COMMON CAUSES OF BANK FAILURES

IN

POST-COMMUNIST COUNTRIES

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Common Causes of Bank Failures in Post-Communist Countries

Abstract: *Initial attempts at bank decentralization in post-communist countries of Central and Eastern Europe were largely unsuccessful. Many newly established banks quickly went bankrupt. In this paper we look at cases of bank failure in various post-communist countries throughout Central and Eastern Europe and identify common factors leading to the bank failures. We then relate this assessment to the full societal transformation hypothesis and discuss how inadequate banking legislation in post-communist countries paved the way for bank failures.*

As soviet communism collapsed in Eastern Europe in 1989, the countries of Central and Eastern Europe began the unprecedented transition from their highly-centralized economies to market-dominated economies. A crucial part of this transition is the decentralization of the banking system, which underpinned the centrally planned soviet society. Unlike most banking systems, "the bank in the centrally planned economy was an administrative agency and had almost no common features with any commercial bank. Money was an accounting tool only and the central planner decided on capital allocation and production levels."[1] Though the process of bank restructuring varied throughout Central and Eastern Europe, initial bank failures throughout the region can be attributed to some basic problems experienced in all of the countries.

This paper is organized into four sections. The first section presents and discusses the decentralization of banking and the causes of bank failure in post-communist countries. The second section discusses laws and regulations used to curb bank failures and banking crises in post-communist Central and Eastern Europe. The third section illustrates the findings using specific cases of commercial banks in Lithuania. The fourth

[1] George Blazyca and Janusz M. Dabrowski, Monitoring Economic Transition: The Polish Case (Brookfield, VT: Ashgate Publishing Co.), 1995.

and final section assesses the importance of the common factors leading to bank failures in these transition economies. Findings are then related to the concept that a complete transformation of an economy, such as the change from a command to a market dominated economy, requires a concurrent change in the economic, political and social policies of a country. This is hereafter called the full societal transformation hypothesis.

Decentralization of Banks in Post-Communist Countries and Causes of Bank Failure

Shifting from the state-owned monobank system to a banking system suitable for a market economy has proven difficult in all of the post-communist economies. Establishing a sound banking system, "a process that took hundreds of years in Western Europe and decades in Japan is being telescoped into a few years in Central and Eastern Europe and the Former Soviet Union (FSU)."[2] Though the approaches to bank reform have been varied, problems in making the transition from one banking system to another have been fundamentally the same in each of the post-communist countries. A pattern of bank failures due to bad loans, lack of banking skills, lack of regulation, deposit insurance, mismanagement, and corruption has hampered the transition process.

Bad Debts

The soviet banking system was based on a monolithic central bank, which performed both central bank functions and extended credit to industry. While the central bank was usually assisted by a savings bank which collected deposits, no commercial banks existed. "The government received and dispensed all moneys, and allocative efficiency was not a matter of concern."[3] Money passed through the planned economic system based on a credit plan developed by planning authorities. The central bank used the credit plan to develop a cash plan regarding the allocation of cash. The funds were then channeled to specialized banks representing the various sectors of the economy (e.g. the agricultural bank) for lending to enterprises. Loans were disbursed without regard to whether they could ever be repaid under normal market conditions, and "interest rates had no role in the allocation of credit."[4] "Credits were granted to allow enterprises to cover losses and long-term financial short-falls when they failed to meet plan targets without sufficient economic justification. This banking practice tolerated and encouraged economic mismanagement, eroded repayment discipline and clogged channels of money circulation with surplus payment funds."[5] The existing loans then formed the first group of bad loans that the transition economies had to contend with while restructuring their banking system. The new banks were hampered by inherited bad debt. That is, as the post-communist countries moved away from the planned economic system and transformed their banking systems from the monobank to a two-tier banking system, their

