

ISSUES OF COUNTRY FINANCIAL SECURITY GOVERNANCE

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Abstract

Financial security of a state is one of the fundamental factors of its independence and sovereignty in the context of globalization and the permanent instability of social and economic processes. In this paper, we are going to analyze the factors that determine condition of financial security, aiming to explain dependence on the financial security of the harmonic development components of the financial system. We stress the need for effective financial system governance by regulators for national economy growth and development.

Key words: financial stability, financial system, financial security.

Introduction

No doubts that state's financial stability is important in contemporary conditions of development. Countries with better-developed financial systems tend to grow faster (Levine, 2003).

Internationalization of finance has meant less regulation than ever, and regulation was scarcely very effective even at the national level (Whitney, 2007). Risks to stability have been increased, despite various policy steps to contain the euro area debt crisis and banking problems (Yan, 2012). The great recession has proved again that collapse of financial markets inevitably leads to crisis phenomena in the real economics sector.

In Ukraine the deep social-political crisis accompanied by the external aggression is laid upon the consequences of financial-economic crisis. The situation causes the necessity of the authorities' adequate actions regarding support of financial security and economic stabilization. However, the meaning of the terms "financial stability" and "financial security" is rather different in Ukrainian economic literature, legislation and in the Western economic science.

The purpose of this paper is to try to articulate definitions of financial stability and financial security as well as to outline main dangers to financial security of Ukraine in contemporary conditions and main streams of administrative impacts of authorities as regards their evening-out.

1. Defining financial system, financial stability and financial security

The prevailing approach to define financial system's essence, in the western economic science, is functional-organizational approach. Financial system incorporates markets, intermediaries, financial service firms, and other institutions through which households, private companies, and governmental establishments implement financial decisions made by them. (Bodie, Merton, 2000) Financial systems are crucial to the allocation of resources in a modern economy. They channel household savings to the corporate sector and allocate investment funds among firms; they allow intertemporal smoothing of consumption by households and expenditures by firms; and they enable households and firms to share risks. These functions are common to the financial systems of most developed economies (Franklin, Gale, 2001).

Merton (1995) identifies six core functions performed by the financial system:

- provides a payment system for the exchange of goods and services;
- it is a mechanism for the pooling of funds to undertake large-scale indivisible enterprise;
- a way to transfer economic resources through time and across geographic regions and industries;
- method of managing uncertainty and control risk;
- a provider of price information to help coordinate decentralized decision-making in various sectors of the economy.
- enables eliminate the consequences of asymmetric-information and incentive problems when one party to a financial transaction has information that the other party does not.

The financial system has the crucial role of availing funds to the real sector, any interference in its central role, causes asymmetrical flow information leading to financial instability (Mishkin, 1999).

The concept of financial stability is used to estimate the protectibility of financial system with the aim of providing effectiveness of its functioning.

Financial stability is a broad concept, encompassing the different aspects of finance (and the financial system) – infrastructure, institutions, and markets (Schinasi, 2004). Both private and public persons participate in

markets and in vital components of the financial infrastructure (including the legal system and official frameworks for financial regulation, supervision, and surveillance).

Financial stability not only implies that finance adequately fulfills its role in allocating resources and risks, mobilizing savings, and facilitating wealth accumulation, development, and growth; but it should also imply that the systems of payment throughout the economy function smoothly. The concept of financial stability relates not only to the absence of actual financial crisis, but also to the ability of the financial system to limit, contain, and deal with the emergence of imbalances before they constitute a threat to itself or economic processes.

Financial stability is a condition under which an economy's mechanisms for pricing, allocating, and managing financial risks (credit, liquidity, counterparty, market, etc.) are functioning well enough to contribute to performance of economy.

Financial system is regarded in two aspects in the Ukrainian economic literature: by internal structure and by organizational composition. By internal structure, financial system is an aggregate of rather separated inter-related areas and divisions of financial relations, which represent specific forms and methods of exchange, allocation and reallocation of GDP (Yukhi-menko et al. 2010). As a rule, the basis of separation of financial system realms is the level of economic system, and herewith four realms can be distinguished: microeconomic level – finances of commercial firms and finances of households; macroeconomic level – national finances; world economy level – international finances; generic level – financial market. By organizational composition, financial system is an aggregate of financial bodies and institutions governing monetary flows in the economy and characterizing the system of finance governance in a country. Taking into consideration the above mentioned interpretation of financial system, financial security is understood as protectability of financial interests on all levels of financial relations; certain level of independence, stability and sustainability of country's financial system under influence of external and internal destabilizing factors endangering financial security; ability of national financial system to provide effective functioning of national economic system and constant economic growth. Thus to understand the essence of financial security the concept of financial stability is not enough, as it does not embrace the characteristic of public finance's state. Financial stability is subject to control or influence by public authorities, however it does not include fiscal and budgetary components characterized through sustainability of public finances and monetary stability.

