

# SPATIAL STRUCTURE AND THE EXPANDING EUROPEAN INTEGRATION OF THE HUNGARIAN BANKING SYSTEM

ZOLTÁN GÁL

## Introduction

Financial Geography as a newly established sub-discipline of Economic Geography deals with the flows and transformation of the money, and the spatial, institutional and regulatory structure of financial capital (*Leyshon, 1995, 1997*). The recent growth of interest in the Geography of money has been stimulated by an explosive growth in information technology and financial services and also by the profound changes, upheavals (crises) that have remapped, and are continuing to transform financial landscape of the World (*Leyshon-Thrift, 1988*). These changes are usually associated with a single word, globalisation. Globalisation –giving a definition by Ron Martin – refer to the increasing integration of financial markets, hybridisation, convergence and stretching of economic relationships across the space, regardless of national borders and institutions, and to the growth of „stateless monies” that move electronically around the globe at a very high speed, ignoring national borders and economic territories (*Martin, 1999*). Financial globalisation is inherently geographically constituted, the product of organisational, technological, regulatory and corporate strategies by individual firms, financial institutions and authorities in specific location. Divergent forces of *deconcentration/decentralisation and concentration/centralisation* are consistent with financial globalisation, which are shaping the evolving *geographies of the national, regional and global finance*. Different monetary spaces – national, global and local, regional – coexist, as it is recognised that globalisation of finance is a global-local process.

These changes have several effects on the emerging single European market, where finance with the European banking licence lies in the heart of the policy. The emergence of the European Monetary Union encourages mergers and acquisition activity across the EU in order to strengthen the position of financial institutions to hold their own in increased competition. While cross-border acquisition has been limited, the emergence of new large national universal banks, as the amalgamation of several national or regional institutions, is bound to have important spatial consequences, as they are located in the existing financial centres. These banks will have even more power to dominate the European market

(Leyshon–Thrift, 1997). Changes which imposing a universal monetary space for Europe remove a significant element of national and regional autonomy concerning the monetary control over their economic territory. The consequences of financial integration will effect regional and local banks as well as different national banking systems. Small and local banks might suffer a competitive disadvantage initially, eventually a two-tier banking system would emerge with *one tier consisting of international banks* and the *second tier consisting of local banks* (where local banks include local, regional and national banks devoted to their domestic markets).

The accessing countries of Central and Eastern Europe, such as Poland, Czech Republic, Slovenia, Slovakia and Hungary which followed their reintegration into the world financial market in the early 1990s. They not only have to adopt new technologies and the financial behaviour it accommodates, but also have to cope with a legacy of bad debts and a lack of experience in credit risk assessment. Central –Eastern European banking systems are accelerating through some features of the stages of development as a result of competition with more advanced systems and state encouragement of banking development. As European Union membership approaches in Central Europe's more advanced economies, Western European banks are aggressively moving to expand into what will soon be a home market for them. The result is the increasing pressure on margins, as more banks compete for relatively little business. This results in a reversal process of concentration than in EU, namely the growing number of institutions. Making matters worse for the locals, the foreign banks often boast deeper pockets, greater expertise and more solid reputation (Anderson–Kegels, 1998). All these challenges that are to be faced are common in these countries, but what could be varied from country to country is the spatial and institutional structure of the national banking systems.

### **The first decade of the development in the Hungarian banking system**

The first important step forward in the modernisation of the Hungarian financial sector was the creation of the two-tier banking system in 1987, which was more adapted to a market environment. Following this Act, the National Bank of Hungary, performing primarily central bank functions and the institutionally separated commercial banks were set up in January 1987. Commercial banks who originally had corporate clientele were admitted to the retail market, while financial institutions were given commercial banking licenses. In contrast to Hungarian traditions, a specialised rather than universal banking system has been created in 1987, sorting

different type of banks by functions (34 commercial banks, 8 specialised banks, mortgage banks and building societies, 236 co-operative savings banks).

Since the reintroduction of two-tier banking (after 40 years discontinuance) the banking system was opened up to the world as a competitive and rapidly growing sector. The transformation into a market economy, the radical diminution of the state's role in the business sector, privatisation, foreign capital inflow, a more intensive participation in the international division of labour and European integration all provided new opportunities and challenges for banking. The new actors of a rapidly developing economy, the mushrooming of associations and corporations and the greater demand for corporate and retail markets will transform the present banking system. Money markets will undergo radical rearrangements in the future and the balance of power will change as a consequence of market competition. Banks struggle for larger shares of the expanding market and for new customers that require both the expansion of the banking network and the perpetual innovation of banking.

If we take ten years of development in the banking system into consideration it can be divided into different periods. The short period between 1989–1992 was the peak time for foundation of new banks. Competition was also increased by the entrance of the new foreign-owned and joint venture banks founding their own subsidiary banks in Budapest (*Bácskai*, 1997).

After the period of rapid and extensive expansion the banking system was characterised between 1992–1995 by the first bankruptcies and failures. Over-gear expansion of balance-sheets and increasing risk-taking stood in contrast with the low level of financial standing and the huge sum of inherited debt that was accumulated in the central bank before 1987. This automatically led to the loss of market shares of the Hungarian owned banks and strengthened the position of foreign banks. Pecuniary difficulties of the mainly state-owned banks made inevitable the restructuring of the Hungarian banking sector, together with the loan, bank and debtor consolidation. The main purpose of bank consolidation and privatisation was to decrease the percentage of state ownership in the banking sector to at least below 25%.

In the third period, commencing in 1995, a stabilised and a more competitive banking system emerged, characterised by successful privatisation of the banking system resulting in a slower expansion in the banking from 1996 onward. In this latter period of development the branch network expansion was one of the major phenomena. This was due to business policies of banks shifting from the corporate to the retail market, intending to gain more of the market shares through easier access to retail customers, and on the other hand strengthening the competition which force mainly foreign banks without branches to build networks in order to hold their ground. Growing retail market from the mid–1990s has urged banks to establish their extensive nation-wide network of local branches. (This occurred

partly through acquisition of offices of the liquidated banks and partly through the opening of new branches). Parallel to stabilisation processes, the growth of newly established banks halted and the founding of joint-ventures and subsidiaries of foreign banks were compensated with mergers and liquidations through the strengthening of concentration in banking. In the last years, new types of banks were formed, serving the special interest of the money market (mortgage banks, building societies, land and mortgage bank), but the concentration in banking will continue.

One of the most important alterations in the Hungarian banking system was that the *role of foreign capital in ownership* was determined. As the consequence of foreign capital inflow into the Hungarian banking, the structure of ownership was entirely transformed; parallel with the process of the significant decrease in state ownership (20% recently), shares of foreign capital attained 65% of the banking system, gaining a majority of market shares within a short time. This very high proportion of foreign capital is among the highest in the European context. In the UK 53% of ownership is foreign, but in Finland it is only 1%, in Germany 2%). The main investors are, according to the portion of invested capital, still the leading German and Austrian entrepreneurs, following by the American, Dutch, French, Japanese and Korean investors. Activity of the Dutch banks is indicated by the fact that all the top-ranking Dutch banks opened subsidiaries in Hungary (ABN Amro, ING, Rabobank) but British banks are conspicuous by their absence (*Várhegyi, 1997*).

To summarise the role of foreign capital in the Hungarian banking system it can be said that such a rapid process of privatisation of banking without foreign capital inflow would have been impossible. Foreign capital inflow into the banking system together with the ownership shares from privatisation, comprising a total of 220 billion HUF, that was directly invested into banks based in Budapest but ran through the channels of a branch network.<sup>10</sup> Already in 1995, foreign banks, occupying one fourth of the total market, accounted for 70 % of profit returns due to their high profitability, which was twice as much as in the Hungarian owned banks. Foreign capital investment has contributed significantly to the growth of international competitiveness of Hungarian banking. (Per capita investment of foreign capital accounted for 1,950 USD in Hungary, compared to 1,040 USD in the Czech Republic and 832 USD in Poland till 1999.) (*Wachtel, 1997*).

