Finance and Banking

The Macroeconomic Context - A Favourable Factor to Continuous Change and Extending Banking Risks

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Abstract: Globalization, as a contemporary source of the capabilities and risks, is a reflecting theme for every domain of environment and research. In the new economy, financial globalization, which already has an appreciable record of manifestations, is a phenomenon with deep consequences on the mechanism of the world economical activities. A hierarchical order of rules and responsibilities together with the profound manifestations are the coordinates of our contemporary existence and they represent the base of systemic risks. Hence, the implementation of Basel standards is controversy; it may represent a competitive advantage including Romanian banks as Romania is now a European country.

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1. Globalization - the source of the contemporary capabilities and risks

Wealth and power were a priority, during the evolution of mankind, according to which they have developed strategies and development objectives. The means of acquiring them were different; they were specific to each historical stage. Their manifestation was also different: migration, colonization and nowadays globalization.

Nowadays, under the sway of speed and of information, the concept of globalization has become a major concern on the agenda of the Heads of State, managers, scientists and even ordinary people, rich or poor.

As any phenomenon, globalization has been the object of study, research, analysis, prediction for the economic, political, technical, cultural, social, humanitarian environment and many more, so that there is no involved or unaffected specialization, by this exclusive opportunity.

The concept of "globalization" appeared for the first time in a dictionary in 1961; by the 1989 came in terms such as markets, tendencies, events, communications, risks and others such as global warming.

Over time, as a controversial phenomenon and much discussed in the press, the globalization, under different expressions, becomes for many authors of different specializations, the subject of numerous works. The appraisals were also appreciative when it was about increasing the wealth, but it was also criticized, when the globalization was causing a global crisis.

There are interesting opinions of researchers able to detach the inertia of routine of experiences and feelings when prophesying the future of mankind. John Naisbitt and Alvin Toffler are the most popular futurologists with prospective researches on globalization.

John Naisbitt[1] launches the idea the mankind's future shaped by mega tendencies and Alvin Toffler, in his "War and anti-war"[2] and "Power Shift"[3], he puts the new system of wealth creation and information revolution on the forces that induce "the future shock".

Globalization is therefore an objective process as a result of the third wave of development of humankind evolution resulted from the digital revolution and information management which "made available to consumers and economic operators a whole range of new capabilities"[4] such as:

a) for consumers:

- purchasing power being substantially greater;

[1] Naisbitt, J., *Megatendinţe, zece noi direcţii care ne transformă viaţa*, Colecţia Idei Contemporane, Editura Politică, Bucureşti, 1989.
[2] Toffler, A. şi H., *Război şi antirăzboi. Supravieţuirea în zorii secolului XXI*, Editura Antet, 1995.
[3] Toffler, A., *Powershift, Puterea în mişcare*, Editura Antet 1995.
[4] Kotler, P., *Managementul marketingului*, Ediţia a IV-a, Editura Teora SRL, Bucureşti, 2005, p. 1.

- greater variety of available goods and services;
- a large amount of information;
- many opportunities to facilitate interaction and the approach of launching or receiving orders;
- the possibility to exchange opinions about products and services;

b) companies:

- the possibility of exploiting a new and redoubtable information and sales channel, with a increased range to communicate and promote their activities and products;
- more and diverse information about various markets, customers, potential customers and competitors;
- facilitating and accelerating internal communication between their own employees;
- two-way communications with customers and potential customers and more efficient transactions;
- the possibility to send ads, coupons, samples and information only to customers that have requested or consented to receive such things;
- adapting the offers services to individual customer requirements;
- improving the supply, recruitment, staff training and internal and external communications;
- reducing costs by improving logistics and operations.

The phenomenon generates new convergence in the national and international economic life due to structural transformation, quantitative and qualitative products in human thinking and behaviour in the mechanisms of organizational and functional structures of the economy, in the scientific research and technology, in the politics and in the environment.

Globalization is a factor of progress and economic growth.

