

EVOLUTION OF THE BANKING SYSTEM IN LITHUANIA: FROM STATE-OWNED MONO-BANKS TO A MODERN BANKING SYSTEM (1988–2004)

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The creation of a modern banking system in a post-command economy is the subject of this article. The case of Lithuania is investigated throughout the time period of 1988–2004, which is divided into four periods: genesis, early stage, crisis period, and late stage. The substantiality and importance of experience accumulation and learning is shown as a considerable factor of the system building. The initial part is intended to provide some broader, although brief characteristics of the environment in which the new banking system of Lithuania was emerging. The second part provides the chronological process of events in the area. An attempt of periodization of systemic economic reforms is presented in the third part. The final chapter contains some conclusions.

Key words: banking system, Bank of Lithuania, legal regulation of banking, disturbances in banking system, bank privatization.

Introduction

The process of systemic transformation of the former Soviet-type command economies towards the market system has been thoroughly investigated and its regularities largely disclosed. Three groups of measures, liberalization, privatization, and stabilization, have been named as the principal directions of systemic changes (Balcerowicz, 1998, 129, 152–153; Balcerowicz includes privatization into a broader concept of restructurization of main social institutions).

However, the main features having been identified and described, one more regularity deserves to be defined as characteristic of the countries which embarked on to radically transform their economic and political systems, which is the importance of experience accumulation and learning. This especially concerns the sectors of the economy which either did not exist in the centralized economic system or were represented just by title but not by content. The modern banking system is the case among several others (almost all of them are market

system institutions non-existent in the command economy).

The market economy is characterized by two layers: the financial system, which comprises money and capital markets (i.e. the banking sub-system, insurance institutions and securities market) and the layer of real economy, embracing all units that produce goods and provide services for the satisfaction of consumers' and producers' needs.

The financial system warrants that the savings collected by most of production units and households are promptly transferred to a relatively small group of investors who use them to augment the nation's production capacity.

In other words, the real growth of a market economy depends on the functioning of its financial system. Since the growth (the rate of growth) is of crucial importance for the newly emerging market economies, so is the role of their financial systems.¹ This is especially so with regard to the banks which are the core of the modern financial systems. Together with other financial institutions, banks help to solve problems of market failures, such as market incompleteness, transaction costs, externalities and informational asymmetries (Reininger, Schardax and Summer, 2002, 7).

¹ The former communist countries, after they turned to systemic transformation, were classified as "transition countries". In its semi-annual *World Economic Outlook*, the International Monetary Fund had used to divide countries of the world into three major groups: advanced economies, developing countries and countries in transition (*World Economic Outlook. September 2003*. – IMF. Washington, D.C., 2003, p.163). Beginning from the spring 2004, IMF has changed the classification; now countries are grouped into two broad categories: advanced economies (29 countries) and other emerging market and developing countries (146 of them). – See *World Economic Outlook. April 2004*. – IMF. Washington, D.C., 2004, p.176–177.

Lithuania's economic development confirms both the importance of the newly created (or radically restructured) financial system (with banking as a sub-system) and the necessity of a certain period of time for experience accumulation and learning. It also cautions about the danger of structural destabilization in the banking sector and, presumably, in the whole economy. A more precise investigation of the Lithuanian case of modern banking system creation provides strong arguments for the need, on the one hand, not to overlook the threats of ignorance and lack of expertise and, on the other hand, of the necessity of institution building and management professionalization at the initial stages of a systemic economic reform.

The surroundings of systemic banking transformation

In the period under review, Lithuanian commercial banks started operating as independent economic actors gradually rising their role in economic development. The expansion of banks was determined by the political, economic, public and social changes that were taking place in Lithuania. With changes in the whole political, economic, social and geopolitical situation, time was needed not only to convince the society that banks were the best institution for saving, but, at the beginning, to secure that banks are not established by crooks.

Like the other post-communist countries of Central and Eastern Europe², Lithuania failed to avoid problems in the activities of banks. The

² A study covering three Central European countries (Czech Republic, Hungary and Poland) revealed that all of them had experienced banking crisis in the initial phase of transition. The main causes of the crisis have also been basically the same (Reininger, Schardax and Summer, 2002, 77).

fall of some commercial banks, which took place in 1995–1996, shocked the society and disclosed the imperfection of the bank activities. The consequences of collapses of commercial banks were felt long. On the other hand, after the cure of the banking system, the policy and activities of Lithuanian banks, including the central bank (Lietuvos Bankas) policy and, managed to become trustable providers of savings and credit services for the national economy.