In the consequence of successful privatisation competitiveness of the banking system is strengthened: increased its balance sheet account, improved the quality of portfolios, but the proportion of the bad debts is still higher than the EU average, which have increased significantly by certain banks (Postabank, Realbank). By the end of the 1990s the Hungarian banking system affected by radical legislative, administrative and institutional changes, such as the privatisation of many banks, foreign capital inflow, the introduction of a more universal banking model, the

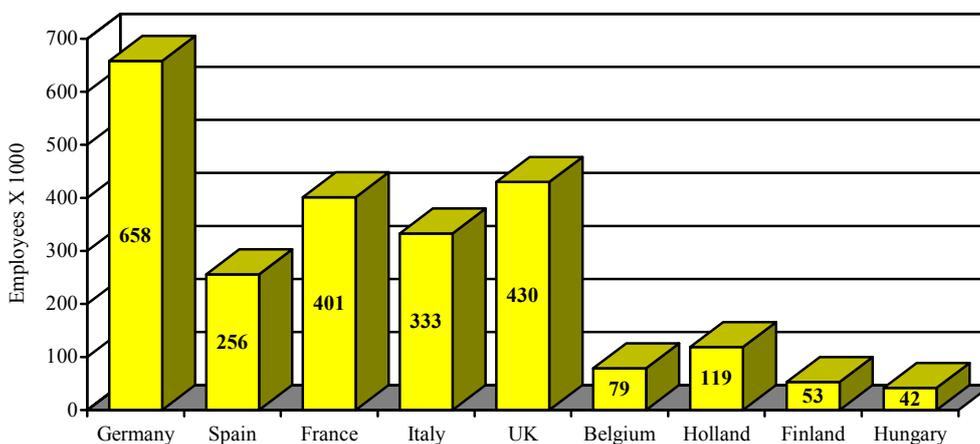
liberalisation of the credit market and the consequent intensification of competition.

The dimension of the Hungarian banking system is small according to the size of banks and the ratio of balance sheet status to GDP (72% for Hungary and 110–240% for EU countries). The total assets in the Hungarian banking system is still only a fraction of a big European banks, and the largest Hungarian bank (OTP Bank) is only the sixth among Central Europe's largest banks ranked by assets. Concerning the number of employees in banking reached 45 000 in 1990, but after that is started to diminish and by 1998 fell back to 38 260 employees. However, the ratio of employment in banking expanded within the share of employees from 1% in 1990 to 2.5% in 1997. (This ratio in EU countries ranges from 2–4%.) In the banking and insurance sector of Budapest accounted for 47% employees worked in 1996 that was 3.65% of the total employment in Budapest. In contrast, Vienna had 42,000 (5.6% of total employment), and in Munich 59,000 (9.8%) worked in banking and insurance (*Figure 1*). The smaller size and extension of the banking network is highlighted by European comparisons.

Countries with smaller territories, such as Belgium and Holland there are seven times more branch offices and in the less densely populated Finland has twice as much offices than in Hungary. The number of branches in 1995 accounted for 1000, but the consequences of rapid expansion in the last few years it grew up to 1400. (Gál, 1998) (*Figure 2*).

Figure 1

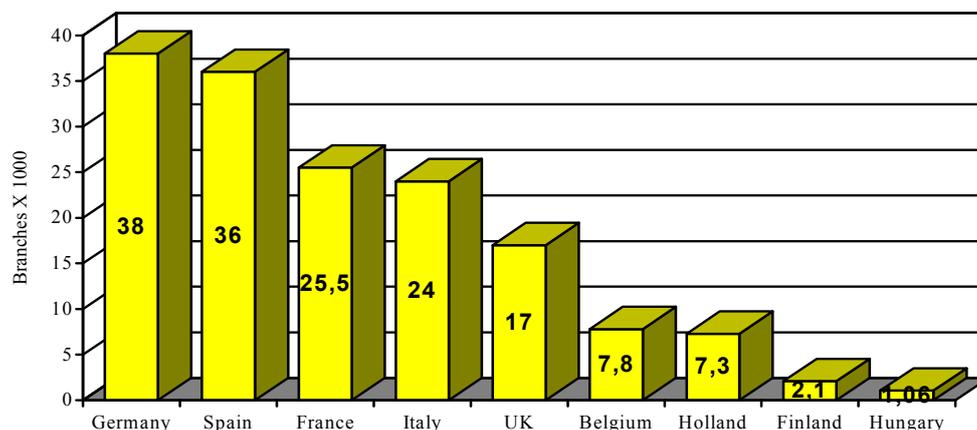
*Employment in banking in some European countries (1994)*



Source: BIS 66<sup>th</sup> Annual Report 1996.

Figure 2

*Number of branches of banking in some European countries (1995)*



Source: BIS 66<sup>th</sup> Annual Report 1996.

### **Structural and spatial polarity of the banking system in the 1990s**

Concerning the merger and acquisition activity in the different European national banking systems, there is a recognition among member states of the possibility of increasing concentration in banking in Europe, leading to domination by large banks situated in few financial centres of the single market. Recent global financial crises highlighted the vulnerability and constrain of the state supervision of the international financial markets, questioning for the traditional control functions of the nation-state. In the consequence of the diminishing financial role of the state the growing importance of the *EMU at supranational level* goes parallel with the strenuous effort being made to build up strong *regional financial markets* that will be able to serve the interests of the regional economy better and represent a link. Between local economies and financial centres. The Hungarian banking system is characterised by the lack of strong local and regional banks that one can argue, explainable partly with the adjustment to the more concentrated international banking structures, but on the other hand it is the result of structural polarisation.

The spatial structure of banking system is polarised compared to the network which existed at the turn of the century (when the number of independent banks scattered throughout the countryside were overshadowed within the banking net-

work, and there were proportionally few branches in banking before World War I, consequently only 5.7% of the network was concentrated in Budapest), the recent banking system is characterised by strong spatial concentration (Gál, 1999a).

The fact that all the 41 banks except one are based and headquartered in Budapest results in a deformed structure in the banking system. Banking in Hungary is still the most centralised branch of the economy with a definite centre in Budapest. The leading position of Budapest in the financial sectors, especially in banking and insurance, is more striking than in any other sectors. Consequently local and regional banks are missing from the Hungarian banking system. (However, this strongly monopolistic structure is more in line with international tendencies, which are characterised by over concentration at the global level; in contrast to other transitional economies, such as Poland, where the role of regional banking is significant.)

From the deformed spatial structure of the banking network of the early 1990s arose more difficulties:

Lower density of the network meant both the low level of availability of branch offices and the higher structural polarisation of the branch network. On the one hand this meant that the rapid expansion of banking, initially concentrated almost exclusively in Budapest, was not followed by the extension of the branch network at a rapid pace in the countryside. On the other hand the new banks established in 1987 inherited a particular branch network from the National Bank of Hungary, since branches were missing from certain county seats, accompanied with a spatial-regional asymmetry. The structure was even more distorted by the fact that the traditional retail bank (OTP-National Savings Bank) had had offices usually in all settlements where population exceeding 5000, but the dynamically developing foreign banks just started to expand their branch network in the last few years.

The other marginal pole of the national banking system is the dense network of the co-operative savings banks scattered throughout the countryside. The most important disadvantages of these are their weak financial standing (accounting for only 5% of the total balance sheet of banking) and lack of strong centres or headquarters. Despite the number of co-operative savings banks being 1,700, thereby accounting for 62% of the total national network, most of these small savings banks situated in the smaller towns and villages have a very low capital circulation and can supply only a narrow range of services.

The third reason of the polarity is, that branches of banks based in Budapest have much less room for making independent decisions than the branches of county seats during the communist period. Since the Hungarian banking system is characterised by over centralised management, controlling and structural system, branches are not in a real decision-making position, partly because they have got only limited information. Most of the banks offer the same services all over the country and do not have local advertising strategy. Banks usually do not lay stress

on the uniform appearance of their branch offices; therefore appearances very much depend only on the hierarchical position of a certain bank.