Today globalization has developed a new stage of its evolution, becoming a complex, irreversible and inevitable phenomenon, which requires a new people's way of living and thinking about themselves and humanity through time and space.

The two elements, namely time and space resources are sustainable for the present and future wealth.

Time as a resource of wealth, knows also new development possibilities under the action of the new capabilities generated by the information era. Adapting speed is the key for improving the time resource! "Il est temps de passer à la vitesse supérieure"[1].... The speed is responsible for the present future! Moreover, as Philip Kotler, said "The future is before us. The future has already happened."[2]

2. The effects of globalization in the financial - banking. Domination of financial risks

In the new economy, the financial and banking environment are among the first and most exposed to shocks caused by the propagation speed of information, financial globalization is a phenomenon with profound consequences on the mechanism of operation of overall economic activity.

Financial globalization is already a considerable record of events during its evolution.

Opening the national financial markets, their deregulation, the development of new financial instruments, the expansion of banks and other international financial institutions, the involvement of foreign financial institutions on national markets and domestic financial institutions on foreign financial markets have facilitated the intensification of international flows of capital, thus creating a functional global financial system.

During its evolution, the financial globalization has known manifestations specific to the development level of each historical period, identified as: early modern era, Classical Period of Gold Standard, Bretton Woods phase and the contemporary era.

Developing communications and the private international financial system have determined that after 1960’s, the Bretton Woods System pillars could no longer be

[1] COMMISSION EUROPÉENNE, Theme*: Statistiques générales et régionales,* Luxembourg, Office des publications officielles des Communautes europeennes, 2006.
[2] Kotler, P., *op. cit*., p. 1.

supported and it appeared the premises of creating the new global financial space, known as “cybernetic space of computer banking”[1].

The internationalization of the industrial production, developing the global markets for goods and services has naturally and irreversibly led to globalization of the monetary markets.

Money becomes more than ever, "a modern means of communication between the main actors of economic life, separated in time and space"[2] and a barometer of the changes which occur in the economic world.

These prerogatives, along with the possibilities of superior valuing through specific operations, required the separation of the financial capital from the productive capital, between themselves, however, it was maintained a system of relations. With the increasing influence of the global financial market over the conditions on the business environment, the relationship between financial capital and productive capital has adopted other nuances.

However, by handling the instruments’ characteristics - interest rates, exchange rates, and prices - the international financial capital has become a decisive role in the life of each country. Therefore, the financial analysts considered the international finance capital responsible for the emergence of "global capitalist system"[3] which, in turn, has favoured the financial capital’s freedom to move where is better rewarded, that is in a global financial area represented by the financial market.

The expansion of the global financial market is linked to the exit of the currency under national laws and the regulations issued by central banks; in the 1960s, the market of euro-dollar, that is the market euro currency made pressure on the U.S. dollar and led to the collapse of Bretton Woods System (the 15th August 1971, President Nixon announced that the dollar was no longer freely convertible into gold, thus portend the end of fixed exchange rates and the Bretton Woods system).

Global financial flows and networks have encountered a spectacular intensity and expansion after the crash of Bretton Woods System and especially since 1973 when the Organization of Petroleum Exporting Countries has increased four times the oil

[1] Scholte, Ian Aart, *Global Capitalism and the State*, in International Affairs, no. 3, July, 1997, p. 427-452.
[2] Popescu, Ion A., Bondrea, Aurelian A., Constantinescu, Mădălina I., *Globalizarea: mit şi realitate*, Ed. Economică, Bucureşti, 2004, p. 133.
[3] Soros, George, *Criza capitalismului global: Societatea deschisă în primejdie*, Ed. Polirom ARC, Iaşi – Chişinău, 1999, p. 105.

price. Increasing intensity and expansion of global financial flows and networks has been achieved on the effects of deregulation of the financial markets and the contemporary technological revolution.