The economic science, viewing retrospectively from the one and a half decade that has elapsed, is now in a position to make an objective assessment of the process of development of commercial banks, evaluate the reasons for the definite situations, activities of various officials, as well as their influence on the restoration and development of the domestic banking system.

There is still a lack of scientific research necessary to characterize the development of commercial banks during the period under review in an integrated way. The issue of bankruptcies of some and of the collapse of the largest banks has not been sufficiently investigated yet, despite the fact that attempts have been made to discuss the problem in one aspect or another (Fleming, Chu, Bakker, 1997, 42–45)

Research of this kind after restoration of independence was carried out neither in Lithuania nor in the other Baltic States. Few similar works may be traced in other Eastern and Central European countries in transition, therefore the authors of the present paper had to elaborate their own methodology of the investigation of the topic (The Economist, 1997; Rostowski, 1995, 233; Dziobek, van der Vossen, 1999, 157).

The paper covers the chronological limits of 1988–2004. The beginning of the period dates back to 1988, when, during the years of “perestroika” and National Revival, the genesis of the contemporary national banking started; the in-

vestigation ends with the year 2004, when Lithuania became a member of the European Union.

The development of the Lithuanian system of commercial banking, discussed in the paper, is divided into four periods: genesis, early stage, crisis, and late stage. Various phases of development of the banking system are characterized considering both essential moments in the country’s political and economic life and the events that were the turning points for the object under investigation and had a decisive influence on the priorities during different periods and a direct influence on the development of contemporary commercial banking.

The historical process of modern banking formation in Lithuania

The beginning of the contemporary domestic banking in Lithuania dates back to the years of “perestroika” (1988–1989). In the period of National Revival, the issue of the establishment of the Lithuanian banking system became an integral part of the concept of Lithuania’s economic sovereignty (Liekis, 2000) In accordance with the concept of national banking, a plan was drawn to restructure the Soviet mono-banking system into a two-tier banking system, with the traditional functions of the central bank entrusted to the Bank of Lithuania (Lietuvos Bankas) established (re-established) in March 1990, i.e. shortly after the restoration of independence had been proclaimed (11 March 1990) (Terleckas, 1995).

The development of banking in Lithuania during 1988–1990 virtually depended not only on the fundamental economic restructurings that were taking place in the country, but also on international political events. As long as the international community had not recognized Lithuania as an independent state, the Bank of Lithua-

nia could not be recognized by western central banks as the central bank of Lithuania. The creation of a contemporary banking system in Lithuania was delayed by an economic blockade launched by the Soviet Union in April–June 1990 and the absence of international recognition of the State of Lithuania, which ended along with the failure of the *coup d'état* in Moscow in August 1991.

Although some changes (towards commercialization³) took place before the restoration of independence, the more profound transformation began on the ground of resolutions passed during 1990. The banking reform was accelerated by adopting legal measures narrowing the scope of activities of some state-owned specialized banks at the same time, and the material basis of the Bank of Lithuania was developed from two formerly specialized banks (Lietuvos Respublikos Aukščiausios Tarybos ir Aukščiausios Tarybos Prezidiumo dokumentų rinkinys, 1991, 115–116). After nationalization of Soviet banks, their commercial functions and customers were inherited. The commercial banks that already operated at that time were actually in a position to accumulate capital for the Bank of Lithuania. At the end of 1990, the Lithuanian Bank of Industry and Construction alone was able to transfer over 10 million roubles to the reserves of the Bank of Lithuania.

In the process of development of the contemporary banking system in Lithuania, opinions of the representatives of two economic schools

– advocates of Lithuanian banking pattern in the pre-war period and those of the contemporary free market model – clashed. This affected the development of both the Bank of Lithuania and of domestic banking in general. As the first view prevailed during the first phase, creation of modern banking was delayed in Lithuania.

The following tasks of utmost importance were solved at the initial stage of the banking reform: Lithuanian banks were separated from the banking system of the Soviet Union and nationalized, the Bank of Lithuania was established and started operating, foundations were laid for the activities of state-owned and private commercial banks.

The major legal acts passed for the regulation of activities of commercial banks provided favourable conditions for their growth in quantitative terms. Since the legal acts regulating the activities of commercial banks were quite liberal, many companies and small groups of individuals capable of accumulating primary capital were able to establish banks. By the end of 1993 there were 28 banks in the country (Bankų statistikos metraštis 2002, 2003, 11)

In 1991, when voucher privatization started, a number of new market entities emerged and took hold of a considerable share of the national economy. This was used as an opportunity to accumulate property for various criminal groupings as well, which began forming up at that time. Exploiting lax banking and commercial laws, as well as the poor banking supervision, these groups made a significant negative impact on the position of commercial banks and actually jeopardized the stability of the banking system of Lithuania.

