

**IMPACT OF THE FINANCIAL GLOBALIZATION ON THE
DEVELOPMENT OF BANKING SYSTEM OF UKRAINE:
INSTITUTIONAL-LAW ASPECT**

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ABSTRACT

An analysis of financial globalization's processes and factors, their impact on the development of national banking system of Ukraine has been made. The definition "banking system" within the context of globalization processes has been clarified from the viewpoint of identificational factors of the banking system itself including institutional and functional approach to determine the banking system.

Key words: globalization, banking system, central bank, banking regulation

Last decades we witnessed the significant increasing of international financial markets, growth of the transaction volumes on the currency and capital markets, progress in information and telecommunication technologies, liberalization and deregulation in capital markets movement, and the appearance of new financial instruments. These changes in global scale stipulate that capital markets and capital movement growth can bring either an increase in effectiveness of world financial market or threat to the national economies and banking systems. As a result, the globalization has lead to changes in almost all areas of national economies on macro, and micro levels, thus creating new opportunities and certain threats.

The globalization of the world economy can bring, first of all, the new opportunities in differentiation of economic development of the country,

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and therefore, the strengthening of its economic potential [1, p. 351]. This allows some countries to significantly improve their economic positions, thus secure political stabilization and wellbeing of citizens. Taking into account that globalization occurs among countries with various level of economic development, only developed countries can reap the fruits of new opportunities in establishing agricultural relationships and strengthening their role in the world economy.

Developing countries undergo substantial threats as a result of globalization processes, since in most cases these countries are considered to be “commodity attachments” to the world economy; such countries are lagging far behind technologically, their economy is under downturn pressure, inflation and heavily depends upon price changes in the world financial markets on raw materials. Due to the global market development, local economies of some countries are deprived of any economic stimulus and motivation.

Despite the existing threats, we totally comprehend and understand the importance and irreversibility of globalization for emerging markets countries. While creating and establishing of the banking system in Ukraine, we should take into account both positive and negative aspects of globalization. The main attention should be paid to successful integration into the global processes, namely to develop on the basis of the rule of law effective and stable banking system.

The establishment and development of the banking system in Ukraine and other countries within a context of European integration has been devoted a lot of analysis. Research has been done by Ukrainian scientists A.Halchynsky, O.Dzyublyuk, O.Kozyuk, V.Mischenko, A.Moroz, S.Yuriy, as well as Russian scientists O.Lavrushyn, A.Symanovsky, A.Tavasiyev, V.Usoskin, western analysts P.Rose, G.Soros, S.Fisher and others. Although a lot of attention has been paid to the questions of the development of banking system, the meaning of banking within the context of globalization processes needs additional research. Approaches to interpretation of the definition itself “banking system” remain also discussible.

The purpose of this article is to analyze the processes of globalization and its main factors; the impact of globalization on the development of a national banking system; clarification of the meaning “banking system” within the context of financial globalization.

A detailed research concerning the development of banking system in Ukraine is quite acute and badly needed as a result of globalization processes and their impact on banking activity in Ukraine. This corresponds to the fact that many banking systems in various countries of the world including the developed ones undergo the strengthening of internal and external factors' influence, harsh competition on national and international markets, financial and economic instability. Last decades many countries in different parts of the world suffered a large number of banking crises, which became almost permanent. The proof of this is the research of experts from the International Monetary Fund, the leading world financial institution, who beginning from 1997 identified 112 of systemic banking crises in 93 countries and 51 banking crises between 1975 and 1995 years. One of such banking crises was "savings and loans crisis" in the USA at the end of 1980s of the last century. American society paid high price of more than 150 bln dollars [2, p. 7]. Since then, Argentina, Russia, Indonesia, Turkey, South Korea, Ukraine and many other countries sustained a severe system banking crises.

The world financial crisis, which gripped the globe beginning of September 2008 has impaired the banking systems in many countries of the world including Ukraine. The collapse of the largest investment banks and financial companies of the world such as Lehman Brothers, Merrill Lynch and AIG among others has been a trigger of the largest world banking crisis since the Great Depression.