The start of the 1980s and 1990s was the first period of boom in the establishment of banks: 17 commercial banks founded about 350 branches, concentrating 85% of the new offices into the provincial cities. During the next period of the two-tier banking system between 1992–1996 the network was considerably restructured. Expansion of the banking system was restricted very much by the huge inherited debt imposed a large burden on the institutions. The smaller banks went bankrupt (Ybl Bank), others were liquidated (Dunabank, Iparbankház) or some of them were merged. The big banks rescheduled their policy of network building and a few closed some of their branch offices, but the other banks such as Budapest Bank and Postabank started a spectacular growth in network expansion. Accordingly, between 1992–1996 the number of banking institutions decreased due to the bankruptcies, mergers and the purchasing processes of privatisation. In only two years (1995–1996), six banks were liquidated or merged into other commercial banks.

The foreign-owned banks started to expand their branch network (by purchase through privatisation and opening new branches) later and more cautiously than only after 1995. There are different reasons for this more cautious policy. There are different reasons for this policy. On the one hand, these banks were strong enough in terms of capital intensiveness, therefore they could adjust the pace of network building to their own pace of development. On the other hand, foreign-owned banks were first of all interested in corporate banking supplying services for the joint-stock companies. The boom period of the establishment of joint-stock companies was in 1990–1991 and afterwards the corporate market started to become saturated. However, the foreign owned banks switched to rapid expansion through building their extensive branch network, gaining both larger market shares and leading positions in terms of profitability, and grew more rapidly than the bigger banks.

Recently, the tendency of concentration has decreased due to the successful expansion of the foreign-owned and medium-sized banks. The balance of power in the banking system which held sway at the end of the first decade of two-tier banking will be expected to readjust according to growing competition for larger market shares. According to surveys, a shift from the moderate de-concentration will emerge and the few large banks (from the group of the medium-sized and the foreign-owned ones) with considerable financial standing will dominate in the retail market. Besides these, 10–15 banks will play an important role in the banking system.

### **Spatial development of the Hungarian banking network**

Regarding to the diffusion of the banking network, it is very important to survey the geographical location and the different hierarchical types of settlement where banks are located.

At the birth of the two-tier banking system the network was characterised by a certain spatial balance due to the evenly allocated branches of the OTP Bank (National Savings Bank), located in more than 270 settlements. After the foundation of the new commercial banks significant spatial asymmetry occurred within the country since certain banks were missing from particular regions and county seats: KHB (Commercial Credit Bank) dominates in the Great Plain region, MHB (National Credit Bank) in Northern Transdanubia and BB (Budapest Bank) around Budapest.

The spatial appearance and the regional diffusion of the new branches of banks reflected the Hungarian economic processes in the 1990s:

The prevailing majority of economic associations, within it the joint-venture companies and the accumulated capital outside Budapest flowed into the Transdanubian region, firstly into the north-western part. All these are underpinned by indices of corporations, associations, household savings and figures of indebtedness for the population.

The structure of diffusion of the banking network had followed this spatial pattern for the first time by the beginning of the 1990s. At that time banks were interested mainly in building up branches in the Transdanubian region. This was evident because the largest unexploited territories of financial services were situated in Western Hungary.

Significant differences among the greater regions had practically evened out, except in Northern Hungary, by 1990, and the disadvantage of the Transdanubian region came to the end. From the mid-1990s, after saturation of Transdanubia, the larger cities of Eastern and Southern Hungary became the main targets of branch network expansion (Gál, 1998).

There were significant differences behind the well-balanced greater regions concerning network density within the regions and counties. In some counties the number of new branches exceeded ten between 1978–1990 (Győr-Moson-Sopron, Baranya, Hajdú-Bihar), while in other places only a few branches were opened (Fejér, Komárom-Esztergom, Tolna) and in some counties exclusively planted only in the county seats (Borsod, Fejér, Szabolcs-Szatmár-Bereg). An extreme exception was Esztergom-Komárom County where no branch was opened between 1987–1990 in Tatabánya, the county seat, where economic depression affected its heavy industrial background. For instance, during the short period between 1995–1997 there was no increase of the branches in North-Western Transdanubia, as it was viewed as a saturated region.

A general characteristic of the period between 1992–1996 was the growing importance of Budapest in the expansion of the branch network (319 bank offices made up 26% of the national network in 1997). All banks starting to open new branches have opened 2–3 new offices in the capital city in the past five years, and last year 20 banks had branches there.

Within Budapest most of the principal offices of banks are based in the inner districts. The spatial concentration of the institutions gives a strong impetus to the formation of the central business district, where the office buildings of banks became an important functional-morphological element of the townscape. In 1990 about two thirds of the financial organisations were based in the 5th District, namely in the core area of the city centre itself which is still the most popular domicile for new banks. By the end of the 1990s business (financial) functions of the 5th District had become saturated and a few years ago the financial organisations started to diffuse towards the surrounding inner city districts. Despite the expansion of banks the low density of network in Budapest is surprising, namely one office per 7,758 inhabitants (15,000 without the OTP). This fact unambiguously demonstrates the low level of the extension of the banking network in the capital city. The lack of banking services is more striking in the outer area of Budapest, resulting in overcrowded city centre branches.

In Hungary the number of banking institutions is 1,319, together with 1,700 co-operative savings banks, stands at about 3,100. Taking the figures of the network density into account, there is one office per 3,200 inhabitants, which is still a much lower density than in the Western European counterparts, where there is one bank per 1,400–1,500 inhabitants. In spite of the boom in the foundation of new branches (last year a branch office opening ceremony took place every week on average) mainly by the foreign and joint ventures banks. These banks still do not have enough branches in Hungary, although spectacular progress has been made, especially since 1996.

Surveying the banking network according to the network density figures we can find a few counties with lower density of banks. Szabolcs-Szatmár-Bereg and Pest counties are the most unsupplied areas, accounting for half of the national average in 1995. In the case of the former, its economic and geographical situation, the activity of entrepreneurs, the low level of foreign capital inflow etc. would be the explanation for the smaller interest of the banks. In the case of Pest County, the capital city causes backwash effects, which influence the development of the banking network. Relative to population, Hajdú-Bihar, Borsod-Abaúj-Zemplén, Komárom-Esztergom, Nógrád and Fejér counties were also badly supplied by banking services. These counties could be the main target areas of expansion in the near future.

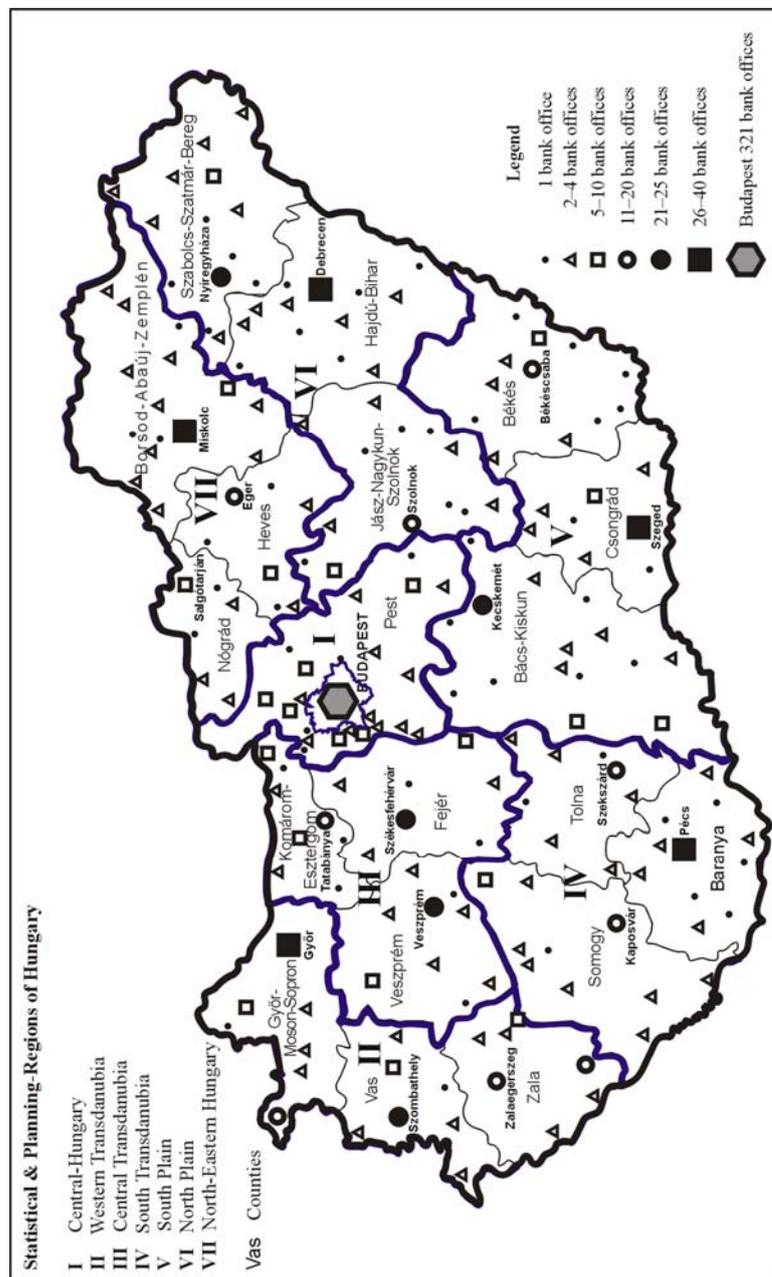
Surveying the distribution of the banking network according to the settlement types is more expedient than investigating at county level; all the more so as bank-