One of the most serious problems during the original period was that, with minor exceptions, domestic specialists in finance had been trained for the planned economy. Most banks employed

³ The first legal acts regulating of the functioning of the contemporary banking system appeared during the years of "perestroika" and national revival. Although they provided a primary legal framework for the formation of the loan market of commercial banks, their complete enforcement was only possible in a sovereign state.

staff of low qualification and competence who, in extending credits, failed to perform a comprehensive analysis of the activities of their customers. Many new bankers and businessmen failed to adequately respond to the changes of the situation in various business areas, in the development of the national economy when many economic entities became insolvent.

While, due to the general economic deterioration, the financial situation of most enterprises kept worsening, the interests on credits and deposits as well as the bank margin remained very high, determining the accumulation of bad loans. One may also claim that depositors and small shareholders of banks indirectly contributed to the emergence of problems in the activities of credit institutions and banks. Initially, they received considerable interests and/or dividends and practically were not interested in the actual management of such credit institutions or in the use of funds accumulated by them.

At the beginning of transition to the market economy, commercial banks were not the only institutions to collect individuals' savings and legal entities' funds. In the period 1992–1994, various small credit companies, quite often established as financial "pyramids", became serious competitors to commercial banks by offering high interest rates and thereby managing to attract and subsequently appropriate considerable amounts of cash. The law of 15 July 1993 imposed a prohibition on savings collection and loan provision for economic entities other than credit (banking) institutions (Valstybės žinios, 1993, No. 31-714)

In 1993, when hyper-inflation showed the first signs of exhaustion, the national currency – the Litas – was introduced (on 25 June). Inflation, however, was still galloping, slowing down from the average rate of 1021 per cent in 1992 to 410 per cent in 1993 (Vetlov, 2002, 39). After

extensive national debate, the Government of Lithuania took the decision to shift its monetary policy to the currency board arrangement (CBA).

The Law on the Credibility of the Litas was passed on 17 March 1994 and as from 1 April 1994 the automatic money supply regime was in place. Litas was pegged to the anchor currency (the US Dollar, from 2 February 2002 the Euro). The supply of Litas was directly linked to the earnings of the anchor currency which, in turn, was inflowing the economy depending on its performance. Contrary to the ordinary monetary policy, under the CBA the inflation rate was the cause for money supply rise, not vice versa (Vetlov, 2002, 32).

Abandonment of the autonomous monetary policy severely limited the function of the Bank of Lithuania as the lender-of-last-resort. According to some analysts, partly because of this the Bank of Lithuania failed to properly perform its vital function of commercial banks' supervision. This, however, seems not to be true, at least objectively. On the contrary – introduction of currency board regime asks for "...a full set of appropriate prudential regulations, including on capital adequacy, domestic and foreign currency liquidity, loan loss classification and provisioning, open foreign exchange position, insider and large exposure and maturity mismatch limits" (Enoch and Gulde, 1997, 13). On the other hand, "...CBAs were not essential in ensuring fiscal discipline in the Baltics" (IMF Occasional Paper 151, 1997, 13).

As analysis of press reports, academic literature and documents of the time shows, during the pre-crisis period the activities of the Bank of Lithuania as the central institution in performing the functions of money and credit regulation and supervision on behalf of the state and all banks were over-influenced by the Seimas and the Go-

vernment. Despite the fact that the Bank of Lithuania's autonomy was objectively conditioned by its functions as the central bank, of which maintaining the stability of the national currency and prices was the most important, this autonomy was violated quite frequently during the period under discussion.

An effective operation of the central bank is only possible if it is not influenced by politicians and in the absence of any pressure on their part. In order to avoid such situations, many countries have introduced, by adoption of legal acts, some protective mechanism: management of the bank is appointed for a term, the duration of which exceeds the term of the Parliament and the Government. Unfortunately, this was not the case in pre-crisis Lithuania.