The source of the world financial crisis was a 2007 sub-prime mortgage crisis in the USA. The sub-prime mortgage crisis was an excessive and inappropriate loans to ordinary citizens with low income to buy real estate who later had gone bust and had been unable to repay these loans. As a result of untransparent and unregulated activity of banks and other financial companies on the stock market, the financial crisis spread later to other sectors of the real economy. The financial companies and banks extensively traded assets (derivatives, etc) with far beyond fair market value. Ultimately, the policy of pricing on the core commodities and futures markets was distorted as well [3, p. 14]. But the statement that sub-prime mortgage crisis in the States caused the world financial crisis is not correct. We agree with a viewpoint of professor A. Halchynsky regarding more fundamental sources of the world financial crisis.

According to A.Halchynsky, the changes in proportions of monetary structure, and the ratio of real and “quasi money” during the last decades along with a fact that banking system together with commercial banks played a key role in servicing of speculative capital movement, have led to the world financial crisis [4, p. 8].

Since the general public debt in the USA including outstanding mortgage debt is approximately 14 trln. dollars and average daily volume of transactions on the world currency market is around 3-4 trln. dollars out of which only 5-7% service the real economy and trade, the rest – 90% are speculative transactions, we could easily attribute the roots of the world financial crisis to speculative operations by financial intermediaries on the world markets. Commercial and investment banks as rule are those financial intermediaries, which are being transformed to financial institutions to service the speculative capital movement. Therefore, researchers and analysts should not only quest for causes of banking crises, but also try to find ways to prevent crisis of a banking sector in the future.

While establishing the new system of market relations, a national banking system is a core element for the development of financial market and public sector economy as a whole. The model of the banking system should correspond with distinctive features of national economy and take into account the trends of financial globalization. To build an effective banking system it is rather important to evaluate and analyze the whole spectrum of circumstances, conditions and factors to achieve stabilization of the banking system along with addressing the needs of national economy in banking services. From methodological viewpoint, the evaluation of factors and conditions having influence on the establishment and development of national banking system as well as its key elements – banks, is to be based on the qualitative distinction of the impact of macroeconomic factors on the national banking system in general and the operations of an individual bank. Though for this hypothetical bank, macroeconomic factors are really important, but microeconomic factors, for example, the chance to maximize a profit at the expense of risk management systems and general level of risk, thus jeopardizing the operations of other banks, play the key role.

In scientific literature a lot of approaches to the definition of the essence or meaning of a banking system have been presented. But some grounds of theoretical base of this definition are discussible and need additional studies. In essence, most researchers traditionally understand the banking system as a set of different types of banks and banking institutions, their interdependence and interrelation existing at the particular historical period [5, p. 21]. But to present and formulate a holistic approach to the definition of “banking system”, it is not enough to separate and indentify some elements of the banking system. It is rather important to disclose an internal pattern of these elements and present their interrelations and dependence of each other.

A.Zagorodniy, G.Voznyuk, and T.Smovzhenko consider the banking system as “a set of various banks and other credit institutions, which function within an unified and common financial mechanism” [6, p. 422]. Russian scientist G.Tosunyan adheres to similar approach as well. Mr. Tosunyan includes to the banking system not only banks, but also “non-banking credit institutions” [7, p. 127]. Under the such approach, the difference between banking and credit system is almost being erased since we attribute to nonbanking credit institutions investment companies, credit unions, leasing companies, pawnshops, trust companies and others, which are key elements of the credit system. Since the banking system is a pillar of the general credit system of the state, to attribute other credit institutions to the particular banking system is not appropriate.

The known researchers O.Dzyublyuk [8, p. 134-140; 9, p. 66-99] i M.Savluk [10, p. 92-114; 11, p. 454-469] have comprehensive approach to the essence or meaning of the definition “banking system”. They thoroughly consider the banking system as a complex economic mechanism, disclosing the purpose of the banking system and its specific functions in the economy. In essence, professor O.Dzyublyuk appropriately discloses the meaning of the banking system via analysis of main organizational and economic conditions, which define the functional aim of the banking system.

While supporting the functional approach to the definition “banking system” and its meaning or essence, we consider that it is appropriate to widen the limits of this definition via paying attention to not only the viewpoint of the methodology of functional and institutional approach

(availability of the system of financial institutions and their functional interrelations), but also to the influence of internal and external factors on the banking system.