The financial services providers - banks, insurance companies, stock exchanges, etc. - began to engage in international operations, the credit and the insurance knew an expansion related to foreign trade. If at the end of the XIXth century and early XXth century, the international network of banks was limited; between 1960 and 1970 there was an unprecedented expansion of the multinational banks, particularly the American ones. After 1975 the Japanese banks have become the stars, they occupied the top positions in the specialty rankings.

The competition for extending the portfolio of financial services to a national and global scale has led to increasing the degree of focusing and centralization of the financial activities. Except for some domains of the extraction area, the highest degree of globalization in the financial services domain is the phenomenon with the most broad and complex manifestation. Thus, in the financial services sector the focus has led to the emergence of true financial supermarkets, which, on the principle of scale economies, cover a wide range of financial operations and investment and a wide range of consultancy services, insurance, intermediate and even tourism.

International financial centres are focused on London - New York - Tokyo.

The centre of the international financial markets with the fastest response to changes of world business cycle is New York, however, according to the number of the carried out transactions, London holds the supremacy, having the advantage of their geographic position and tradition.

Financial operators tend to get closer to customers, especially to international corporations, which has led to the focusing on the banking system in these centres, but also in major cities of the world where it connects most of the world transactions such as Frankfurt am Mein, Amsterdam, Dusseldorf, Hamburg, Zurich, Milan, Sao Paulo, Hong Kong, Singapore, Sydney, Chicago, Toronto etc.

Financial flows have accompanied for a while foreign trade activity, subsequently forming a unique market, far from the traditional trade, with banking players and multinational corporations.

The feature of this market is linked to the high degree of international capital mobility and the response speed of the structural changes occurs in the global economy. Any non-synchronization in economic and monetary policies of the States with the tendencies that manifest globally, would attract penalties from the market, sometimes the consequences are dramatic, by triggering crisis with global effects. Most recent examples are supported by the crash of Wall Street since 1987 or the Asian crisis in 1997, which highlighted the threats of ignoring the mechanisms of international financial market by governments.

Because of the propagation and contamination speed of other components of the global market and the consequences of the recession nature, it is obvious the financial dominance in the face of the industrial powers.

At the same time, it is indisputable that this rule is different, as are patterns of contact in international developed financial markets. Distinctions are marked in particular by tradition and guidelines and claims on government investment.

The gearing in the global financial system is about factors that have national specific pattern. For example:

- London remained the centre of international finance because of its central role in Euro-currency market, of the conservative government policies of repealing controls on exchange and opening towards financial liberalization within the European Union.

- France through social measures, on the will to promote Paris as a centre of international finance, abolished the controls on the capital, while promoting a policy of financial liberalization, which led to a considerable increase in transactions with other financial instruments and establishment of futures stock market in 1986, at four years, after London.

- In Germany, faced with the pressure exerted on the trade flows of funds to the interior, the controls on capital have been used as tools of resistance to these threats until 1981 when it switched to the capital liberalization, but with the monetary reserves regarding the derived products which remained low in development.

- Under the pressure of the current account deficits that followed the 1973 oil crisis, Japan has seen unprecedented financial openness that has determined since 1998 the movement to the appliance of a new liberalization implementation of the financial sector and to give up at the latest controls over capital flows.

- Active attempts of involvement in foreign affairs showed in Sweden; since 1970 has liberalized capital flows, controls removed to the late 1980s and opened in 1989, after the French financial future exchanges.
- In the U.S.A, since 1974 there have been removed the controls on the capitals, the dollar remained the main international currency and the New York central system of the majority of the global financial activities.

The financial system through the two components - financial markets and banks - plays a fundamental role in the functioning of modern economy, in the process of economic growth, in the efficient granting resources in society.

The financial practices of developed countries, where competition has led to innovation and diversification, have created alternative financial systems. Preferences of actors involved in financial transactions ranges between market-based and bank-based[1]. There is already a competition that positions first, in some countries (e.g. USA, England), the capital market before the banking system due to the benefits of increasing wealth, protection of shareholders, reducing corruption, appropriate legislation, reduced inflation and so on. In other countries such as Germany the successful practices balance inclines towards the banking system.