Another important peculiarity characteristic of the initial period was the model under which the central bank of Lithuania was also engaged in commercial activities, i.e. in accumulating savings and providing loans like a commercial bank. This can be regarded as an attempt to revive the pre-war traditions in the operation of the central bank under novel conditions, because in the pre-war time the central bank of Lithuania performed both the functions of the central bank and of commercial banks. Activities of the central bank, having taken this way, led to a deadlock both for the Bank itself and for the entire Lithuanian banking system, which was inevitably to occur sooner or later. In 1992, the Bank of Lithuania had to renounce its commercial functions, giving them over to the newly established State Commercial Bank of Lithuania.

It may generally be stated that early in the pre-crisis period the activities of commercial banks were greatly affected by the shortcomings in the legal regulation of banking activities. Even after the adoption of the main legal acts, the legal framework for commercial banking did not

crystallize properly. Such a situation resulted from the adoption of the national laws on commercial banking in 1992 and 1994, which affected the quality of bank activities yet could not prevent from cases of abuse. Neither the first Law on Commercial (Stock) Banks (containing the system of deposit insurance) adopted in 1992 nor the second Law on Commercial Banks (without such provision) adopted in 1994 were able to prevent cases of possible abuse (Valstybės žinios, 1992, Nr. 24-696; Valstybės žinios, 1995, Nr. 2-33).

The initial development of commercial banks showed that every inaccuracy or breach of legal acts distorted the activities of the banking system, bringing subsequently painful results. Legal acts for the regulation of activities of commercial banks in force at the time as well as other normative acts contained a number of deficiencies, quite often setting legal preconditions for the irresponsible behavior on the part of bank managers, clients or both. According to the effective legal acts of the time, in most cases a culprit who had committed a criminal act did not formally breach the legal norms regulating banking activities or the internal rules of the bank. In view of the above, from outside, such criminal acts looked lawful and later, in the course of the judicial proceedings, the material damage caused by such criminal acts would be justified by "the normal risk of the failure to repay loans" (Bužinskas, Šadžius, 2002, 45, 23-42).

Introducing an order into the legal framework of commercial banks could not be separated from the domestic legal policies in which a necessity for cardinal changes became increasingly evident. However, legal provisions of the Civil and Criminal codes in effect at that time lagged behind those of the legal acts passed and behind the establishment of basic provisions of the market economy, while some of them were

even contradictory for some time. This can be explained by the fact that drafting and passing legal acts related to a variety of spheres of domestic life was at the initial stage then.

Similarly to other post-communist countries of Central and Eastern Europe, which were implementing economic restructuring and changing over to the market economy, there were also broader reasons for banking system instability. It was the macroeconomic environment, the Lithuanian economic system itself, when the establishment and operation of most small credit institutions and commercial banks took place under inflation extended throughout the country. Rapid inflationary changes were taking place in the country: in 1991, yearly inflation was 382.7 per cent, in 1992 – 1163, 1993 – 188.7, 1994 – 45.1, 1995 – 35.7 per cent (as at the end of the year). The high inflation rates masked a poor credit evaluation. When the successful stabilization began to cut the rates of inflation, the banks' weakness in many cases came to surface (Dziobek, Pazarbasioglu, 1998, 9). The sudden inflationary changes undermined the financial situation of enterprises which began working under market conditions. At the beginning of the transitional period, the Lithuanian economy saw a considerable downturn. The rate of exchange of the national currency fluctuated widely.

Both the general situation in the national economy and disturbances in external markets affected the performance of banks. The unsound operation of companies, their bankruptcies forced banks to reduce their credit volumes. The economic situation in the CIS countries worsened the financial position of most economic entities, because mutual settlements were interrupted and funds were frozen. Therefore, the banking problems can be regarded also as reflecting the poor economic situation in the country at that time.

By the end of 1995, 27 commercial banks were registered by the Bank of Lithuania, but only 12 of them actually functioned (Lietuvos banko 1995 metų ataskaita, 1996, 24). This may be related to both the lack of competence, experience and qualified staff and the intended activities being based on unclear selfish reasons and goals as well. In addition, under the circumstances of relevant banking supervision and control, a considerable portfolio of bad loans accumulated. At the initial stage, banks extending credits actually did not require provision of collaterals and guaranties, because there was quite little private property in the country at that time. Banks were seriously damaged by the enterprises that had been awarded credits guaranteed by state-owned enterprises that later went bankrupt. The majority of credits so obtained subsequently became unwarranted credits. It was permissible without any good reason to collateralize low-value equipment and other tangible assets as well as to receive credits several times exceeding the value of their collateral. Quite often credits were issued against no collateralized property whatsoever, which set formal preconditions for squandering.

