Recent Developments in Bulgaria

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It is a great pleasure for me to participate in the present discussion on central banks and the financial system in the framework of the symposium on central banking issues in emerging market-oriented economies. The change from a centrally planned to a market-oriented economy involves changing attitudes, institutions, and organizations. In this respect, the overall objective of the reform is to base the economy on the newly functioning market system. I am not going to follow up all the ways the reforms should be defined.

It is important, however, that the transition occurs along with the establishment of active financial markets. But since it will take a long time to establish them, the setting up of a competitive two-tier banking system would be an important complement. Foreign banks and the use of foreign banking expertise should be encouraged. The government or some other central institution may have to assume the responsibility for bank liabilities that could no longer be serviced, and for nonperforrning loans. The central bank should be independent and would need to develop the requisite skills for implementing monetary policies and for supervising the banking system after the banking statistics are available. Let me brief you on the existing structure of the banking system in our country and elaborate on the problems we are facing during the transition period.

Today the banking system consists of the National Bank, the Bulgarian Foreign Trade Bank, the State Savings Banks, eight older commercial banks, and 59 new commercial banks that until 1990 were branches of the national bank. Very recently the Bank of Agricultural Credit and the first private bank would give priority in providing services to private sector institutions. Most of the banks are organized as stock companies. Their shares are usually owned by the National Bank, by the Bulgarian Foreign Trade Bank, or by large nonfinancial enterprises.

I would like to mention the important reforms in the banking system that were introduced in 1989 in establishing a two-tier banking system. Those reforms involved, as I already said, the creation of 59 new commercial banks, which resulted from the transformation of the former branches of the National Bank of Bulgaria. This began the process of establishing an independent central bank. Under the new system, all banks are permitted to make both operating and investment loans to any industry or private business. They will also be authorized to receive deposits from individuals and to grant mortgage loans. At the present time, only 10 banks are licensed to deal in foreign exchange.

The present banking system is small in terms of the number of branches and people employed. It is also simple in terms of the types of deposits, liabilities, and financial arrangements. We do realize the need to modernize and restructure the banking system so it can play the important role of helping restructure the economy based on market principles. At the same time, we have already taken steps toward the creation of a financial sector operating on the basis of both market principles and competition. In that respect we are facing two groups of issues. Let me now come to some of the problems and issues related to the structure of the banking system.

First, one of the objectives of the reform is to eliminate the monopoly of the State Savings Banks in dealing with households and, at the same time, to encourage commercial banks to mobilize deposits from households. The other objective is to create conditions for the banking system to provide a wide range of banking services to households and enterprises, including the many private enterprises now being formed.

Second, the equity of the commercial banks is now owned mainly by the National Bank, by the Bulgarian Foreign Trade Bank, and the large nonfinancial enterprises. Arrangements of this type may create serious problems for the banks that are now considering transferring the shares owned by the National Bank to the public and giving preferences in the operations of privatization of the bank to new shareholders who are completely independent from other banks or from large borrowers from the banking sector.

Third, the size of most banks is excessively small. It is well known that small banks have difficulties being efficient. There are different methods of overcoming these difficulties. It seems more appropriate at the present time for our country to follow one of those solutions. Since the National Bank of Bulgaria retains a large participation in the equity of the commercial banks, it can play a decisive role in leading those banks into mergers with each other or into their absorption by the largest commercial banks created in 1987.

A fourth issue is developing efficient payments services, which will be one of the main contributions expected from the modernization and restructuring of the banking sector. The necessity of training the staff for banks in an expanded branch network of the existing banks must not be overlooked. Furthermore, I again stress the necessity of establishing prudential bank supervision, with the primary objective to ensure stability of the financial system through a supervisory process that features on-site examinations and off-site analysis.

The second group of issues we have to deal with are those related to credit and interest rate policies. Needless to say, one of the severe problems is the monetary overhang. At present, the overhang represents about 100 percent of the gross domestic product. It is well known that a monetary overhang will cause inflation to accelerate. In order to reduce inflationary dangers that exist, we are introducing the following policy: an increase in interest rates is forthcoming. It is a fact that the present level of interest rates on deposits and credits is very low. We intend to increase the basic rate from 4½ percent to 10 percent. It is difficult now to envision such interest rate levels because of the budget situation, the maintenance of a number of controlled prices, and the financial situation of many of the companies. In this respect, we are going to pursue an interest rate policy providing real positive returns on financial savings instruments and involving real positive costs for borrowers.

To prevent the inflationary effects which could result from the expansion of the money supply, at the beginning of this year we introduced a system of credit ceilings. First, the nominal stock of investment credits from each bank cannot until the end of 1990 exceed the level reached at the end of 1989. This means that new investment credit can only be granted by each bank after the repayment of investment credits outstanding. Second, the nominal stock of working capital credit granted by each bank must be reduced by the end of this year to 95 percent of its value at the end of 1989. In introducing these regulations, we know that we might create difficulties for some productive enterprises, which might force the National Bank to lessen the restrictive policy for the expansion of total domestic credit. This could be achieved by following a less restrictive policy on working capital credits to new companies and to existing companies that present a sound program either of producing goods for export or of producing key goods that have to be imported at present.

In order to activate the financial sector we are moving to establish an interbank market. At the same time we are looking to establish both new financial markets and products—for example, a market for government securities so that the government budget deficit can be financed in a less inflationary manner.