ing institutions have more links to the cities and towns, therefore capital flows is an important indicator of the different urban processes. Since by the beginning of the 1990s the number of branches had exceeded the number of larger cities, which had been the main targets of the earlier expanding banks, consequently these banks turned their interest towards the smaller settlements. The first branches in villages were also opened .

Those banks just recently started to develop their network – most of them are foreign owned – situating themselves solely in regional centres. As a consequence of this, certain larger cities (Pécs, Győr, Szeged, Székesfehérvár), despite not being seats of a regional bank, have been started to play significant roles in the operation of financial services in which different organisations of the financial sector (banks, insurance companies, consulting) attract each other mutually. This also induces increased competition in the local-regional market.

At the beginning of the 1990s the banking network was rather more polarised, both hierarchically and regionally, than nowadays. A more developed network existed in the county seats and in the cities of Western Hungary (which were targets of foreign companies and banks); while in Northern Hungary and in the northern part of the Great Plain the banking network is less developed than in Pest county, where the central role of Budapest counterbalances its disadvantage. In recent years a shift has taken place, levelling out the expansion of the banking network in favour of the eastern parts of the country. During these years the number of branches in the cities of Eastern and Southern Hungary increased more rapidly than in the western counterparts which were previously the most saturated parts of the country, considering the number of branches. It can be said that the network building expansion of branches initially followed the pattern of the spatial-economic division of the country, as banks mainly were opening branches in Western Hungary. Since the mid-1990s, after the relative saturation of West-Hungary and owing to the process of nivellation, banks have started their expansion towards the eastern and southern parts of the country along the urban hierarchy. Two years ago, Győr, Pécs, and Székesfehérvár were considered the largest financial centres outside Budapest, while recently Miskolc gained the leading position in the number of branches (37), followed by Győr and Kecskemét (each with 32 branch offices), then Pécs and Szeged (31–31), and finally by Debrecen (28). The main targets are the large cities in East and South Hungary, such as Miskolc, Szeged, Debrecen, Nyíregyháza gained a temporary leading position in size of the local network (*Figure 3*).

Figure 3  
 Regional distribution of branch network in the Hungarian towns  
 (included banks headquartered in Budapest, excluded cooperative savings banks)



Source: edited by the author based on the Bankinfo database 2000.

The Hungarian banks, because of the centralised structure of banking, aim at completely covering the relatively small banking market. This tendency promotes equalisation among the different parts of Hungary. However, differences occurring in the number of branches do not mean differences in the quality of banking services. This latter one is much more dependent upon the territorial embeddedness, which can induce mutual attractiveness toward the other types of financial, and business services. The agglomeration of financial services not only generates the competition in the local market but might result in the performance of certain regional financial centre functions in larger cities despite the lack of locally based institutions.

In conclusion it can be seen that different banks are situated on different levels of network construction in the recent period of development. The share of the larger cities from the banking network intensively increased from 35–40% to about 50% (with Budapest 66%) between 1987 and the early 1990s owing to the fact that at least a dozen new banks entered the market and started their network development. Bankruptcies and the rationalisation policy of network development in the following period mainly affected these larger cities as the major beneficiaries of the boom in banking expansion. Despite several new branches opening, the proportion of larger cities within the banking network fell to 43% (or 63% including Budapest), parallel with the network diffusion towards the smaller settlements.

Taking the expansion of the banking network into account, some experts believe that the spread of electronic home banking will counterbalance the traditional way of branch office building. According to others, whose opinion I share, there is a brighter future for the traditional expansion of the branch network since customers are much more devoted to a personal style of administration and rely more on branch offices. Despite the probability that virtual banking will be widespread in the future, building a more cost-intensive branch network is still very important. In addition, about 40% of the population has as yet no contact with banking. The figures for the year 1998 justify both these theories of the future prospects of banking (Bonin et al. 1998).

### **The challenges of regional banking**

Study of banking history reveals a wide variety of the development of different national banking systems. These systems currently experience spatial diversity, arising from the particular location of a distinctive financial centre and from the differences in spatial structure and in the origins of particular national and regional banking. The Hungarian banking system is characterised by the lack of regional banks and by the strong agglomeration of the services in the financial centre of

Budapest, that can be partly explained by the accommodation to the conditions of the more concentrated international financial markets, which currently undermining and diminishing the role of the local markets. However, recent moves, both toward supra-national economic, political and monetary unions and towards secession and regional autonomy, have tended to undermine the usefulness of the nation state and simultaneously strengthen the role of locally based regional units. In contrast to the concentration processes in the global markets the growing significance of European regionalism requires establishment of the regional money *markets and institutions financing regional policies*. Globalisation and the emergence of global financial spaces may actually serve to open up opportunities for local-regional alternatives (Lee, 1999; Porteous, 1996):

- Money is sensitive to local differences in economic return (crises still have a distinctly local origin) and local, regional banking systems tend to be more rooted in and committed to the local economy and community than local branches of centralised national or international banks.
- The effects of the financial crises increase the instability of global markets and seriously questioning the regulative and controlling role of the nation-state over capital flows.
- Decentralised banking systems have been important in certain European countries, such as Germany, Italy, France, and Poland.
- The boom of private enterprise, privatisation, the necessity of their presence in the local markets and competition for the retail markets also requires the expansion of the banking network in the regions. Regional banks may well be serving the interests of local economies and SMEs better than financial-centre banks whose priorities relate more to national and international markets.
- Besides the corporate and the retail market project financing will be one of the another businesses for banks which have to support the regional development programmes through financing infrastructure, power and telecommunication investment and co-operating with regional and local administrations.

To survey how the money moves between locations and regions raising the problems of integration between the global and local level, or between centre and periphery that concerns an irregular financial division of labour between central and peripheral areas. Emergence of uneven economic development among regions large extent is caused by the uneven interregional capital flows. Capital is mobile across regional boundaries and usually flows from the regions with lower profitability into the regions offering higher rate of return. Consequently capital is concentrated into the financial centres of the core areas, which can be resulted in re-

gional inequalities within the single European markets as well (*Porteous, 1996, Leyshon–Thrift, 1997*).

The extremely concentrated national and international financial markets and the lack of strong regional markets might slow down regional economic development in the long run because of different factors stated below:

Certain national and international banking centres discriminate against particular regions. This refers to usually credit discrimination which means that nationwide banks are less prepared to make credit available to agents in the periphery because they allocate loanable funds based on an implicit regional reserve ratio. Core regions and financial centres through the centralised branch banks may invest the savings drained out of the peripheral regions in favour of lending in core regions, slowing down the development in the peripheries and resulting in spatial polarisation of the regions (*Chick–Dow, 1988*).