December 1995 may be considered the peak of disturbances in the activities of domestic commercial banks, when a moratorium on the activities of the two large commercial banks, JSC Lithuanian Stock Innovation Bank and JSC LITIMPEKS Bank, was declared. These banks held 17 per cent of the assets of banks in operation at the time. Although the collapse of these large banks did not develop into a general crisis of the banking system, it nevertheless made harm to the development of the financial system and the economy of Lithuania, and undermined trust in banks both domestically and abroad for some time. In 1995, because of the turbulence in the banking system, the national budget did not re-

ceive LTL 118.7 million. The downfall of the banks had a direct impact on 30 per cent and an indirect impact on 70 per cent of economic entities. Since the responsibility towards depositors had not yet become a legal category by that time, the population incurred huge losses. Due to the population's loss of confidence, individuals' deposits across the functioning banking system declined by LTL 377.6 million over the first three quarters of 1996. While in 1994 the assets of commercial banks made up 31 per cent of GDP, in 1996 they shrank to 19 per cent of GDP (Garbaravičius, Kuodis, 2002, 19).

The shock in the commercial banking system was caused by the inefficiency of legal acts, regulations and norms, of audit, internal control and banking supervisory institutions (Fleming, Chu, Bakker, 1997, 42–45). There was a lack of legal acts for the regulation of banking activities. The establishment of a legal framework lagged behind the extension of the credit market. The development (and improvement) of legal acts for the regulation of banking activities intensified only after the downfall of large banks, whereas not legitimized credit institutions and small banks started collapsing much earlier. The Bank of Lithuania controlled the activities of commercial banks (e.g., the infamous commercial bank “Sekundės bankas”) superficially, checking their submitted annual reports only. The Government and its divisions (Ministry of Finance and Ministry of the Interior) had no right to interfere with the activities of commercial banks. Manifestations of political lobbying were noticeable. Bank bankruptcies were determined by the inability of bank managers to adapt to the changing macroeconomic environment in due course, by the unprofessional management of banks, wrong lending policies and poor assessment and analysis of the business risks, and by restriction of

the functions of the Bank of Lithuania as the lender of last resort.

Implementing Resolution of the Seimas of the Republic of Lithuania of 29 December 1995 “On Urgent Measures for Addressing Banking Problems”, legal acts aimed at protecting individuals' deposits and enterprises' funds as well as at the restructuring of banks were drafted (Valstybės žinios, 1995, Nr. 107). Relevant amendments and supplements to the Civil Code, Criminal Code and Administrative Code were made, aimed at disclosing and putting on trial persons guilty of the downfall of banks, for criminal or administrative violations on their part.

After the downfall of banks, rapid expansion of the legal framework regulating the financial sector followed. The legal system of banking improved, much progress was achieved in adopting relevant legal measures. Newly adopted legal acts of the Bank of Lithuania had considerable influence on ensuring the stability of the banking system. However, the legislation of the Republic of Lithuania, like in the previous years, was quite often amended, and the formation of structures for its enforcement was too slow. This can partly be explained by the lack of administrative skills and, sometimes, by the absence of mid-term strategies.

Events and actions of the authorities that followed them witness the continuous process of learning in the sector. At that time Lithuania was already receiving technical assistance from the USAID (United States Agency for International Development) and from the EU (under PHARE programme and through the bilateral relations with its member states). According to the USAID-Lithuania Financial Sector Impact Report, over 15 mln USD were spent for programmes to assist the country in building the well regulated, robust financial environment con-

sisting of proper institutions and professional managers (Kriauciunas, 2000).

The creation and development of the Lithuanian banking system presents a particular example of the learning curve which demonstrates that unit costs are lower the greater is the cumulative output of an industry. Unfortunately, the specificity of identifying the learning process and its impact on direct and indirect (social) costs of bank services as well as on many other transition processes is still not recognized as a regularity.

Periodization and main factors of banking system creation in Lithuania

Analysis of shocks in the activities of Lithuanian commercial banks during the period 1995–1996 allows to claim that in the process of establishment of a contemporary, effectively functioning Lithuanian banking system the mistakes of the past need to be examined along with the experience of western countries in the area, because the banking systems of many countries have already gone through similar situations.

The measures of cure of the banking system and redrafting legal acts coincided, to a large extent, with the general rehabilitation of the national economy. The year 1995 was the first when the economic output stopped declining and turned upwards. A survey of several parameters of the development of banking and economy convincingly proves that during 1996–2004 Lithuania maintained good prospects for growth, enhanced its banking and financial systems, and increased and strengthened the private economy sector.