Monetary stability refers to stability of the general price level; financial stability to the stability of the key institutions and markets that go to make up the financial system. Sustainability of public finances, as it is interpreted by experts from the Organization for Economic Co-operation and Development (OECD, 2009), includes four basic criteria:

- solvency, or the ability of government to fund existent or possible future liabilities;
- the ability of government to sustain economic growth during long-term period;
- justice, or the ability of government to provide pure financial advantage for future generations, not less than pure advantages granted to the modern generation;
- stable taxes, or the ability of government to fund future liabilities without tax burden increase.

The observed difference in definitions allows us to consider financial security as the combined definition, which consists of financial stability, monetary stability and sustainability of public finances.

2. Concept of financial security governance

The definition of conceptual principles of forming the effective and efficient mechanism of national finance risk management targeted to prevent crisis phenomena and to minimize their consequences, will provide effective functioning of national economics and national economic growth.

Financial security is conditioned by the ability of public authorities to provide sustainability of national financial-economic development and payment-settlement system, observance of basic financial economic parameters of national economics, optimal allocation and rational utilization of budgetary resources as well as by the ability to make external borrowings optimal for the national economy and effectively utilize them, neutralize the influence of financial crises and deliberate actions of international (states, TNC, interstate formations) and national (clannish-corporate, mafia structures) economic agents on the national economic and social-political system, prevent the outflow of capitals abroad, crimes and administrative delinquencies in the financial area. Thus, the state of national financial security directly depends on governance efficiency.

Governance is determined as rules, enforcement mechanisms, and organizations. It means the process of decision making and the process by which decisions are implemented (or not implemented), involving multiple actors. Good governance is one that is accountable, transparent, responsive, equitable and inclusive, effective and efficient, participatory and that is consensus oriented and that follows the rule of law.

The system of financial system governance includes legislative guaranteeing and national bodies, which determine priorities, develop and implement financial policy of Ukraine.

The basic principles and directions of national policy of Ukraine with regards to providing the national financial security are defined by the Concept of provision the national financial security (CMU, 2012). According to the Concept, financial security is the state of national financial system where necessary financial conditions for the stable social-economic development of the country are created, its sustainability to financial shocks and disbalances is provided, conditions for maintenance of its integrity and unity of national financial system are created. Financial security in its turn has the following elements:

- banking security, is the level of financial sustainability of country's banking institutions, that enables to ensure effectiveness of banking system, functioning and protecting t external and internal destabilizing factors regardless of conditions of its functioning;
- non-banking financial sector security is the level of development of stock and insurance markets that enables fully meeting needs of society in the specified financial tools and services;
- debt security is the appropriate level of internal and external debts taking into account costs of its servicing and effectiveness of use of external and internal borrowings and optimal ratio between them sufficient to meet actual social-economic needs that does not threat to national sovereignty and its financial system;
- budget security is the state of providing the solvency and financial sustainability of public finances that enables the national authorities most effectively implementing their functions;
- currency security is the state of exchange rate formation characterized by high society trust to the national currency, its sustainability, creates optimal conditions for progressive development of the national economy, attraction of foreign investments to the country, integration of Ukraine to the world economic system as well as maximally protects against shocks on international currency markets;
- monetary-credit security is the state of monetary-credit system providing all subjects of the national economy with quality and available credit resources in the volumes and under conditions favorable for achievement of economic growth of the national economy.

The subjects of guaranteeing the national financial security are: the President of Ukraine, the Supreme Council of Ukraine, the cabinet of Ministers of Ukraine, the Council National Security of Defense of Ukraine, ministries

and other central authority bodies, the National bank of Ukraine, regular courts, Office of Public Prosecutor of Ukraine, local state administrations and local authority bodies and citizens of Ukraine and their associations.

Governance of national financial security requires solving of a wide array of issues related to the definition of financial security criteria; continuous tracing the factors that provoke external and internal threats of national financial security; elaboration of measures for their prevention and overcoming.