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[2] Jacek Rostowski, Banking Reform in Central Europe and the Former Soviet Union. (Budapest, Hungary: Central European University Press), 1995, pg. 1.
[3] Arnoud W.A. Boot and Sweder van Wijnbergen, "Financial Sector Design, Regulation and Deposit Insurance in Eastern Europe," Banking Reform in Central Europe and the Former Soviet Union (Budapest, Hungary: Central European University Press), 1995, pg. 50.
[4] Ceyla Pazarbasioglu and Jan Willem van der Vossen, "Main Issues and Challenges in Designing Bank-Restructuring Strategies," Central Bank Reform in the Transition Economies (Washington, DC: International Monetary Fund), 1995, pg. 27.
[5] Kathleen J. Woody, Soviet Banking and Finance (Cambridge, England: Woodhead-Faulkner Limited), 1990, pg. 27.

banks shifted from "a situation in which all money is "outside money" to one in which most money is inside money, i.e. the liabilities of the banks instead of the state."[6]

A second wave of bad loans followed the decentralization of the banking system, as the restructured banks began extending loans, many of which were non-performing. In each of the transition economies, the ratio of non-performing loans to total loans was high. *Table 1* shows the ratio of non-performing loans to total loans in various post-communist countries as they were in approximately 1995.

Table 1: Ratio of Non-Performing Loans to Total Loans

Country Name	Ratio Non-Performing Loans to Total Loans
Armenia	33%
Azerbaijan	34%
Belarus	35-40%
Georgia	30%
Kazakhstan	35%
Kyrgyz Republic	63%
Tajikistan	46%

Constructed using statistics from "Main Issues and Challenges in Designing Bank Restructuring Strategies"[7]

In most post-communist countries, "the five largest banks account for more than 75% of the non-performing loans."[8] Formerly state-owned banks and the formerly

[6] J. Rostowski, "Creating Stable Monetary Systems in Post-Communist Economies," Centre for Economic Performance Discussion Paper No. 141, April 1993, pg. 5.
[7] Ceyla Pazarbasioglu and Jan Willem van der Vossen, "Main Issues and Challenges in Designing Bank-Restructuring Strategies," Central Bank Reform in the Transition Economies (Washington, DC: International Monetary Fund), 1995, pg. 48-61.

specialized banks account for a large share of the total non-performing loans, as shown below in *Table 2* using figures available in 1995.

Table 2: Ratio of Non-Performing Loans to Total Loans Accounted for by Formerly State-Owned Banks

Country Name	Non-Performing Loans Accounted for by Formerly State-Owned Banks
Armenia	90%
Azerbaijan	90%
Kyrgyz Republic	95%

Constructed using statistics from "Main Issues and Challenges in Designing Bank Restructuring Strategies"[9]

Lack of Skills

The large number of new non-performing loans can be attributed in large part to a basic lack of banking skills. "Under the planned regime, bankers made essentially no assessment of creditworthiness: their job was to implement and monitor the credit plan devised elsewhere."[10] The skills necessary for successful banking in a market-dominated system were not developed in the planned economy. "The banking system inherited from the Soviet era lack[ed] trained personnel who are qualified in accounting, auditing, and supervisory capabilities vis-a-vis international standards."[11] Soviet bankers had no experience in credit risk assessment, financial analysis of borrowers, cash flow analysis,

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[8] Ceyla Pazarbzsioglu and Jan Willem van der Vossen, "Main Issues and Challenges in Designing Bank-Restructuring Strategies," Central Bank Reform in the Transition Economies (Washington, DC: International Monetary Fund), 1995, pg. 42.
[9] Ceyla Pazarbasioglu and Jan Willem van der Vossen, "Main Issues and Challenges in Designing Bank-Restructuring Strategies," Central Bank Reform in the Transition Economies (Washington, DC: International Monetary Fund), 1995, pg. 48-61.
[10] Patrick Honohan. "Banking System Failures in Developing and Transition Countries: Diagnosis and Prediction," BIS Working Papers No. 39, January 1997, (Basle, Switzerland: Bank For International Settlements Monetary and Economic Department), pg. 9.

or computation of basic profitability. The bankers in the post-communist countries also lacked these skills, since they were drawn from the same labor pool as those in the previously planned-economy. No reliable financial data on borrowers existed to aid bankers in determining who was a good credit risk and who was not. With no real loan experience and no reliable financial data, banks were bound to make mistakes in allocating loans. "Many of the loans made were poorly selected."[12]