National banks can only slowly acquire local embeddedness. The distance between decisional and operative centres within a national branch bank structure reduces the availability of information about local firms and local growth prospects. The uniform lending standards by nationwide banks disproportionately affect certain regions. Credit is made available on the same terms in different locations through the branch system regardless the specific regional requirements and conditions.

In a national branching system, local branches may adopt more cautious and restrictive lending policy, as they are likely to be constrained by head office in the degree of freedom as most of the strategic decisions are made at headquarters of banks. Because of the centralised structure the decision-making autonomy is limited therefore large loans require head office approval. Local branch management of national banks is often in the hands of directors only temporarily committed to that branch who tend to be very risk averse, opting for safe large investment, rather than riskier smaller investment, even to the detriment of important innovative projects for the growth of the local economy. On the other hand, if a national bank is seeking to rationalise its operation, it is likely that the branches in peripheral and economically declining areas are the first to be closed down (*Porteous, 1996*).

Within the centralised banking network information asymmetries are often occurred: the headquarters very often assess higher risk due to poor information on small borrowers in remote or peripheral regions, and because of market segmentation. Larger distance between peripheral regions and the core centres cause larger cost of transactions and monitoring and may result in a more expensive credit (*McKillop–Hutchinson, 1990*). Information and transaction costs of the supply side are higher in relatively isolated regions for lenders based in the core. Although the cost of credit may be equalised across regions in an integrated banking system, the availability of credit may differ, which continues to limit the access to the credit supply.

The solutions in a longer term should be *the reorganisation of the institutional and managerial structure of the banks* and to find what kind of banks (local, regional or national) are the best suited to foster development of peripheral regions. On the other hand there is a strong need to create decentralised financial sources and establish regional financial centres in order to serve interests of local economies better. The regional banking systems represent a link between local economies and national, international financial centres. This highlights the problems of *integration between the global, national and regional level*. The integration model is a kind of reaction on theories exclusively focusing on „localism” and „globalisation”. In the first, it is considered to be detrimental to set up of banks from outside of the region, through opening of branches, mergers, or the purchase of local banks. The localism theory based both on the notion of local segmentation of financial markets and on the idea of keeping the savings of a region within the boundaries of the region. This latter can be counterproductive as savings must be free to move in search of the best investment opportunities and returns in a wider unified monetary system. Local banks have smaller ability to invest savings in the same area where they were collected, as local banks very often tend to have grater willingness to export and invest capital – under better conditions of returns – out of the region than do local branches of external banks. Therefore, the main challenge for a region is to offer the best opportunities for investment, attracting capital. On the other hand, the theory on *globalisation*, leads to the argument that global integration of the financial markets removes regional disparities in financial structures and capital availability. In fact, advantages of globalisation are not distributed evenly among regions, as they tend to be located in the stronger and better organised ones. So, in the absence of corrective policies, regional disparities could become wider rather than narrower (*Alessandrini-Zazzaro, 1999*).

The best way to solve the integration problems is the co-existence, complementarity and interaction between different regions and between the centre and the periphery. This reorganisation can be take place through passive integration that arises from outside of the region and means not only capital inflow, but also the entry of non-resident banks opening new branches or incorporating local banks. On the other hand, regional, local banks, in an active way, can participate in inter-regional expansion, which allows local banks to open up to the outside without abandoning their own regional hinterlands. It is important for regional banking system to compete with other areas in order to gain benefit of both regional and sectoral diversification. The inter-regional integration of banking system is the most suitable model for the future development in Europe and this model can be partly adopted by the Hungarian banking. It offers perspective of the development of regional finance partly through branches of national banks channelling the innovation and providing wider range of services and strong equity background in order to protect less prosperous local branches. On the other hand, the modernisation of

the existing local banks and the creation of new institutions in the regions meet the challenges posed by technological, institutional and regulatory changes that transform the world of finance serving the needs of local economy and communities. The most important step towards this system is the establishment of a strong regional financial centre that can serve the interests of a particular region:

Regional centres have an ability to capitalise on localised information spillovers that reduce the costs of local lending, and are closer to the actors of the local economy. The more centralised firms lose their competitive edge if their headquarters are located far from the region where they intend to operate.

Prosperous regional centre can prevent capital drainage from the region by the national financial centre.

Regional financial centre, which is closer to its hinterland, may have lower fixed costs and therefore it is able to serve better SMEs.

The traditional national financial centres face decentralisation forces as their costs of operation are increasing (expensive labour cost, high real estate and renting prices), and the rapid development of communication technology appears to strengthen the forces favouring decentralisation since large volumes of information may increasingly be accessed from remote locations at low cost.

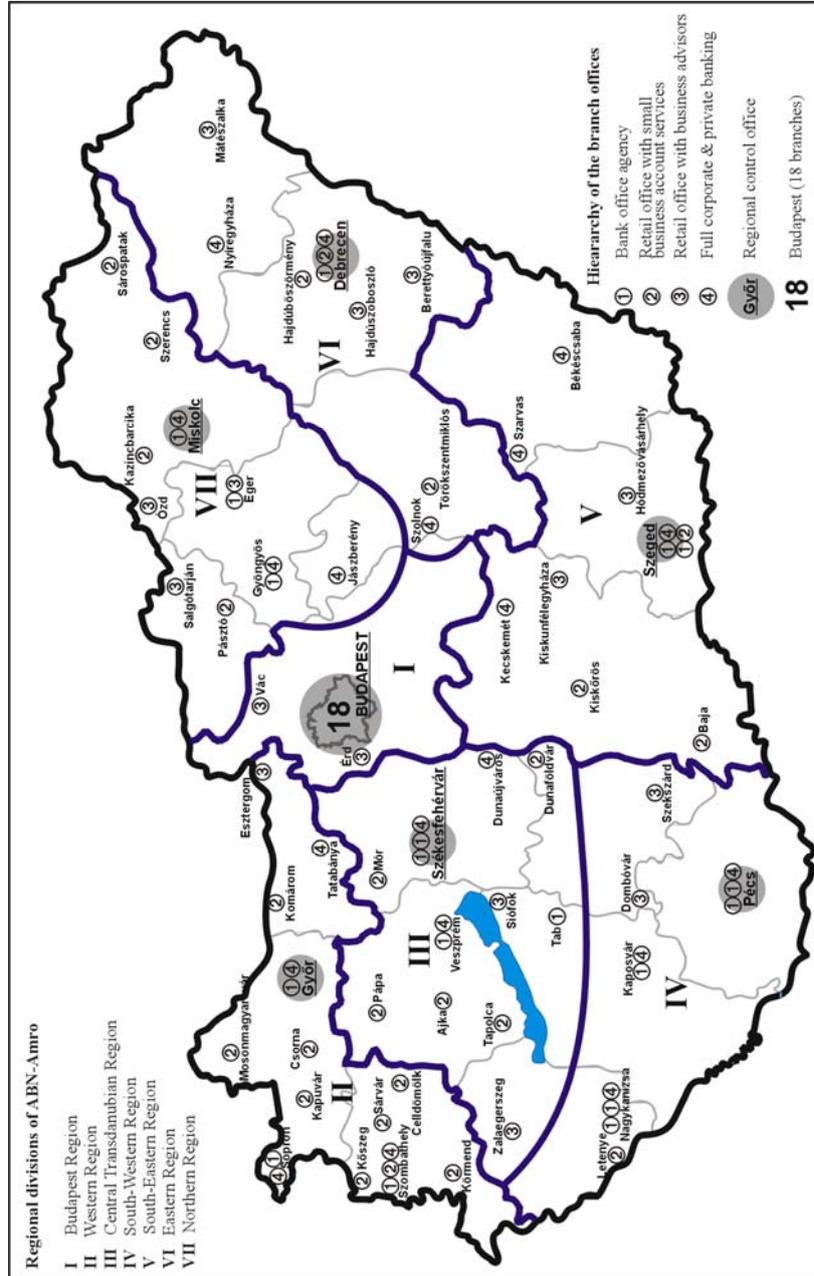
The Hungarian banking system is characterised by a strong spatial concentration. The leading role of Budapest is unique even in European context. The fact that every bank is headquartered in Budapest results in a deformed structure in the banking system. Banking in Hungary is still the most centralised branch of economy. The conditions of capital concentration are unfavourable outside Budapest and the most developed regions of the country. There is a threat of new kind of dependence between the capital city and the regions: filtering-down persists, the central region, making use of advantages of its location, filters the most profitable lines of banking (corporate, portfolio management, risk management, private banking) and diverts to the peripheries the traditional, uniformed and less profitable services. Taking into account capital transfers (regarding to banking capital and the central budget flows) among Budapest and the regions it can be said that capital transfers at the expense of the regions is negative (*Figure 3*).

