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IMPACT OF PUBLIC-POLITICAL FACTORS ON TRANSFORMATIONAL PROCESSES IN NATIONAL BANKING SYSTEMS

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Abstract

After the global financial crisis, banks must reconsider their position in the light of profound changes in the economic, social and political spheres, which are causing transformation processes. On the one hand, we emphasize the benefits of banking relationships that establish close contacts with the bank's customers. Through a long-term orientation, economic relations banking evens out incentives, it supports the long-term needs of the bank's clients, which leads to lower inequality and increased innovation in the economy. On the other hand, the interaction between politics and the banking system can cause transformational development and have negative aspects. First, with new frontiers and competition in banking, banking can be particularly prone to political interference. Second, the shock from a bank's relationship can be passed on to its borrowers. We consider how banking relations can overcome their shortcomings in the context of the systematic transformational impact of administrative and state-political factors on the banking system of the national economy. The article provides an overview of the current scientific literature of domestic and foreign authors, considering the impact of administrative instruments for regulating banking competition, as well as the boundaries of state intervention in banking activities. The main features of the state's impact on the national banking system and the conditions for such a process have been determined. The negative aspects of the excessive influence of political institutions and regulatory bodies of economic, monetary management on the transformation processes in the banking system are revealed.

Keywords: Banking system, transformational development, banks, banking competition, stability of the banking system

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1. Introduction

One of the main stages in the formation and development of the domestic banking system is the creation of its first level in the form of a central bank, which in 1860 was named the State Bank of the Russian Empire. This bank was opened by decree of Emperor Alexander II dated May 31 (June 12), 1860. This event will mark, according to several authors (Cherskaya, 2015; Isaeva, 2011), the second stage in the development of the Russian banking system of the market (capitalist) type up to the tragic events of 1917. The events of 1917 led to a change in the course of free credit and financial relations to the total nationalization of banking and its practical liquidation.

In 2020, it will be 160 years since the establishment of a full-fledged banking sector of the Russian state. The entire history of the construction and development of the domestic banking system is associated with many difficult periods, which were accompanied by restructuring, transformation, reformation, and in the period 1917–1922 – conditional liquidation. The market stages in the functioning of the banking system were characterized by ups and downs and an increase in the role of credit and financial institutions in the economic development of the state. While the planned socialist national economy suppressed any private initiative and credit organizations played the role of distributive monetary and financial institutions within the framework of the state economic and budgetary plan. With the transition of the Russian economy to the market type of management, the transformation processes in the Russian banking sector continued with new features, and various stages of transformation and restructuring of the architecture of the Russian banking system are observed to this day. Modern macro-banking policy and banking supervision are aimed at proportional regulation of the activities of credit institutions. In this context, it is advisable to consider the factors of an administrative and state nature that influence transformations in the Russian banking sector. This study will highlight the main features of such processes and identify their problematic aspects for the national economy.

2. Problem Statement

Following the global financial crisis, the regulatory framework of banks has undergone significant changes, which has led to an increase in the level and quality of banking capital, liquidity regulation and structural changes. An important aspect in such conditions is the nature of the impact of changes in the rules for conducting banking activities on the development of national banking systems. In recent years, the Russian banking sector has been characterized by active transformational development, which has a negative state on entrepreneurial activity, the development of the real sector of the economy, and the stability of national economic development. In such conditions of frequent changes in the institutional structure of the banking system and its organizational structure, it is important to study the main factors that cause the transformational development of the national banking system, using world experience.

3. Research Questions

The subject of the research is the analysis of world experience in the influence of administrative and state-political factors on the transformation processes in the development of national banking systems

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with the identification of features, risks and negative consequences. Disclosure of the subject of research is seen in the following issues:

1. Consider the approaches of world authors to the assessment of the main administrative and state-political factors that have a negative impact on non-transformational processes in national banking systems.

2. Identify the main problematic aspects associated with the boundaries of state political intervention in banking and causing transformation processes in the banking system.

4. Purpose of the Study

Based on a systematic approach in assessing the world experience of transformation processes in the formation of banking relations, determine reasonable boundaries of administrative and state-political influence on the transformational development of national banking systems to minimize the negative risks of the instability of banking activities.

5. Research Methods

Basel III capital requirements can increase the attractiveness of banking relationships in the long term. However, implementation is essential, and capital requirements should be increased gradually and during periods of relative economic stability to prevent a shock to bank lending (Jiménez et al., 2017).

It is even less clear whether liquidity regulation is related to banking relationships. The authors (Duijt & Wierts, 2016) find a small impact of liquidity requirements on corporate bank lending, but confirm that liquidity requirements affect the structure of bank liabilities. Consequently, liquidity regulation can affect the amount of funding that banks receive from underlying deposit relationships.

In general, banking can serve as an anchor of stability for the economy in times of crisis if it successfully overcomes the problem of deterrence. The revised regulatory framework provides further support for banking relationships. In a crisis, the tension between political forces and banking relations is increasing. While in times of crisis, banks may need government support to maintain stability, it is important to maintain a competitive banking environment. However, politicians may have more corrupt motives during their involvement in banking.