The banking system does not exist separately. Such system is a key element of an economic and financial system of the country; the banking system within above mentioned systems performs specific functions, being in permanent interrelation between other components of the economic and financial systems and having a certain level of hierarchical interdependence [12, p. 35]. Therefore, it is not appropriate to consider banking system separately from the real economy. The certain level of interdependence between economic and banking systems allows us to come to a conclusion about interdependence and correlation between the effective development of the banking system and general economic condition of the state including a social wellbeing of its citizens since banks are naturally interrelated with all sectors of the real economy. Such interdependence is most visible under the influence of changes in business cycles. For instance, during economic boom period, the banking system is being developed not only due to effective operations of some banks, but also thanks to an increasing demand for banking services from the side of real sector of the economy, while the increase in output leads to a growth in banking operations first of all in providing loans to businesses. This situation allows commercial banks not only to increase the profitability of their operations, but also to secure the stability of banking institutions and banking capital. On the contrary, during downturn period, businesses and large companies including corporations do not need loans from the banks, business climate is negative within the country, which leads to downsizing of banking operations, falling in banking profits and worsening of the whole banking system of the state.

Adhering to the methodology of systemic research and keeping in mind the functional approach to the definition of banking system's essence or meaning, it is important to find factors of influence on the banking system, which are about to cause changes in the integrity and completeness of the banking system and its quantitative and qualitative characteristics. To achieve this goal it is necessary to consider a category "system" in its gnoseological meaning and include in the definition of "system" not only the certain order in the particles' hierarchy and their connections, but also

the whole, complex system, which consists from positioned in order and interconnected particles [13, p. 31].

Taking into account such approach to understanding the essence of “system”, we should consider the availability and functionality of connection’s mechanisms between the components of the system, function and goal of the system, the influence of the factors of internal and external environment as the key identificational features of the system excluding the key elements of the system.

Interconnected elements of the system are being formed within certain social and economic environment under the influence of mechanisms of internal and external connections among the components of the system. It is essential to emphasize that changes in some separate elements of the system (change in structure, change in mechanism of interrelation of some separate elements, change in influence of their weight) may cause the destruction of the whole system or its elements, as well as change systemic interdependence and ultimately lead to changes in quantitative and qualitative characteristics of the system.

By applying the methodology of theory of systems to understand the essence of the banking system we have to analyze the key identificational features of the banking system.

The organizational structure of the banking system is a two-tier principle. The first tier is a central bank, which is independent from a government and accountable to parliament. The second tier are banking institutions or commercial banks (state owned and private), which are independent from authorities and the central bank in part of the financial activity of these banks. Considering the functional structure of mechanisms in connection among the main components of the banking system, namely commercial banks, we should analyze such system from the position of building the system in accordance with a hierarchical principle of certain accountability with an availability of opportunities of the central bank, a bank of the first tier level to be able to manage such system. In two-tier banking system, interrelations among commercial banks are built within horizontal and vertical areas. Vertical relations are characterized by the accountability of commercial banks (state owned and private) to the central bank. Horizontal relations are considered to be the relations of competitive partnership among banks of the second tier.

The organization of functional interrelations among banks within the banking system has an important influence not only on the effective functioning of some banks, but also on the stability of the whole banking system as well as on the relationships within a public sector of the economy and with globalized financial market.

The influence of internal and external environment on the functioning and development of national banking system is of paramount importance. The matter of fact is that the banking system is a key element of the system of the higher hierarchical order, namely economic system. While taking into account zillions of connections between the elements of the banking system and other sectors of the real economy, the influence of general economic conditions and changes in different sectors of the economy on the development of banking system is so strong, that such circumstances can lead even to destruction of the entire banking system or its qualitative characteristics.

Recently, the banking systems of almost all countries of the world have suffered a tremendous external influence as a result of the acceleration of financial globalization. Though to be objective, the influence of financial globalization on the stability and the development of banking system has both positive and negative aspects. It is not possible to limit the processes of financial globalization within the borders of some separate country. Hence, the influence of financial globalization on the development of national banking system needs additional studies and scientific approach.