There are four principal tasks on the agenda of the development of a more decentralised banking network in Hungary. First, it is necessary to expand further the density of the branch network and to extend the range of branch services of the commercial banks in the regions. Second the formation of regional and municipal banks. The third one is the establishment of regional branches of the Hungarian Regional Development Bank. Fourthly, one must ensure the institutional connection of Budapest to international money markets (*Gál, 1999a*).

1) In Hungary the local-regional credit supply operate through the centralised national branch-banking system, and local savings banks operate in restricted rural and urban areas. National banks with branches usually do not provide adequate credit supply for the local SMEs and do not finance municipal projects and infra-structural investments in the regions. National banks are not interested in these less profitable and prudent businesses as they have different orientation of profile and tasks. Therefore they often seem to discriminate against particular regions. Recently, commercial banks with larger network reorganise their institutional and managerial structure forming a hierarchically built domestic network of branch offices, decentralising certain control functions (*Figure 4*). Banks are starting to pay much closer attention to the geography of their distribution networks. Besides national head office they form regional control offices and local branch offices with various functions in order to rationalise their dispersed structures and to take the first steps towards decentralisation and inter-regional integration of banking, in order to use their resources in a more productive way. Regional control offices play the role of intermediate tiers between head office and local branches, having authority over local branches in their geographic areas. These newly created regionally controlled territories of large banks are different from each other, and have not been overlapped the territories of the statistical regions, but their regional headquarters, in the most cases, have been concentrated in regional centres. Recently banks are in the expansion phase of their branch building process. In a few years time they have to concern about network restructuring which is sensitive to geographical variation in profitability, risk, debt and social conditions in a particular area (*Geenhuizen, 1999*).

2) Within the banking system the formation of locally based regional and municipal banks independent from the national branch network would be very important in order to serve regional interests of that region where they operate and assisting in the regional economic development. This require the amendment of the Banking Act, which would allow municipalities, chambers of commerce, economic organisations and private enterprises to establish banks with a strong state support in order to make provision of public duties derives from the state commission. This can be financing public investment, credit supply for local governments, and the intermediation of EU structural funds. These banks can be followed the pattern of the German *volksbanke or sparkasse* and might be based on the stronger Hungarian co-operative savings banks. These institutions will be the major financial agents of municipalities, and will be able to serve smaller businesses better and to promote the direct integration of regions, located in longer distance from the cores, into the global economy. Only a strong regional bank can ensure an adequate credit circulation and can prevent mass capital outflow from a particular region (*Illés, 1993*).

Figure 4  
 The Hungarian branch network and its regional divisions



Source: ABN-Amro magazine. Dec. 1998.

3) Because of the different interests of commercial banks were stated above, only a decentralised regional developing bank network can promote effectively regional development. Therefore, the establishment of regional branches of the Hungarian Development Bank Ltd ("MFB") is necessary. MFB, formed on 1 January 1997, has been the leading institution as the legal predecessor of the wholly state-owned credit institution formed in 1991. MFB's original task is to facilitate the modernisation and invigoration of the Hungarian economy, to participate in regional development, to manage and mediate state funds and allocated for development purposes, and to raise funds in international markets and financing of regional development programmes of municipalities. Furthermore, MFB pays special attention in supporting small and medium-sized enterprises, a sector that plays an important role in the development of the Hungarian economy carrying out large-scale capital expenditure projects in the fields of infrastructure, telecommunication, and the energy sector.

The banks, operating and mediating regional development funds (PHARE, ISPA, SAPARD etc), have to form a network of the regional development banks on regional level in order to mediate European development funds into the level of use. Here it is not enough to create different frameworks of support; there is a strong need to establish institutions mediating funds between the EU/ state level as the provider and the regional levels as the destination. In addition, one of the main tasks of the regional development banks is the promotion of the regional projects and investments from the financial side. This includes the provisions of medium and long-term loans for SMEs, portfolio management and investment advisory services, promotion of the creation of technology centres, incubators and innovation oriented enterprises.

4) Concerning the question whether Budapest will become a real financial centre by international standard. Recently, large cities and different regions rather than simply different nations are in competition with each other in the field of the global world economy in order to gain investment capital, and to connect with the sources of information. As a consequence of rapid restructuring and modernisation of Budapest's economy, the capital city has become one of the most important innovation-centres of the region, which might play an important bridge-head in foreign capital inflow and investment within Central and East European countries. Budapest has a traditional metropolitan townscape, adequate infrastructural background and stable economic environment, which are quite important attractive forces for the investment of multinational companies. Lots of multinational companies (Pepsi Co., Kodak, Nestle, Xerox, Shell) built regional bridgeheads facing Eastern Europe from Budapest. On the other hand, there are certain limits to the growth of such international financial functions in Budapest since telematically based concentration processes, which are characteristic of global money markets, could overcom-

pensate the advantages of geographical proximity. Multinational companies most likely to utilise only the simpler financial services in the Central European region, and the services requiring more resources, will utilise in traditional Western European and overseas financial centres in the future, too. In addition, the smaller size of the national financial market, the weakness of domestic capital (the activity of the black economy), the low level of economic interactions within the regions, the small activity of banking system abroad and the consequently smaller size of banks (smaller provisions for expected liabilities), Budapest is not suitable for the role of regional financial centre. Foreign banks that opened their subsidiary banks in Hungary established branches and subsidiaries in other Central European countries, too. Consequently, foreign banks concentrate more on covering each national market rather than on establishing a single regional banking centre, for instance, in Budapest.

According to some banking experts, Budapest could successfully apply only for the position of a subordinate *offshore like regional financial centre* specialised in certain services. Subject to these conditions, services, which require smaller amounts of capital and highly qualified employees will come into prominence. To carry out all these, it is necessary to strengthen the banking system with the business-like intervention of the state, but the exact date of integration into the EU and EMU may influence the development of the Hungarian banking system and the international role of Budapest (Bellon, 1998).

### **Impact and financial integration on the Hungarian banking sector**

Hungary has one of the best performing banking and financial system in the post-communist CEEs region. The reasons behind this are the following:

- Hungary was the first to abandon the mono-bank system recreating two-tier system (Hungary already had a two-tier banking system when the Berlin Wall came down).
- It was the first to repair the mistakes of the early transition years: loan & debtor consolidation and re-privatisation programme.
- By 1997 Hungary had opened the doors to a higher proportion of foreign banks than in any other post-communist country (ratio of state owned shares had fallen to 11% by 1997).

Despite of its relative small size of the economy, the banking sector dominates Hungary's financial system. The quality of the portfolio of the Hungarian bank sector improved much in the second half of the 1990s (bad debts has fallen to less than 3%) and the average capital adequacy has been around 15–17 percent, point-

ing to a well-capitalised banking sector. The structure of banks' balance sheet has become similar to it has been observed in the EU. Since foreign (mainly EU) investors dominate the banking sector (two-third of the total registered capital and 90 percent of the banking assets) they have contributed to a great extent to the modernisation of banking. Therefore the entry of foreign green-field banks, bank restructuring and bank privatisation to strategic foreign investors have strengthened the stability of the Hungarian banking sector (*Várhegyi, 2002*). While Hungary has been successful in creating a functioning banking system, bank intermediation has not grown as fast as most observers predicted it in the early 1990s. The role and the capitalisation of the banking sector in the economy are rather limited and remain low by international standards. This is largely due to substantial competition from other foreign capital sources such as FDI, direct lending by non-resident banks, intercompany loans, and non-banking funds. Taking the example of the stock of cross-border loans to firms in Hungary, which amounted to 11.5 EUR billion and it was almost as high as the amount of company debt owed to the Hungarian banks (12 billion EUR).