Gradually Lithuania opened up to international capital markets. The beginning of privatization of large state-owned banks, development of banking instruments and infrastructure has

created the necessary basis for capital movement and foreign investments in the country. Free movement of capital was achieved through ensuring unrestricted financial services across the entire domestic market, open and fair competition among economic entities, and the clear, stable and reliable financial sector. The attractiveness of the country's money and capital markets increased investments of foreign capital into the domestically operating banks (Lietuvos banko 1997 metų ataskaita, 1998). Similarly to other economies in transition in the context of universal globalization and liberalization, it was one of the main forces assisting the finalization of the market economy reforms and upgrading its performance.

The fall of some banks in Lithuania stimulated efforts to develop an efficient, stable and competitive system of commercial banking in the country. The banking sector strengthened, its role as a financial mediator increased. The trends of development during the period evidenced that the process of consolidation of domestically operating banks was gaining force. Implementation of the internationally acknowledged practice of conservative and reliable banking began in Lithuania.

The supervision of commercial banks was changed, challenged by increasingly complicated requirements. There was strengthening of relations with other financial supervision institutions inside the country along with close co-operation with the relevant supervisory authorities of the countries whose banks had their branches in Lithuania. Lithuanian commercial banks improved their internal control services, extended the rights of external audit, made the requirements for credit extension more stringent, and took active measures to increase their capital. Conservatism and prudence became increasingly evident in the activities of banks (Ramonas, 2002, 3).

In the process of transition to the market economy, association with the European Union and its subsequent membership became one of the most important strategic goals for the country. It may be expedient to divide the period under review into the following stages:

- 1) 1988–1991 – setting preconditions for the Lithuanian nation to re-establish its statehood, to take over the accumulated experience of western and US democracies, and to begin fundamental systemic reforms in the economy;
- 2) 1991–1995 – establishing contacts with the structures of the European Union and concluding co-operation agreements between Lithuania and the European Union;
- 3) 1995–1999 – signing the Association (Europe) Agreement between Lithuania and the European Union, filling-in the application for the accession to the EU, adoption of the national programme of Accession Partnership;
- 4) 1999–2004 – invitation for Lithuania to begin accession negotiations, transposition and implementation of the EU legal norms (*acquis communautaire*) into the national legal system, a national referendum on joining the EU, recommendation of the European Commission to accept Lithuania into the EU and the respective decision of the Copenhagen European Council in December 2002. On 1 May 2004 Lithuania, together with seven other Central and Eastern European countries and two Mediterranean states, became a member of the European Union.

For the Bank of Lithuania, the period from 1995, i.e. signing of the Association Agreement with the EU, meant the period of activities addressing the tasks related to a safe and effective functioning of the banking sector, ensuring free movement of capital and a stable financial sys-

tem. For addressing these problems, an inter-departmental group was established in the Bank of Lithuania on 19 January 1995. It elaborated a programme which was subsequently transformed into a part of the national law harmonization programme. New legal acts, adopted and harmonized with the European Union requirements by the Bank of Lithuania, had a major influence on assuring the stability of the system of commercial banks.

On the other hand, the crucial importance of privatization of largest banks in Lithuania by foreign investors (large Swedish, German and Finnish banks), as well as taking over the insurance business by Danish, German and Polish capital should not be ignored. T. Garbaravičius and R. Kuodis (2002, 47) conclude: “The increasing foreign ownership in the financial sector has brought stability, qualitative enhancements, increased competition, transparency and efficiency of financial intermediation.”

During the period 1996–2004, a few USAID and PHARE-financed technical assistance projects aimed at improving the banking activities domestically were implemented. Technical assistance was rendered for the purposes of improvement of monetary policy, banking legislation, supervision of credit institutions, capital market development, internal audit, strategic planning and accounting, as well as of the capacity of institutions to effect payments (Lietuvos banko 1998 metų ataskaita, 1999; Lietuvos banko 1999 metų ataskaita, 2000; Lietuvos banko 2000 metų ataskaita, 2001). Identification of the possibilities for Lithuanian commercial banks to compete on the European Union market and strengthening their positions was among the most important conditions that should ensure a smooth integration of the Lithuanian economy into the common market of the Community.