The modern economies have identified innovating solutions for conciliation in the interference area of the two components; the banks add to their concerns also the activities of financial markets.

Along with the development of global financial activity, since 1970 the banking activity took an unprecedented proportion.

The development of multinational American, Japanese and German banks has triggered true global competition, the UK banks being put into difficulty during 1970-1980. With the liberalization of capital markets the banks in France and Sweden became more active. If within a period of time (1970-1980) German and Japanese banks were more focused towards their internal activity, leaving the initiative to the American banks; in modern times the penetration of markets, mergers and partnerships are common actions covered by multinational banks.

The capitals mobility, financial innovation deregulation are the challenges and concerns of most governments and central banks in the civilized countries in establishing macroeconomic and monetary policies, in the administration of

[1] Teodora Vâşcu (Barbu), Bogdan Moinescu, *Sisteme bancare comparate – Note de curs*, Academia de Studii Economice, Catedra de monedă, Bucureşti, 2003 , www.msbank.

decision-making tools such as exchange rates or interest rates as an inflation targeting, adjusting the current account deficit and temporizing/tempering risks, as known that the proportion and the dimensions of the global financial system attract specific effects of the globalization.

3. Systemic risk - the effect of entrainment risk deregulation

The structural effects of systemic risk, especially in the contemporary era when modern financial systems were operating with packages of products and implicitly there were risks formed in packages.

When it is a question of involving the banks, the systemic risk can be amplified, especially in the case of derivative transactions that offer to the participant agents the opportunity for adopting speculative strategies.

An illustrative case would be the Berings Bank of 1995 and Thai currency collapse that triggered the East Asian financial crisis in 1997.

"Power without hierarchies, authority without rules, and decisions without responsibilities"[1] are attributes of the international financial system and the vectors of the global crisis were amplified by the inclination to risk, towards speculative business and towards uncertainty of the transnational financial institutions, endangering the financial discipline worldwide. Such risks are generated, in particular, by the regulatory issues.

Internet communications make financial difficulties to propagate instantaneously, determining the contamination phenomenon to spread very fast, so the financial difficulties encountered by one or more banks have consequences for the others too.

The systemic risk attempts also to the structural changes in the power balance between governments and markets, or between the public and private authority in the global financial system.

The regulation and identification of more effective tools to control systemic risks, especially after the East Asian financial crisis in 1997 are, since 1998, a priority for OECD governments or institutions such as the IMF or World Bank. Therefore, deregulation, dependence on oil, global and national economic and financial

[1] Manolescu, Gh., *Globalizarea şi polarizarea în reţea a pieţelor financiare internaţionale*, Revista Finanţe, Banci, Asigurari Nr. 2/februarie 2007.

imbalances are among others the daily concerns of the world contemporary leaders because of the risk of being out of control which could not be corrected and its effects on the global level.

In the absence of responsible international bodies, each government or regulatory national authority must make decisions at their national level, according to the basic principles applicable to all, including:

- Adopting appropriate budgetary policy;
- Promoting the rules of good service labour markets and goods;
- The implementation of effective networks of social security;
- Establishment of policies that allows the development of an efficient and solid financial system;
- Adopting monetary policy that is focused on a low, stable and predictable rate of inflation;
- Accession of all countries to a new international monetary order and engaging them to follow all rules of the game.

Basel Committee on Banking Supervision has assumed this risk.

4. The History and Necessity of Basel Agreements in Banking Activity

The globalization of financial services, internationalization of capitals and raising money to the rank of modern means of communication have changed the ratio of forces in the global economy in favour of modern financial activities which, holding the nervous centre, controls the functions of the system.

Crises such as the crash on Wall Street, the collapse of the Thai currency or the case of Berings Bank have demonstrated the role and the proportions of a loose financial phenomenon. Systemic risks can be propagated with velocities determined by the synergy of forces and magnitude of the phenomenon “boule de niege”.