Lack of Regulation

Post-communist societies also lacked the skills necessary to regulate banks properly. In most of the transition economies only very "minimal legal requirements were needed to be satisfied and minimal capital requirements were at times less than $10,000."[13] Little bank supervision and few restrictions allowed firms to establish commercial banks quite easily. Consequently, there was a rapid expansion in the number of banks in all of the post-communist countries. In Russia the number of banks increased from 5 in 1989 to 2,500 in 1995.[14] "State enterprises, institutions and/or individuals incorporated themselves as private commercial banks, aiming at financial gains, yet armed with only a nodding acquaintance with financial management."[15] The absence of proper central bank supervision in post-communist countries coupled with the lack of

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[11] Raphel Shen, Restructuring the Baltic Economies: Disengaging Fifty Years of Integration with the USSR. (Westport, Connecticut: Praeger Publishers), 1994, pg. 95.
[12] Michael Borish and Fernando Montes-Negret, "Restructuring Distressed Banks in Transition Economies: Lessons from Central Europe and the Ukraine," Preventing Bank Crisis: Lessons from Recent Global Bank Failures (Washington, DC: The World Bank), 1998, pg. 77.
[13] Stijn Claessens, "Banking Reform in Transition Countries," World Development Report 1996 (Washington, DC: World Bank), pg. 2.
[14] Stijn Claessens, "Banking Reform in Transition Countries," World Development Report 1996 (Washington, DC: World Bank), pg. 2.

knowledge and experience on the part of new bank managers, created numerous irregularities and abuses.[16]

Mismanagement

The simplest explanation for bank failure is mismanagement. Bank failure due to mismanagement can "often be traced to poor lending decisions based on an over-optimistic assessment of creditworthiness, willingness to repay, or the recoverability of delinquent loans; undue concentration of lending ... to particular borrowers.[17] However, bank mismanagement is not always due to inexperience. In some cases, "owners and managers recognized that significant weakness in the banking laws pertaining to insider transitions allowed them to tap a bank's resources. In other cases, owners and managers tried to achieve their short-run profit goals by taking excessive risks within the bank, often in the form of high risk lending, or by assuming large open foreign exchange positions."[18]

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[15] Raphael Shen, Restructuring the Baltic Economies: Disengaging Fifty Years of Integration with the USSR. (Westport, Connecticut: Praeger Publishers), 1994, pg. 99.
[16] Raphael Shen, Restructuring the Baltic Economies: Disengaging Fifty Years of Integration with the USSR. (Westport, Connecticut: Praeger Publishers), 1994, pg. 98.
[17] Patrick Honohan, "Banking System Failures in Developing and Transition Countries: Diagnosis and Prediction," BIS Working Papers No. 39 January 1997, (Basle, Switzerland: Bank for International Settlements Monetary and Economic Department), pg. 5.
[18] Alex Fleming, Lily Chu and Marie-Renee Bakker, "The Baltics – Banking Crisis Observed," (The World Bank, June 10, 1996), pg. 29.

Corruption

"Cultural factors, and in particular corruption,"[19] seriously inhibit the ability of banks to function properly in post-communist countries. The prevalence of fraud and corruption was a prominent cause of bank failure internal to the banks.[20]

Deposit Insurance

Deposit insurance implicitly given by post-communist governments ensured that loans would not be repaid. Banking carried no risk for the banker or his customers – deposit losses were covered by the government, so neither the bank, nor its customers suffered dire consequences when deposits were mismanaged or disappeared through outright fraud. Insolvent banks simply continued to operate, because they were covered by deposit insurance.

Laws and Regulations

As the problems in the banking sectors of the various post-communist countries intensified, the potential for banking crisis in the post-communist region increased. In response, many of the post-communist countries tried to curb bank failures in the same manner. First, capital requirements were raised. Second, licensing requirements became much stricter. Third, countries began addressing the issue of deposit insurance.

