numbers. They did so for a third time after the fall of Communism. As Nikolai Bukharin (1917) wrote:

> "It is finance capital that appears to be the all-pervading form of capital, that form which, like nature, suffers from a *horror vacui*, since it rushes to fill every "vacuum," whether in a "tropical," "sub-tropical," or "polar" region, if only profits flow in sufficient quantities."

Bukharin correctly identified the opportunistic nature of foreign banks. However, he failed to identify a pre-condition and a consequence. First, foreign banks require that conditions be propitious. Thus even after the fall of Communism, Bulgaria resisted selling the country's principal banks to foreigners. This disquiet continued a preference for Bulgarian and even state ownership that dated back to the country's founding. Although foreign banks re-entered Bulgaria after World War I, from the mid-1920s on the state directly or indirectly controlled 80 per cent of all credit (Avramov 1995). Some observers have even suggested that one reason for Bulgaria's "backwardness" is the country's history of government intervention in the economy (Avramov and Sgard 1996).

However, the experience of the 1990s brought an ever-widening recognition of the often overriding advantages of inviting foreign banks in (Buch 1997). First, foreign partners could bring in capital, management skills, systems and experience. Second, foreign ownership of the largest banks could stop the government's exploitation of its banks to keep alive failing but politically sensitive companies, and the concomitant need periodically to bail out the banks. With several successful privatization completed and one still to go, the bulk of the Bulgarian banking system's assets are now under foreign management.

The second point that Bukharin missed is that the initial entry is only a phase in a succession process. Some part of the entry is normal international banking activity that will persist for the long run, but never be of much quantitative importance. A second part is a betting on the success of the Transition process. This too is self-limiting.

The third part, and the one that draws the most concern in Bulgaria as in many other countries around the world, is the majority ownership of large commercial banks by foreign strategic investors, that is, investors that manage the banks. However, to the degree that the strategic investors are successful, this presence too is self-limiting. As the Bulgarian banks, foreign and domestic-owned alike, become more competitive and adept, the foreign owners will no longer have a comparative advantage in general retail and commercial banking, even if they retain an absolute advantage. Thus in time we can expect the owners to withdraw, selling their banks to Bulgarian owners. Just as in the case of the natural world where eventually the normal flora re-establish themselves after a disturbance, relegating the weeds to a marginal presence, in time the bulk of the assets of Bulgarian banking system will again be managed by Bulgaria-owned banks. Still, what the metaphor of ecological succession suggests is that the process is one that will unfold not over years but rather over decades.

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**Table 1: Structure of the Bulgarian Banking System, 1992 - 2000**

| Ownership | | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| State | Number | 72 | 69 | 25 | 15 | 12 | 7 | 6 | 5 | 7 | 3 | 3 |
| | Savings | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | | | |
| | Share (%) | 98.5 | 96.8 | 93.6 | 84.4 | 76.9 | 82.5 | | | 51.1 | 17.6 | 18.1 |
| Bulgarian private | Number | 6 | 11 | 15 | 23 | 22 | 13 | 13 | 11 | 7 | 9 | 10 |
| | Share (%) | 1.5 | 3.2 | 6.4 | 15.6 | 22.4 | 15.2 | | | 6.9 | 9.9 | 10.3 |
| Foreign | Subsidiaries | | | | 0 | 3 | 5 | 9 | 10 | 13 | 15 | 16 |
| | Branches | | | | 2 | 4 | 4 | 5 | 7 | 7 | 8 | 7 |
| | Share (%) | | | | 0.1 | 0.6 | 2.3 | | 25 | 42 | 73 | 72 |
| All banks | Number | 79 | 81 | 41 | 41 | 42 | 30 | 34 | 34 | 34 | 35 | 35 |
| | Assets (BL Bn) | 463 | 582 | 810 | 1072 | 1,089 | 3,301 | 8,076 | 7,589 | 8,223 | 9,774 | 11,908 |
| $H^2$ (a) | | 0.38 | 0.33 | 0.30 | 0.15 | 0.11 | 0.19 | 0.12 | 0.11 | 0.12 | 0.11 | 0.09 |

Notes: (a) $H^2$ is the Hirschman-Herfindahl index. $H^2$ is the sum of the squares of each bank's share of the total assets in the banking system. $H^2$ ranges between 1, which represents a situation of monopoly, and 0, which would represent complete dispersion.

Source: BNB; Ignatiev (1997); Miller and Petranov (1996); Miller and Petranov (2001).

**Table 2: Foreign Banks in Bulgaria**

**Branches of foreign banks**[1]

| Bank | Comment |
|---|---|
| Alpha Bank | Ex-Ionian Bank |
| Citibank | Entered 2001. |
| HypoVereinsBank | Bayerische Hypo- und VereinsBank AG, |
| ING Bank | |
| National Bank of Greece | |
| Piraeus Bank | Former Xiosbank. |
| Société Générale | Closed during 2001. |
| T.C. Ziraat Bankasi | |

**Locally incorporated banks with foreign ownership**[2]

| Bank | Branches | Comment |
|---|---|---|
| Biochim Bank | 155 | BA-CA Group (HypoVereinsBank) – 99.6% |
| BNP-Paribas (Bulgaria) | 3 | Former BNP-Dresdnerbank. BNP Paribas - 80%; EBRD - 20% |
| Bulbank Ltd. | 29 | UniCredito Italiano S.A. - 85% |
| Bulgaria-Invest Commercial Bank Ltd. | 15 | Allianz Bulgaria Holding, Germany - 79% |
| Bulgarian American Credit Bank | | Bulgarian-American Investment Fund |
| Bulgarian Post Bank | 30 | ALICO/CEN Balkan Holdings Limited, USA - 86% |
| Demirbank (Bulgaria) | 2 | Cingillioglu-Dogan consortium |
| Economic and Investment Bank | 10 | Former BRIBank (Bulgarian-Russian Investment Bank). Refco Capital Markets Ltd., Bermuda - 20% |
| Eurobank Plc | 21 | Istrocapital - Bulgaria (Slovak Rep.) - 85% |
| First Investment Bank | 9 | Eur. Privat. and Invest. Company, Austria - 39%; EBRD - 20%; First Financial Brokerage House - 14%. Rep offices: Cyprus & Albania |
| HVB Bulgaria | | HypoVereinsBank Group – 99.6% |
| Hebrosbank | 69 | iRegent Group - 98% |
| Commercial Bank of Greece (Bulgaria) | | ex International Commercial Bank. Commercial Bank of Greece - 64%. |
| ProCredit Bank | 7 | IFC, DEG, EBRD, Commerzbank and IMI |
| Raiffeisenbank (Bulgaria) | 8 | Raiffeisen Central Bank Österreich |
| SG Expressbank | 22 | Société Générale, Paris - 98%. |
| Tokuda Credit Express Bank[3] | 9 | International Hospital Services Co., Japan - 53%; Bulstrad - 33%. |
| United Bulgarian Bank AD | 57 | National Bank of Greece - 90%; EBRD - 10% |

Notes: 1) All foreign banks operating as branches of the parent are located in Sofia. 2) Shareholders of over 10%; http://www.bfia.org/banks.htm 3) Limited domestic license.

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