In pursuance of the strategic objectives of the national financial sector, the Bank of Lithuania prepared its proposals with regard to the following negotiation chapters: "Freedom to provide services", "Free movement of capital", "Economic and monetary union". One of the most significant works of the monetary policy of the Bank of Lithuania was the successful re-pegging of Litas, without changing the exchange rate, from the US Dollar to the Euro, which was accomplished on 2 February 2002 (Alonso-Gamo, Fabrizio, Kramarenko and Wang, 2002, 8-11). From 1 May 2004, after accession of Lithuania and nine more countries to the European Union, the national central banks of the new member states joined the System of European Central Bank. In the further move towards the integration into the Economic and Monetary Union (EMU), the Lithuanian national currency Litas on 27 June 2004 joined the Exchange Rate Mechanism (ERM) II. Thereby Lithuania began the process of fulfilling the convergence criteria. Lithuania expects within two or three years to be able to adopt Euro and thus become a full member of the Euroarea. It is believed that the benefits of adoption of Euro (elimination of the risk of exchange of currency, encouragement of investment in Euroarea, etc.) will be much bigger than the negative outcomes (the refusal of the possibility to re-install if the currency board regime is revoked, the autonomous monetary policy, rather high one-time expenses on exchange of currencies to Euro, some confusion in prices and their perception by general public; most of them

will be temporary and will mainly manifest themselves during the initial couple of years).

Conclusions

For the sake of generalization, some closing remarks might be formulated as follows:

firstly, in our opinion, the experience of the evolving Lithuanian banking system strongly evidences the importance of a well developed institutional framework in a market economy. This, in turn, means that a new banking system can in no way be created instantly and to be speeded up needs outside funds, expertise and controls. This is perhaps one of the reasons why banking systems in many post-communist countries have fallen into foreign hands;

secondly, in the first decade, the former post-communist countries, now emerging market economies, have been undergoing a phase of intensive learning and experience accumulation, especially in the process of creation of their financial system; any negligence of learning brought significant losses to the system;

thirdly, the decision to turn the former soviet mono-banks into commercial banks, although largely inevitable, was the main cause of subsequent bank failures and misbehaviour; a deeper conversion was vitally needed;

and, last but not least, among the direct reasons for the large costs inflicted on the society by bank failures was, to a large part, underestimation of the importance of regulation in the banking system.

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BANKŲ SISTEMOS EVOLIUCIJA LIETUVOJE: NUO VALSTYBINIŲ MONOBANKŲ IKI MODERNIOS BANKŲ SISTEMOS (1988–2004)

Jonas Čičinskas, Linas Šadžius

Santrauka

Sovietinio tipo komandinių ekonomikų radikalus pertvarkymas plačiai tyrinėtis ir aprašytas. Išskirtos trys pagrindinės to pertvarkymo kryptys: liberalizavimas, privatizavimas ir stabilizavimas. Straipsniu atkreipiamas dė-

mesys į tai, kad sisteminiai posovietinių ekonomikų pertvarkymo dėsningumai apima dar vieną, ketvirtą dėsningumą – patirties kaupimą ir mokymąsi, formuojant modernų rinkos ūkį. Šis dėsningumas ypač būdingas

kuriant tas rinkos ūkio institucijas, kurios iki tol egzistavo tik nominaliai arba jų apskritai nebuvo. Tai pasakytina apie bankų sistemos kūrimą. Lietuvoje modernios bankininkystės formavimasis nuėjo sudėtingą kelią, kuriame galima išskirti keturis etapus, nusakancius šiuolaikiniam rinkos ūkiui būdingos bankų sistemos genezę, ankstyvąjį etapą, krizės laikotarpį bei perėjimą į sveikos bankininkystės sistemos funkcionavimą. Pirmajam, genezės etapui, vykusiam 1988–1991 m., būdinga komercinių bankų steigimosi pradžia, pastangos mokytis ir kaupti patirtį bei pagrindinių finansų sistemos institutų kūrimas. Antrasis etapas, 1991–1995 m., pasižymėjo glaudesnių ir institucionalizuotų ryšių (laisvos prekybos su ES ir vėliau asociacijos su ES sutarčių pasirašymas, daug dvišalių susitarimų). Kaip tik čia ėmė ryškėti ir pražištinga patirties stoka, klaidos bei tam tikrais atvejais piktavaliai bankų sistemos formavimo, komercinių bankų kūrimo ir funkcionavimo veiksmai. Tai atvedė prie trečiojo etapo – 1995–1996 m. bankų sistemos sukrėtimo (kartais vadinamo bankų krize), kuris tačiau nevirto sisteminė krize. Ketvirtasis etapas pasižymi ryžtingomis institucinėmis reformomis, taip pat bankų privatizavimu su visa užsienio kapitalo ir patirties įtaka, atsiradusia tuo pagrindu bei veiksmais, vykdant pasirengimą narystei ES. Iš esmės iki Lietuvos įstojimo į ES 2004 m. šalyje buvo sukurta stabili, visoje Bendrijoje