[19] Jacek Rostowski, "The Banking System, Credit and the Real Sector in Transition Economies," Banking Reform in Central Europe and the Former Soviet Union (Budapest, Hungary: Central European University Press), 1995, pg. 27.
[20] Alex Fleming, Lily Chu, and Marie-Renee Bakker, "The Baltics – Banking Crisis Observed," (The World Bank, June 10, 1996), pg. 31.

Capital Requirements

One of the steps taken by each of the post-communist countries to stem the tide of bank failures was to raise minimum capital requirements. The tightening of capital requirements forced banks to either increase their reserves, merge with other banks, or lose their licenses. This resulted in a decrease in the overall number of banks in each country. For example, Estonia implemented several consecutive increases in minimum capital requirements. The first increase in minimum capital (an increase from $40,000 to $500,000) in January 1993, reduced the number of commercial banks from forty-two to twenty-three.[21] This was then followed by a second increase a year later to $1.2 million minimum capital for new banks; a grace period of one year was allowed for existing banks to meet the new minimum requirement.[22] Other post-communist countries also experienced large drops in the number of banks when they raised minimum capital requirements. For instance, the number of banks declined from 52 to 35 in Armenia, from 211 to 180 in Azerbaijan, and from 223 to 101 in Georgia as a result of increased minimum capital requirements.[23]

Licensing Requirements

In addition to increased minimum capital requirements, the post-communist countries strengthened their bank licensing policies, which resulted in fewer new entries into the

[21] Ardo Hansson, "Reforming the Banking System in Estonia," Banking Reform in Central Europe and the Former Soviet Union (Budapest, Hungary: Central European University Press), 1995, pg. 142.
[22] Ardo Hansson, "Reforming the Banking System in Estonia," Banking Reform in Central Europe and the Former Soviet Union (Budapest, Hungary: Central European University Press), 1995, pg. 142.

banking sector, license withdrawals from problem banks, and an overall sounder banking sector.

Deposit Insurance

After raising minimum capital requirements, and tightening licensing requirements, some post-communist countries began to limit government guarantees on deposits. Estonia took a very simple approach to deposit insurance. It fully guaranteed only *household* deposits at the Savings Bank, and no others.[24] Limiting deposit insurance to only household deposits achieved a number of objectives. First, it sent a clear message to depositors that universal deposit insurance did not exist in Estonia, as it was available only on household deposits at a single bank. Second, limited deposit insurance reduced the possible cost of protecting depositors in the event of a bank failure. Third, limited deposit insurance allowed Estonia's central bank to focus its supervisory capabilities on the banks in which it guaranteed deposits. Finally, limited deposit insurance clearly established that failing banks would not be rescued, thereby applying pressure on both bankers and depositors – the former to operate more conscientiously and the latter to monitor their bank accounts more diligently.

New laws and regulations regarding minimum capital requirements and deposit insurance strengthened the banking systems of post-communist countries. Stricter

[23] Ceyla Pazarbasioglu and Jan Willem van der Vossen, "Main Issues and Challenges in Designing Bank-Restructuring Strategies," Central Bank Reform in the Transition Economies (Washington, DC: International Monetary Fund), 1995, pgs. 48-51.
[24] Ardo Hansson, "Reforming the Banking System in Estonia," Banking Reform in Central Europe and the Former Soviet Union (Budapest, Hungary: Central European University Press), 1995, pg. 159.

licensing regulations reduced the number of weak and insolvent banks, which had sprung up as a result of initial, inadequate banking legislation in most post-communist countries. Restricted deposit insurance compelled bankers to act more within their budget constraints, and depositors to become more careful in their banking choices. Limited deposit insurance raised the cost of sloppy or unscrupulous banking by confining deposit guarantees to the most closely supervised banks, forcing other banks to absorb the cost of mismanagement and deposits lost through risky loans or outright fraud. As long as an implicit government guarantee on all deposits had existed, banks had used outside money to cover their liabilities, because they knew that the system would repay depositors whose money was lost. Limited deposit insurance marked a true change from the previous monobank system to the two-tier banking system. It signaled that banks in the post-communist system were no longer working with outside money, but with inside money and the losses that banks incurred – whether through mismanagement, recklessness, or fraud – were theirs and not the state's. The banking climate changed from one in which banks could lose money with virtual impunity, to one in which the state would no longer cover a bank's losses. This marked a clear departure from both the economic and social system under the previous command economy and a transition into the market-driven economic system.