In the advance assessment of the European integration we have seen that the Hungarian financial integration – comprising the activities of foreign investors and the availability of foreign finance for domestic borrowers– will have a significant impact on the Hungarian banking sector.

To assess the advantageous and disadvantageous impacts of the EU integration we have to see that the common monetary framework and the liberalised capital flows will be beneficial only in the long run as they create more severe competition from the date of accession. EU accession may influence net capital inflow to Hungary, but the possible effects are ambiguous. On the one hand, diminishing sovereign risk may raise inflows into the banking and corporate sector. On the other hand, Hungarian banks will be in a better position to diversify assets geographically and they will benefit from their local knowledge. It seems to be unlikely that Hungarian banks will target advanced EU markets, but it is possible that they will expand their market scope in other accession countries as few example already demonstrate this aspiration.

The banking network will continue to change as the number of universal banks will decline, but on the other hand the number of specialised institutions may rise. The major effect of integration is that the number of current subsidiaries of foreign banks will be turned into foreign bank branches according to the non-discrimination principle of the place of origin of the capital and newcomers may open branches. This could further diminish the role of the resident banks and decrease the bank capitalisation subsequent to EU accession. Foreign bank cross-border branching out require much lower capital adequacy ratios, which will be compensated for the unlimited liability of the foreign parent bank. The accession can be expected to promote further competition, resulting a bank margin and operating

cost decline. Competition will be stronger in corporate market, where the competition has already driven down margins and where rivalry will certainly intensify after accession. However there is a good potential for resident bank to benefit from their local knowledge in the lending to the SMEs sector. In retail markets where resident banks already exploit their knowledge they do not face strong competition. Although in retail segment with the increasing numbers of non-banking actors may divert some resources from the established banking network (*Várhegyi, 2002*).

Generally we conclude that the one hand, accession should further enhance the integration of Hungary's banking system with those of EU making the banking more stable and efficient. On the other hand, we have seen that the high spatial and structural polarity within banking sector<sup>1</sup>, which in some remote provincial areas may have a lesser capacity to promote their economic development. These areas might experience certain disadvantage as a result of the financial integration in Europe. In the consequence of the European integration the Hungarian banking will face very similar structural issues as its Western counterpart, namely the widespread of universal banking, mergers & acquisition fostering by increasing competition not only within banking sector but from the side of non-banking players. Globalisation and integration of financial spaces open up opportunities for both local-regional and large pan-European financial alternatives (universal multi-country and global banks), and consequently the major losers of the integration will be the medium size domestic banks. All these challenges facing the Hungarian financial system require new structural and regional policy from the banking side and a more efficient coordination and supervision from the regulators' side.

### **Predictable regional impact of the financial integration**

There is currently considerable interest in debate over the impact of increasing European economic and monetary integration on the regions of the EU. Opinion is sharply divided whether EMU is leading to regional economic convergence or regional economic divergence. Ron Martin's recent comprehensive paper examined the theoretical arguments and empirical evidence of these opposing views (*Martin, 2001*). Among these theories the Optimum Currency Area (OCA) stresses the need for economic homogeneity across regions as a precondition for establishing a unified monetary space. Neoclassical models predict that the European currency area should lead to regional economic convergence of the sort implied by OCA theory. On the other hand, theories of regional growth based on localised

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<sup>1</sup> Characterized by "redlining" policy of the recent years on the side of the SME segment especially in the regions.

increasing returns and endogenous growth, predict that EMU will lead to regional divergence, which is counter to the requirements of the OCA model. Recently, regional economies across EU do not appear to have moved significantly nearer to those conditions. The empirical evidence on regional trends suggests that while “regional convergence took place some extent between 1950s and the mid-1970s, since then, as the process of European integration itself has deepened, regional convergence has slowed and ground to halt” (*Martin, 2001*).

In the Mid-1990s few argument predicted that the prospect of greater integration between Eastern Europe and Western Europe will be limited and may prove illusory (*Budd, 1997*). One of the major argument of these critical outsider views is that the lack of properly functioning financial system will be unlikely to serve and fulfil the wide range of economic and financial requirement (inherited bad debt issue, state budget constraint, risk-related capital adequacy ratios, EMU’s convergence criteria) before the integration take place. The domestic capital markets in the CEE countries are unlikely either to develop sufficient maturity or to overcome considerable difficulties in the short to medium term to provide adjustment role of the integration criteria (*Budd, 1997*). As we have seen in the previous chapter of this paper Hungary (and most of the other accession countries as well) very rapidly and successfully has overcome of structural adjustment problems of the financial, in particular the banking sector at national level. Such an unpredictable rapid pace of successful privatisation and following modernization of the banking sector together with the appropriate adoption of the EU directions for the financial markets and state supervision surpassed even the most optimistic expectation of the observers.

However this exaggerated pessimistic view of modernization prospect of the CEE countries is acceptable in the case of regional impacts of the accession. That argument predicts that the fiscal adjustment to fulfil the EMU convergence criteria will have a greater impact on the regions of these accession economies, and may increase the regional differences and the economical vulnerability of the regions. The imposition of monetary and fiscal convergence criteria may puts up a further barrier to the wider integration of Europe in the case of the too rapid accession process of CEE countries to the EMU. This latter might reinforce the problem of uneven development and may strengthen the core-periphery regional structure within the new accession countries.

There is no doubt the main cost of joining the Union and later to the common currency area together with the loss of the national monetary instruments accession countries might experience certain disadvantage as a result of the financial integration. Several studies have examined asymmetric monetary shock so far at national level, but only very few have done at regional level and none of them surveyed the possible reaction of the financial sectors in the case of the accession countries’ regions. In the following we analyse the possible macroeconomic effects of the EU

and EMU integration at regional level in Hungary using national and Eurostat Database. The methodological approach following some previous surveys' methods, based in the Theory of OCA, has consisted in comparing the values of correlation coefficients for different economic variables among every region, national and European aggregates (*Ramos–Ollero–Surinach*, 2001). The analysis of asymmetric shocks at a regional level is related with the degree of concentration of economic activity. The consideration of the fact that European regions did not have sovereignty to apply their own autonomous policy implies that inside every national state regions could have been adversely affected by the national single monetary policy in the emergence of the asymmetric shocks. In this sense, the consideration of the effects of accession into the European Union and the Economic & Monetary Union necessarily involve to take account the relative situation of every region inside their own country. The methodology used in this section consists in comparing the value of the correlation coefficients between the growth rate of the same variable (GDP per capita growth rate) for four different territorial levels such as the Hungarian regions, the nation state level and the European level. Two different definitions of the European aggregates are considered in the study: EU–15 and the EMU–11 levels. The comparison of these values permits to assess the advantages and the disadvantages (the macroeconomic cost) for every Hungarian region, which will be, participate in the EMU in the future. If the relationship between every region and the European aggregates are as intense as the relationship with the pervious national aggregate, the relative position of the region in this new macroeconomic framework will be similar to the pervious one. The disadvantageous effects will be negligible and namely there will be no additional macroeconomic cost for the given region<sup>2</sup>. The pervious surveys assessing the degree of symmetry of economic shocks experienced by the EU regions and states, have focused on the evolution of GDP, prices and wages, those are strongly correlate to the objectives of the monetary policy (*Ramos–Ollero–Surinach*, 2001). Our survey analyses the relationship among the growth rates of per capita GDP at market prices (PPP) in all Hungarian NUTS II region from the period 1996–2000.

In general it can be said that most regions keep the same relative status inside the country when comparing the previous situation with the European aggregates.

Although in Hungary there are significant regional differences, the data of GDP per capita growth rate between 1996 and 2000 (in the period of economic recovery) represent slight spatial equalization within the country.

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<sup>2</sup> To distinguish between the significant and non-significant correlation we used the *Brander and Neuser* model (1992) suggests that at a 5% level of significance the values obtained from the expression  $2/\sqrt{n}$ , where  $n$  is the number of observation of the considered series.