apbruotų teisės normų pagrindu veikianti bankų sistema. Straipsnyje teikiamas tyrimas baigiamas išvadomis. Jose teigiama: (a) Lietuvos bankų sistemos formavimasis įtikinamai rodo, kokį svarbų vaidmenį rinkos ekonomikoje turi jos institucinė struktūra. Tai ypač pasakytina apie finansų sistemą, nuo kurios lemiamai priklauso realiosios ekonomikos procesų tolygumas, stabilumas ir plėtojimasis; komandinės ekonomikos paveldas šioje srityje buvo pagrindinis veiksnys, dėl ko daugelyje pokomunistinės ekonomikos šalių bankai, siekiant pažangos, perėjo į užsienio savininkų rankas; (b) pirmasis dešimtmetis Lietuvoje, kaip ir daugelyje kitų pokomunistinių šalių, buvo intensyvaus, kartais ir skaudaus mokymosi ir patirties tiek kuriant visiškai naują ekonomikos sistemą, tiek formuojant finansų sistemę joje kaupimo metas; bet koks mokymosi vangumas, nenoras mokytis, kvalifikacijos neadekvatumas kėlė bankų sistemai papildomų problemų ir net grėsmių; (c) nuostata paversti buvusius komandinės ekonomikos valstybinius bankus rinkos ūkio komerciniais bankais buvo vienas iš tų sprendimų, kurie lėmė didelius šiuolaikiškos bankų sistemos kūrimo sunkumus ir stambaus masto piktnaudžiavimus; (d) viena iš svarbiausių didelių sunkumų ir stambiųjų finansinių praradimų priežasčių yra nepakankamas bankų sistemos institucinio reguliavimo svarbos įvertinimas.

EVOLUTION OF THE BANKING SYSTEM IN LITHUANIA: FROM STATE-OWNED MONO-BANKS TO A MODERN BANKING SYSTEM (1988–2004)

Jonas Čičinskas, Linas Šadžius

Summary

The radical restructuring of the Soviet-type command economies has been broadly investigated and described. Three main directions of the restructuring of the economic system were identified: liberalization, privatization and stabilization. The article draws attention to one more regularity – experience accumulation and learning while building a modern market economy. This regularity is especially appropriate for the creation of the institutions which existed before the reform just nominally or did not exist at all. This concerns also the formation of banking. The modern banking sector in Lithuania went a complex way which could be divided into four stages representing its genesis, early stage, crisis period, and transfer to a sound banking system. The first stage, 1988–1991, is characterized by establishing the first commercial banks, efforts to learn and accumulate experience, and the building of main institutions of the financial system. The second stage, lasting from 1991 till 1995, saw expansion of closer and institutionalized relations with

the EU and its member states (by signing the free trade agreement – and later the Association Agreement – with the EU, intensification of bilateral cooperation with member states). Exactly in this period the destructive lack of experience and in some cases deliberate malevolent actions did appear in the formation of the banking system and in activities of commercial banks. All this led to the third stage – a shock in the banking system (called banking crisis), which took place in 1995–1996 but did, however, not turn into a systemic crisis. The fourth stage was the period of determined institutional reforms, banks' privatization which brought both capital and experience, and the activities caused by preparation for joining the EU. In essence, by 2004 a stable banking system operating on the basis of the main rules common to the whole European Community was established in Lithuania. The article ends with conclusions. They state that (a) the formation of the Lithuanian banking system proves without doubt that the market economy

is highly dependent on its institutional structure. This especially concerns the financial system which essentially impacts the regularity, stability and growth of the processes in the real economy. The heritage of the command economy in this field was the main factor which, in search of progress, brought the majority of banks in post-communist countries into the hands of foreign owners; (b) the first decade in Lithuania, as well as in many other post-communist countries, was the period of intensive and sometimes painful learning and experience accumulation, both in the creation of a totally new economic system and in building its

financial sector; any delays in learning, refusal to learn, inadequacy in qualifications raised additional problems and even threats for the banking system; (c) the decision according to which the former state-owned mono-banks were turned into commercial banks functioning in a market economy was among the solutions which caused great difficulties in creating the modern banking system and in some cases led to a large-scale fraud; (d) among the main reasons for great difficulties and heavy financial losses was underestimation of the bank regulation institutions and procedures.

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