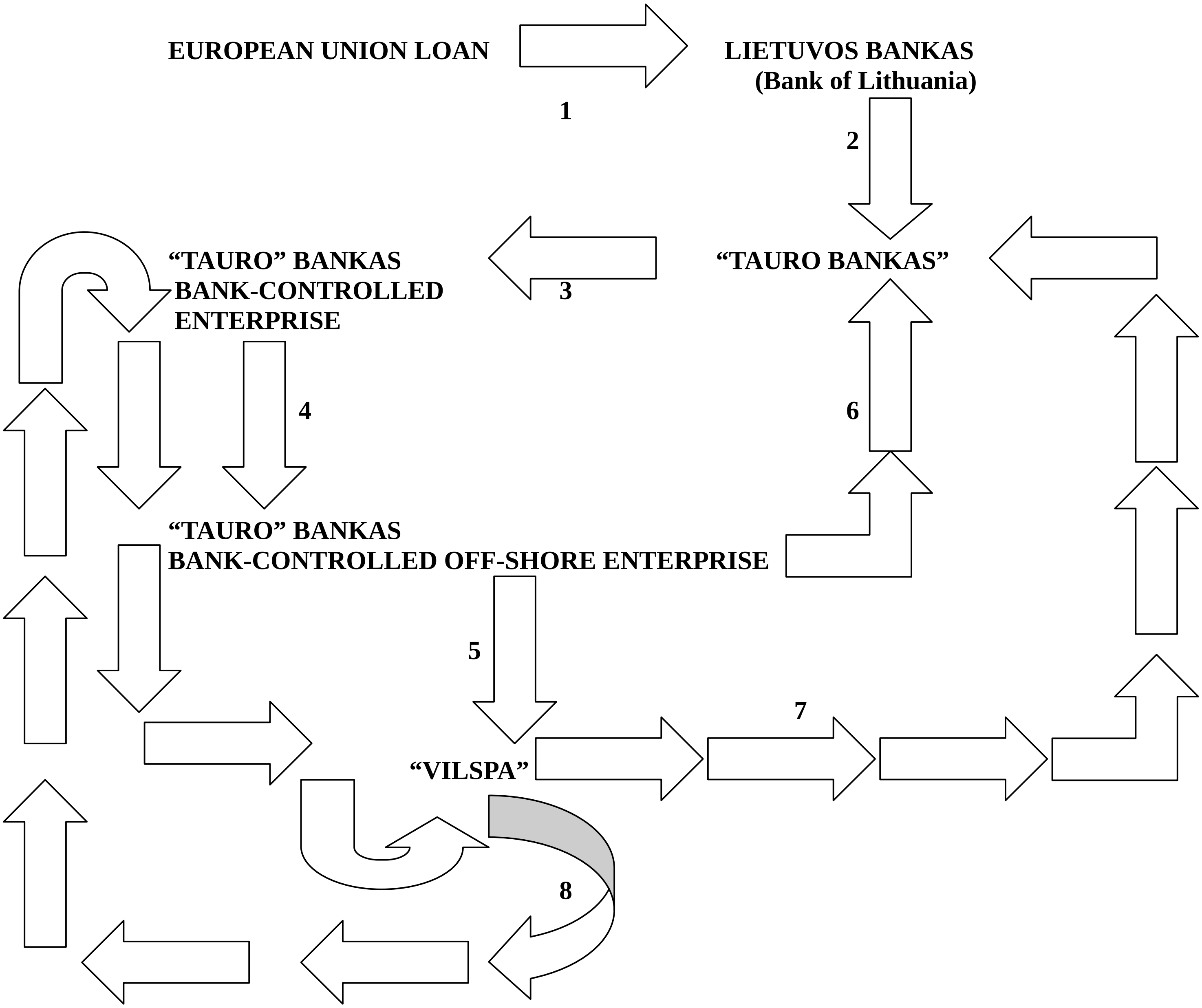
<u>Case Studies</u>

The literature on bank failures in post-communist countries is fairly general, with cites to only a few case studies. This is due in large part to the fact that most cases are still in court and information regarding specific cases is restricted mostly to what is published in a country's national media. Once the cases are resolved in court, scholarship will be based on court data. Currently, it is possible to follow the unfolding situation as it is reported in journalistic form.

Published newspaper reports in post-communist countries are revealing. They provide accounts of how specific banks were formed, defrauded, and bankrupted. They trace political histories of bank owners and managers, uncover financial networks formed by members of the former soviet *nomenklatura*, report instances of bank officials stealing money, opening accounts abroad and disappearing. They mention organized crime and point to links between the political, business, and banking sectors. They uncover details of loans that were signed for but never issued, of missing money, of fraud and harassment, of suspicious suicides and fear in the banking industry. Journalists following the financial sector publish whatever they can find to show how the money is circulating through the banking industry.

In some cases, millions of dollars intended for economic development have disappeared in the banking system. For example, in Lithuania, the daily newspaper *Respublika* published the following outline showing how "Tauro" Bankas laundered money:

<u>"TAURO" BANKAS MONEY LAUNDERING OUTLINE</u>[25]



[25] Audrius Lingys, "Tauro Bankas – Aiskeja Aferu Mechanizmai," *Respublika* (June 27, 1997, nr. 148), pg. 1.

The money moved in the following manner: first, the European Union issued a loan to Lithuania's Central Bank. Second, a loan was issued to "Tauro" Bankas from the Lithuanian Central Bank. Third, "Tauro" Bankas loaned millions of dollars to an enterprise that it controlled. The money was then transferred to an account that the enterprise had at "Tauro" Bankas. Fourth, the bank-controlled enterprise immediately transferred the money to another account at "Tauro" Bankas that belonged to a "Tauro" Bankas-controlled off-shore enterprise. Fifth, this bank-controlled off-shore enterprise then "bought" furnishings for "Vilspa" press, and