West Transdanubia was the only region, which in the consequence of the higher level of its state of development has differed from the more fluctuating general national and regional tendencies. However, it is important to remark that the average correlation with the national level is always higher than average correlation with the European aggregates, but correlation with EMU aggregates are usually expected to be higher than correlation with the EU aggregates.

Table 1

*Correlation coefficients among per capita GDP growth rates between 1996–2000 in Hungary*

Regions	EU	EMU	HUN
HUNGARY	0,80	0,85	–
Central Hungary	0,89	0,90	0,92
Central Transdanubia	0,81	0,70	0,87
West Transdanubia	0,19	0,48	0,70
South Transdanubia	0,45	0,69	0,83
North Hungary	0,45	0,60	0,89
North Great Plain	0,81	0,75	0,91
South Great Plain	0,70	0,84	0,96

*Source:* own calculation.

In general terms the standard deviation of the correlation coefficients also increase when considering the European aggregates. In the case of our preliminary surveys we have to consider that in the period of examination Hungary was still not part of the EU and the optimal date of the accession to the EMU is still under debate. Therefore our survey has to be considered as a speculative prediction of the impact of integration. From this table we can conclude that:

- It is predictable that most Hungarian regions will keep the same relative status within the country after the European integration they had previously.
- Regions with low correlation with the national level might have still low correlation with the European aggregates. For example: the West and the South Transdanubian regions therefore demonstrate a more resistant position in terms of the integration.
- There are some regions with high correlation with the state level that show quite low values with the examined European aggregates (they demonstrate less significant correlation with the European aggregates. This means that the majority of the Hungarian regions might be the potential losers in the inte-

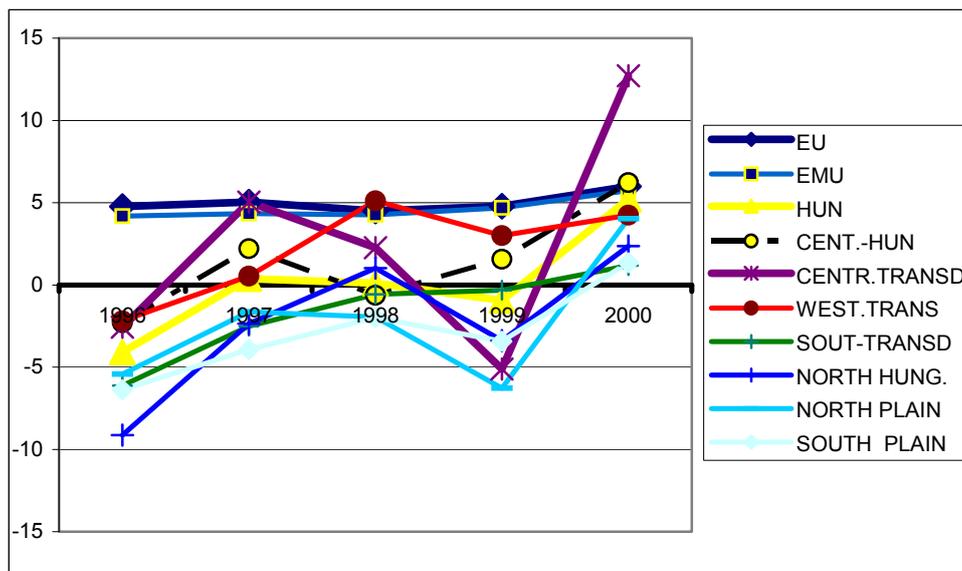
gration process (North Hungary, North-Great Plain and the South Great Plain regions respectively).

- The only regions which might keep its relatively stable and well developed situation is Central-Hungary with the metropolitan district of Budapest and the Central Transdanubian region might experience only a slight vulnerability after the integration.

Further research is required in order to analyse ex-post the consequences of the stable regional differences and the real impacts of the integration in the future. Although there are pessimistic arguments, which predict that the integration of the newly accession countries (with the incorporation of a ‘new periphery’) will distort the “prospects for a comprehensive Europe of the regions” (Budd, 1997), regional economies of the EU have shown large differences in the recent years and do not appear to have moved nearer to the monetary convergence conditions.

Figure 5

*Trends in the per capita GDP growth rate between 1996–2000 in Hungary*



Source: edited by the author.

## Conclusion

In evaluating the competitiveness of the Hungarian banking system, it can be said that the banking sector has been strengthened since 1994 and it has become a more profitable sector. However, progress in banking is significant only comparing to the previous state of the banking system: by international standards the capitalisation of the sector is still low. The quality of the portfolio of the Hungarian bank sector improved much in the second half of the 1990s (bad debts has fallen to less than 3%) and the average capital adequacy has been around 15–17 percent, pointing to a well-capitalised banking sector. The structure of banks' balance sheet has become similar to it has been observed in the EU. The role of the Hungarian banking system in the economy lags behind the more developed countries. The ratio of balanced-sheet footings to GDP is 72%, which is a very low percentage, but it indicates an enormous opportunity for progress in the banking market. Hungary decided earlier than many other countries to privatise state-owned banks to foreign strategic investors who not only injected capital but also a wealth of expertise into the banking sector. In 1995, banks with foreign ownership that accounted for one quarter of the market produced 70% of profit after taxes. Their profitability and efficiency was twice higher than at banks of Hungarian ownership (*Várhegyi-Gáspár, 1997*). Until now, the activity of foreign banks depends on their subsidiary companies, which have to be established before starting their operation.

Despite the general recovery of banking, the sector has remained polarised in many ways. The Hungarian banking exemplifies a pre-eminent position of the national financial centre (Budapest) partly due to Hungary's much smaller market size and the weakness of the regional economies. It seems plausible that there is no place for such strong regional financial centres in a small domestic market and the small geographical areas of the created regions, but to find the right way of certain decentralisation in the banking sector is inevitable. One of the marginal poles of the national banking system is the dense network of the co-operative savings banks scattered throughout the countryside. Summarising the experiences of Hungarian banking, it can be said that the openness of this sector compared to others contributed more to the modernisation and competitiveness of the overall banking system.

Surveying the spatial characteristics of the Hungarian banking system, it can be stated that economic changes are very much dependent on financial services, which reflect the processes of economic transformation. Financial services became the key sector of business services differentiated by spatial and regional development characteristics as well. The spatial structure of the banking sector in Hungary is characterised by a large-scale concentration in Budapest, but the foundation boom of branch offices is also typical in the countryside, as the necessity of presence on

the local markets (collections of resources and credit allocation etc.), as well as the competition for the retail market stimulate banks to build out their national networks.

The presence of the centralised capital market and the lack of decentralised regional financial (banking) system can restrain and slow down regional development in the long run<sup>3</sup>. Local and regional credits can only be received in Hungary through the centralised network of bank offices and through, in limited extent, the weak local co-operative saving banks. Within the centralised banking structure, the regional decentralisation of certain commercial banking services is possible, without questioning the pre-eminent role of the national banking centre, but contributing to a more efficient operation of the network. In the last instance, the question becomes whether the national banking system with this over-centralized character is ready to be fully liberalised and able to withstand increasing competition (with the introduction of cross-border financial services) within the European Union.

Regions of Hungary do not have sovereignty to apply their own autonomous policy implies therefore different regions could have been affected adversely by the national monetary policy and might be affected similarly by the adoption of the criteria of the EMU's monetary policy. In the case of Hungary it can be said that the national monetary policy were not appropriate for most of the regions within the country. As we have seen the conditions of uneven capital concentration are unfavourable outside Budapest and the most developed regions of the country. There is a threat of new kind of dependence on the one hand between the national capital and the regions, and on the other hand between the Hungarian regions and the European financial space resulting in capital drainage and net capital loss in most of the regions. With this background the adoption of the single currency and European monetary policy will change the relative situation of the regions. Although these changes will not be equal for every region, and most of the Hungarian regions will be among the losers unless more active government participation in the support of local-regional finance might diminish the certain disadvantageous effects of integration on the regions.

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<sup>3</sup> At the same time, the commercial banks, which have their headquarters in Budapest, largely concentrate only on the collections of deposits in their national network, resulting in capital drainage and net capital loss in most of the regions.

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