The void of authority, due to lack of international bodies responsible for the global economy, led to alternative solutions and international initiatives of analysis and, if possible, counter the risks. Basel Committee on Banking Supervision, established in

1974, with a role of achieving global stability of the banking system was an attempt in this direction.

The Basel Committee is an international body composed of representatives of the supervisory bodies and central banks of major industrialized countries: Belgium, Canada, Switzerland, France, Germany, Italy, Japan, Luxembourg, Great Britain, Holland, Sweden and the United States. Usually, they have periodic meetings (every 3 months) at the headquarters of the Bank of International Settlements (BIS), where a permanent Secretariat is located.

The fall of Bretton Woods system and the disappearance of "good conduct" in the money domain regarding the currency fluctuations and the changes in interest rates, caused severe disturbances in international financial markets that Basel Committee on Banking Supervision, established in 1974, introduced in 1988 the Agreement on the Capital of Covering Risk.

If by the beginning of the 80's the financial banking community saw the issue of risks only in terms of credit, in the context of globalization of monetary banking and capital markets, the business banking, practices of risk management, the approaches of supervision bodies on financial markets have had significant changes which imposed new rules for banking supervision and up-grading the Basel Agreement, through a project known as the Basel II Agreement.

The Basle Agreement addresses to active banks worldwide. Initially, the agreement of 1988 known as Basel I, set a minimum capital limit only through the credit risk (the most important risk for banks), even if it was assumed that the full allocated capital (minimum 8%) covers other types of risks, by including them in the credit risk.

Starting with 1996, by amending the Basel I Amendment, the risk market has been tackled separately, and to cover it, it was allocated a certain amount of capital.

Subsequent events, such as losses of the European bank environment for over USD 12 billion accumulated since 1992, because of bad managing risks at the level of banking institution, were a concern that the Basel Committee has developed, in 2001-2003, that is the Basel II.

Comparing the two rules in our research, we identified the following differentiations:

Basel I	Basel II
It focuses on only one way of measuring risk	It stresses on the role of banks' internal methodologies, supervisory reports and market discipline
It presents a unique dimension	Flexibility, the list of approaches, incentives for an improved risk management
It has a structure-based on an overall approach	Greater sensitivity to risk

With the new Basel II Agreement, the Committee initiated a model with the level of required capital for various types of operational risks (e.g. losses risk for interrupting/damaging the computer network, insufficient documentation or fraud). Most leading banks allocated more than 20% of their operational risk capital.

The analysis of operational risk is growing continuously, existing three different ways of treating them:

1. the base indicator - it involves using a single indicator that reflects the operational risk for the entire activity of the bank;

2. the standard indicator - the standard indicator presupposes establishing a different coefficient for different types of activities;

3. methods of internal assessment - requiring banks to use internal rules for determining the minimum capital requirement.

Risk banking management is the attribute of risk management aimed at optimizing the performance of banking companies through:

- ensuring further development of the bank;
- extending the internal control of performance on profit centres, customers and products;
- knowing the price of decision on new operations by determining risk;

- rebalancing portfolios on activities and operations.

For the banks in Romania, adopting the principles of the New Basel II Agreement regarding the capital adequacy is a competitive advantage.

The relating rule enables better the risk management, it will reduce the cost of capital and it will free resources for lending, increasing the expectations of potentiating the financial intermediation of corporate and retail sector in our country.

Although, globally, many banks have made progress to implement Basel II standards, the recent events, resulting in massive losses at international financial markets, drew doubts about the performance of the new regulation.

In addition, their responses are expected query relating to issues such as:

- Adopting investment vehicles. The development investment vehicles generate an exposure to risks associated not only to credit but also to packages and / or different lines of business as shown by recent investments from the U.S. market, with high real estate risk.

- the settlement of some demands of differential cost. Thus, there were requirements for lower costs for associated risks of some active packages than for the risks associated with individual assets.
- Determining exposure to risks. Exposure to associated risks should be quantified exponentially and not linearly, according to the principle that the risks are made of.

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