Banking relationships face clear challenges due to the changing political landscape, where political interference, state borders and (lower) competition can become visible (Krylova & Krylov, 2014). A large number of authors in their studies have concluded that political government intervention distorts the distribution of funds within the national economy (Browne & Dinç, 2005; Carvalho, 2014). Political interference in banking can manifest itself through several channels. First, government intervention to ensure banking stability is based on political calculations. For example, politicians postpone government intervention in bankrupt banks during election years for fear of backlash from voters. Second, politicians may favour one group of banks over another (for example, state banks versus private banks, or national banks versus foreign banks). Foreign banks may even be subject to direct or indirect expropriation by the host government; for example, through high taxes or requirements to keep the state debt (Afanasyeva, 2016). Third, politicians use government ownership to influence lending decisions. State ownership is

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associated with less developed financial systems and ineffective governments (La Porta et al., 2002). State-owned banks increase lending during election years and lend profitably to both politically connected companies and in politically sensitive regions (Sapienza, 2004). Politicians influence bank lending policies to reap private benefits, such as the influence of firms in moving jobs to politically sensitive areas (Carvalho, 2014). Fourth, the increase in state participation in the banking system leads to its monopolization (Ezrokh, 2018), nationalization (Tashtamirov, 2019), and technological lagging behind world trends (Tashtamirov, 2020).

It is not clear whether there is a causal relationship between banking orientation and government ownership. A potential explanation could be that state-owned bank's abuse banking relationships because discretionary decision-making based on available information allows for unbridled political interference. An alternative resolution could lead to government banks only using banking because, as central banks, they are closest to firms and have the most access to information. While domestic banks rely on lending relationships to leverage their preferential access to information, foreign banks are using transactional lending techniques to overcome information gaps (Beck et al., 2018).

The banking system may try to contain political interference by changing its organizational structure. A more hierarchical and centralized organizational structure functions better in an environment filled with corruption (Skrastins & Vig, 2019). However, higher hierarchy and centralization can negatively influence decision-making based on the available information required for banking (Liberti & Mian, 2009). It is decentralization and a lower hierarchy that leads to an increase in the availability of information and a decrease in loan standardization, with a subsequent improvement in the quality of loans (Skrastins & Vig, 2019).

A decentralized organizational structure, in which branch managers are given greater autonomy in their lending decisions, encourages lending to small firms. In conclusion, banks' reaction to political risks can influence the volume of banking relationships. A potential solution to this problem may come in the form of banking supervision. Authors (Beck et al., 2006) analyzed whether intense banking supervision can mitigate the disadvantages of banking corruption. They believe that engaging a supervisor to monitor and discipline banks is ineffective in reducing corruption in lending. Instead, supervision, which enhances private monitoring of banks (for example, through the disclosure of accurate information to the private sector), reduces the impact of bank corruption on firms' ability to attract external financing. Countries with strong legal institutions are mostly able to take advantage of banking regulation, which enhances the monitoring of private banks.

State capital support for banks during the financial crisis changed the competitive environment in the banking sector (Hasan & Marinč, 2016). Changing political circumstances could affect competition, potentially reversing globalization and internationalization with further protectionist intentions. It is crucial to determine the approximate boundaries of government influence on the development of banking and the formation of banking relations.

First, the broader government influence over the banking sector can create less competition. (Degryse & Ongena, 2007) provided empirical evidence that in the case of higher competition on the ground, bank branches use more lending relationships. Several other variables can influence the relationship between competition and banking. If large and international banks are present in the credit

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markets, higher competition suppresses investment in banking. However, if small national banks are in the majority, higher competition pushes banks to expand banking relationships. Private small and medium-sized banks support start-ups and provide finance for small and medium-sized enterprises, while large banks contribute to efficiency gains for large corporations. Based on a meta-analysis (Kysucky & Norden, 2016), it was concluded that the quality of banking is higher in conditions where banking competition is high. Consequently, restricting competition can lead to a decrease in the quality of banking services and the limited benefits of banking.

Second, higher boundaries of government intervention protect national banks from external shocks that allow them focusing on banking. Government involvement can prevent the spread of the financial crisis across countries. Giannetti and Laeven (2012) identify the "flight home" effect, where international banks during the global financial crisis cut their lending abroad more than lending in their domestic market. Schnabl (2012) analyzes the transmission of the 1998 Russian default to Peru. Lending to Peruvian firms declined in the aftermath of the aftershock, and the effect was most pronounced for nationally owned banks that borrow internationally, intermediate for foreign-owned banks, and weakest for locally-financed banks.

Banks reduced lending less after the global financial crisis if they were highly integrated with the national economic market and if they provided loans to geographically close borrowers (De Haas & Lelyveld, 2014). This circumstance suggests that banks strengthen their stability if they establish a strong position in local markets that encompass lending and local finance relationships (e.g., local deposit mobilization). Political events and active government intervention in the banking system can reduce the benefits of banking.

6. Findings

First, banking supports national economic growth and increases funding for small and medium-sized firms, the poor and minorities, all of which work to reduce inequality in society. Pressure on banks in the form of interbank competition and customer protection is needed to curb rent-seeking. Second, by reducing information asymmetries, banking organizations facilitate the financing of innovative firms.

However, banking must respond to short-term economic challenges such as financial crises, government intervention, and a revised regulatory framework. While substantial empirical evidence suggests that banks are eager to maintain their relationships with borrowers during a crisis, research also shows that the shock for such a bank is transmitted to its borrowers. The impact is most significant for weak borrowers. For the positive impact of the relationship on stability to prevail, it is crucial to make banks more resilient. In this light, the increased capital level required by Basel III supports the benefits of banking relationships.

7. Conclusion

Transformational processes in national banking systems can be caused both by internal factors (changes in banking legislation, change of political course, government intervention, changes in the competitive landscape) and external factors (world financial crises, economic, technical defaults of individual countries, sanctions and customs trade wars). However, in the process of transformational development, the banking system must meet the highest requirements of stability and reliability, while maintaining the performance of its primary functions (transactional and transmission).

We emphasize that one of the main shortcomings of the Russian banking system is associated with political government interference in banking and the processes of concentration of banking capital. For act on unverifiable information, bankers must be given discretion in lending. However, discretion allows politicians manipulating who seek power over bank lending. Protectionist political forces that reduce competition and tighten the boundaries of banking can put additional strain on banking relationships, especially in large international banks.

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