the money was transferred into yet another account at "Tauro" Bankas. The furnishings were then recorded in the name of the enterprise having received the loan from "Tauro" Bankas. "Tauro" Bankas rented the furnishings to "Vilspa" press in the name of the enterprise that got the loan (arrows marked 8 on outline). And, "Vilspa" press paid the rent into an account at "Tauro" Bankas (arrows marked 7 on outline). The money had been laundered and become the property of the bank.[26]

In other cases, millions of dollars disappeared from banks in the form of non-performing loans. "Turto" Bankas of Lithuania has created a "Black List" posted on the internet, which provides information on its debtors whose debt to the bank exceeds a half-million litas and who are unwilling to repay it. The list was last updated on May 5,

[26] Audrius Lingys, "Tauro Bankas – Aiskeja Aferu Mechanizmai," *Respublika* (June 27, 1997, nr. 148), pg. *Tema*.

1998 and is comprised of fifty-one enterprises and individuals, many of whom are facing criminal charges for the illegal appropriation and squander of assets.[27]

By no means is Lithuania the worst case of bank restructuring in post-communist countries. Its problems are merely indicative of those faced by all post-communist countries.

Conclusion

Despite their different approaches to the bank restructuring process, each of the post-communist countries of Central and Eastern Europe has experienced the same basic problems leading to bank failures. This indicates that all of the countries share an element that hampers the transition process from the mono-banking system to a more effective two-tier banking system. While cross-national analysis may somewhat obscure the details, it allows for theoretical generalization. In this case, the general picture of the experiences of the post-communist countries of Central and Eastern Europe reveals a basic element that explains why bank failures in each of the countries can be attributed to the same causes, despite the countries' different approaches to the bank restructuring process. In other words, we suspect that the common causes of bank failures in post-communist countries may be symptomatic of a general obstacle associated with making an effective transition from one banking system to the other. Findings in the banking sector can then be related to the full societal transformation hypothesis.