Processes of “financial globalism” for the national banking system and banking institutions have the following advantages:

- the spreading of international banking standards and advanced banking practices;
- the building of favorable competitive environment, that make the commercial banks increase their efficiency and quality of asset management; improve and widen the range of banking services and financial products; establish the principles of corporate governance in accordance with international standards;
- the increasing of opportunities to attract cheap funding abroad on international financial markets, which diversifies the sources of borrowed capital for banks and serves the source of an increased volume

- of loans for businesses in the short-term and long-term period, thus allowing to low the general level of interest rates in the economy;
- the increasing of capitalization and consolidation of national banking system, namely, via the processes of merges and acquisitions, especially the acquisition of local small banks by foreign investors;
 - the increasing of general qualification level of the banking personnel, which is to work in accordance with international banking standards to provide up-to-date banking services;
 - the growth of banking system's efficiency due to the increase in competition and decrease in a profitability margin of banking operations.

The processes of financial globalizations have also some major threats and negative influence on the national banking system. We should attribute to this phenomena the following negative aspects:

- liberalization and democratization of financial markets; under such circumstances, the regulation of national banking system is hard to apply, thus jeopardizing the stability of financial markets and national economic security;
- the competitive advantage of national banks is weakened; these local banks can not appropriately compete with foreign banks. Having competitive advantages, the banks with foreign capital are conquering the most profitable segments of national market and are about to service the clients with high credit rating. Simultaneously, the local banks are not able to keep their positions on the market and are forced to service retail credit market and clients with the higher risk profile;
- the predictability of the behavior of foreign investors is rather low during crises in the world and national economies. The owners of foreign capital are first of all interested in safeguarding their own money. The stability and development of national banking system is not the goal of foreign investors. On the contrary, their behavior at the pick of the financial crisis could be the threat to national economic security as a result of uncontrolled foreign capital outflow.

There is no doubt that attracting of the large volumes of foreign capital allows the country to secure a macroeconomic stabilization and is an evidence of certain level of confidence from the side of investors to the

economy and political establishment in the state. In this case we do not mean the short-term and speculative capital provided by foreign investors; what we infer is the long-term foreign direct investments. Therefore, the influence of positive and negative aspects of financial globalization on the banking system and economy depends on the quality of the represented foreign capital. The appearance of the first grade foreign banks on national banking market with tremendous potential should be only greeted. Such policy will bring the effectiveness and stability of national banking system, expedite the competition among banks operating on local banking sector, and finally will facilitate the high level of liquidity and stability of the national banking system and its integration into the global financial market.

Simultaneously, the presence of the large volumes of foreign capital in the banking sector weakens the stability of national banking system due to global trends in instability of capital movements. It is rather difficult to forecast the behavior of foreign investors within the banking sector during financial crises on the world markets or inside the country. Since banking operations have some peculiarities, namely that the volume of own capital is a couple of times less in comparison with attracted capital (own capital approximately equals to 10-15%); during financial instability the foreign investors are very jittered and spooked and prefer to save at least a part of their capital invested abroad than to loose a lion's share at the pick of the crisis. There are a lot of examples of such behavior of banks with foreign capital in the history of financial markets. For instance, in 2001 foreign banks hastily left Argentina, plunging the country into a financial chaos [8, p. 175]. Therefore, we could agree with the fact that the processes of financial globalization have potential risks and negative aspects concerning the national banking system. This attributes not only to the effectiveness of the banking system, but also to the stability of banking system and a level of the country's economic development.

Having made an analysis of the banking system from the viewpoint of identificational features of the system, we could come to the conclusion about the causality of the development of banking system and complex processes taking place both in external and internal environment within the banking system itself. From the viewpoint of institutional and functional approach to the definition of the essence or meaning of banking

system, it is appropriate to consider the banking system as a hierarchically structured and subordinated set of banks operating in accordance with established rules and norms, which are being formed and developed within the limits of national economic system under the influence of internal and external factors.

This approach allows us to consider the banking system as a complex and complete system of interrelations among banks; such system is manageable and self-organized. Above mentioned features of the system are being formed objectively, in other words independently from the wishes of some separate elements of the banking system.

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