[27] Turto Bankas –Juodasis Sarasas. http://www.turtas.lt/juodasE.htm (July 8, 1999, 5:41 pm).

In general, all of the post-communist countries of Central and Eastern Europe share a common political, economic and social background. The implementation of Soviet communism in the countries of Central and Eastern Europe in the late 1930's and early 1940's resulted in the radical transformation of the existing pre-war political, economic and social structures of the region. Existing governments were supplanted with regimes that controlled the populations through an "overarching set of rules and formal norms which deliberately undermined informal social ties"[28] of the pre-war societies. Under the new soviet regimes all political, economic and social activities were controlled by a totalitarian state dominated by a single party.[29]

When communism fell in 1989, the post-communist countries diverged politically and their governments pursued different economic transition strategies. Following the first elections, the element remaining common to *all* of the post-communist countries was their shared social experience of highly centralized communism. Though ethnically different, all of these countries shared a common culture, and here culture is defined as "a particular form of civilization ... the beliefs, customs, arts, and institutions of a society."[30] In this case the common culture was that of the soviet society which developed over the

[28] Francis Fukuyama, "Social Capital," The Institute of Public Policy Colloquium, Fairfax, VA, April 10, 1997.
[29] Ginta T. Palubinskas and Roger R. Stough, "The Role of Champions in Market Development Efforts in Central and Eastern Europe: Guidelines for Leadership Inputs in the Market Development Process, " 1998 Academy of Business & Administrative Sciences Emerging Economies International Conference, Budapest, Hungary July 13, 1998 (http://www.sba.muohio.edu/abas/1998/titles.htm)
[30] Webster's II: New Riverside Dictionary (New York, NY: Berkley Books), 1984, pg. 171.

course of more than half a century, as populations were controlled, educated, trained and integrated by the soviet system.

In making the transition from a monobanking system to a two-tier banking system, the impact of the previously-existing soviet culture has been largely overlooked. The concept that "economic life is deeply embedded in social life, and it cannot be understood apart from the customs, morals, and habits of the society in which it occurs. [and] it cannot be divorced from culture,"[31] has not been amply weighed. Countries which had "tolerated and encouraged economic mismanagement [and] eroded repayment discipline"[32] during the soviet era, developed new banking structures, which were doomed to fail, because the entrenched soviet cultural factors were not addressed in the new banking policies. Inadequate banking legislation during the initial transition from the monobanking system to the two-tier banking system allowed corruption to flourish, and prevented the new banking system from functioning properly.

Corruption is not the only cultural factor affecting the success of the transition from old banking system to the new. The soviet system formed people's basic understanding of money and accountability. In the soviet monobanking system, it was assumed that non-performing loans could simply be rolled-over *ad infinitum* by insolvent enterprises; losses due to mismanagement or fraud were indemnified by the centralized

[31] Francis Fukuyama, Trust: The Social Virtues and the Creation of Prosperity (New York, NY: Free Press Paperbacks, 1995), pg. 13.
[32] Kathleen J. Woody, Soviet Banking and Finance (Cambridge, England: Woodhead-Faulkner Limited), 1990, pg. 27.

government; and, when the soviet government needed more money, it simply printed more. Since allocative efficiency was not of great concern under the planned system, critical banking skills such as risk-assessment were not developed by the monobankers, and networks that support two-tier banking systems and which are taken for granted elsewhere (i.e. credit bureaus, etc.) were not developed.

In making the transition from the mono-banking system to the two-tier banking system it is important to understand both how the banking systems differ, as well as to understand what type of social capital the new system requires in order to function.[33] Social capital, defined as “the ability of people to work together in groups and organizations based on shared norms and values in honesty, reliability, and trust,”[34] determines a country’s level of economic development, as well as how its economy can be structured. Countries with high levels of social capital are able to form large organizations, while countries low in social capital are restricted to economies based on small organizations.

The process of bank reform in the post-communist countries of Central and Eastern Europe has been marked by bank failures due to bad loans, mismanagement, and inexperience. The post-communist countries of Central and Eastern Europe are attempting to quickly achieve what took centuries in Europe and North America, and

[33] Ginta T. Palubinskas and Roger R. Stough, “The Role of Champions in Market Development Efforts in Central and Eastern Europe: Guidelines for Leadership Inputs in the Market Development Process, “ 1998 Academy of Business & Administrative Sciences Emerging Economies International Conference, Budapest, Hungary July 13, 1998 (http://www.sba.muohio.edu/abas/1998/titles.htm)

decades in Japan. The literature regarding the basic factors leading to bank failures in post-communist countries underscores the fact that "banking requires a legal system that facilitates the enforcement of financial contracts, loan recovery, and realization of collateral. Banks must be able to collect what is due to them. If they have no recourse against borrowers who default, borrowers will have reduced incentives to repay their loans. Poorly defined bankruptcy procedures can further reduce incentives to repay and further impair asset recovery. ... the legal framework should include adequate corporate, bankruptcy, contract, and private property laws."[35]

The conceptual framework of this paper suggests that the economic transformation in Central and Eastern Europe will come through concurrent changes in the political, economic, and social policies of a country. "The desired economic conversion from a command economy to a market economy requires a full societal transformation, one which requires a broad and deep or comprehensive change in public policy leading to new and different institutions, e.g. at base alternative property rights, regimes, etc., and reflects the importance of developing sound, interdependent policies. That is, policies aimed at transforming the economic infrastructure must be accompanied by political and cultural policies supporting that change."[36] The case of the banking sector in post-communist countries underscores that. Bank reform legislation itself in the

[34] Fukuyama, "Social Capital," The Institute of Public Policy Colloquium, Fairfax, VA, April 10, 1997.
[35] Carl-Johan Lindgren, Gillian Garcia, and Matthew I. Saal, Bank Soundness and Macroeconomic Policy (Washington, DC: International Monetary Fund), 1996, pg. 94.
[36] Ginta T. Palubinskas and Roger R. Stough, "The Role of Champions in Market Development Efforts in Central and Eastern Europe: Guidelines for Leadership Inputs in the Market Development Process, " 1998

post-communist Central and Eastern European countries, adjusted and improved by experiences with bank failures, demonstrates the determination of these post-communist economies to develop more reliable and complex financial institutions. Furthermore, the journalistic exposes of corruption in the financial sector also point to a higher awareness of the need for accountability in financial institutions. Both legislation and the mirror of popular culture through journalism seem to indicate that the post-communist societies of Central and Eastern Europe are struggling with entrenched soviet-communist culture and demonstrate nascent elements of economies with higher levels of social capital.

Bank reform in post-communist countries is "marked by the coexistence of old and new elements," and "[societies suspended] between the expiration of the old system and the genesis of the new."[37] There is a definitive shift occuring in the level of tolerance for corruption, as indicated by both the journalistic accounts of fraud in the financial sector and the financial sector's own attempt to begin exposing criminals through the development of black lists to curtail fraud. The war against corruption has also clearly been entered into by the national media which seems ready to expose criminal activity, and prosecutors who publicly state that "It is time to end this nonsense of no one being responsible for bank failures: commercial banks have not been held accountable for bankruptcies, the Central Bank, and Financial Ministry have not been held accountable either. The police and prosecutor's offices have declared ignorance, but millions have disappeared, and all of us will have to pay the price for their loss. It should no longer be that way."[38] As tolerance for corruption in the post-communist societies decreases, and laws and enforcement mechanisms are strengthened and institutionalized, the banking sector will become stronger and less susceptible to both internal and external corruption.

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[37] Bronislaw Geremek, "The Transformation of Central Europe," *Journal of Democracy* (July 1999, vol. 10, no. 3), pg. 119.
[38] Audrius Lingys, "Tauro Bankas – Aiskeja Aferu Mechanizmai," *Respublika* (June 27, 1997, nr. 148), pg. *Tema*.

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