The determination of financial security level is carried out in accordance with the Methodical recommendations of calculation of economic security level of Ukraine (CMU, 2013). The methodology provides official indices of financial security level of Ukraine – indicators and their threshold values.

3. Threats to the financial security of the state

Nowadays very important changes in both economic and social-political life, have been happening in Ukraine. It puts the stability of the economic system into the centre of the objective of governance. Financial security is a necessary condition to allow the pursuit of other good objectives of public policy that are important for society. Financial security is not a superior objective for other goals, but it is a necessary condition to achieve them.

The main factors threatening the financial security of Ukraine are:

- limitedness of access to international financial markets (substantial deterioration of international ratings);
- substantial dependency on export-import activity (particularly on import of energy resources);
- worsening of international trade state, increase of payment balance deficit, including account of current operations (trade wars with the Russian Federation, annexation of Crimea);
- deep dependency on foreign creditors (IMF credits);
- influence of world financial crises on the national financial system;
- instability and imperfectness of legislative regulation in the financial area;
- uneven spread of tax burden on companies that causes tax evasion and capital outflow abroad;
- capital outflow abroad resulting from investment climate deterioration;
- low level of budget discipline and imbalance of the budget system;
- national debt increase (debt policy of Yanukovich's government);
- shadowing of economics;

- insufficient level of gold currency reserves;
- substantial level of economy's dollarization;
- significant fluctuations of exchange rate of national currency, not stipulated by macroeconomic factors, considerable speculative component;
- weak development of the stock market, particularly concerning the use of accounting mechanisms and passing of property on securities as well as provision of investor right protection on the stock market;
- insufficient level of capitalization of the financial system.

The situation is the most threatening for budgetary and debt national security. In accordance with international standards and indicators generally accepted in science, the optimal volume of national debt must not exceed 60% GDP. If the level is exceeded the state can lose financial independence and go bankrupt. The public debt of Ukraine over 2010-2013 reached 40% GDP compared to 12% in 2007, and according to the project 2014 – 52,7%, international reserves of the National bank of Ukraine from 2011 to early 2014 reduced more than twice as much to the critical mark of 15.5 milliards U.S. dollars (CMU, 2014).

Debts of the country are economically justified only when expenditures made at their expense facilitate the increase of future budget revenues or reduction of future budget expenditures, i.e. have positive yield rate allowing the state to pay off the principal debt and to pay interests. That is, such resources must act as the financial ground of implementation of structural transformations in the country's economy, infrastructural projects. Public borrowings of Ukraine during the recent years were used to pay current budget deficit, viz. were in fact eaten away that deepened the debt precipice.

Budget security is characterized from year to year by the growth of public budget deficit. While annually the Ukrainian state loses around 140 milliard UAH from tax unpayment, and over 100 billion UAH are stolen away on public procurements. About 200 milliard UAH were withdrawn from the public budget of Ukraine due to "tax pits" in 2013. The notion "tax pits" can be characterized as commercial firms with the staff of one or two persons, and insignificant authorized fund. Usually, such companies are specially established by financial-industrial groups to implement tax minimization schemes, legalize contraband or unregistered goods. It may be state that via such companies, enterprises of the real economy sector that act as customers, try to avoid payment of VAT (minimize liabilities) or to groundlessly reimburse from the budget, "clean out" money and convert to cash. Normally such structures live for one-three months.

Banking and non-banking security characterizes the ability of financial intermediaries to fulfill their functions to the full. Financial intermediation plays a role in the growth process because it is an integral to provision of funding for capital accumulation and for the diffusion of new technologies. Four broad groups of services carried out by it:

- mobilising savings;
- diversifying risk;
- allocating savings;
- monitoring the allocations of managers.

Financial intermediaries (both banks and non-banking institutions) are not able to ensure appropriate fulfillment of all their functions today. Credit resources have become much more expensive as a result of interest rate increase, outflow of deposits is observed because of high instability in the country, depreciation of national currency for more than 50% caused the considerable losses and reduction of profitability, decrease of incomes of business and households leads to reduction of the insurance market, capitalization of the stock market remains low.

Conclusions

The financial component, which influences directly national interests and sustainable economic development, plays an important role in the system of economic security of Ukraine. The national security in the financial sector includes security issues in the public sector, in the management of public debt sector, state guaranteed debt and corporate sector debt as well as in taxation, in the real economy financial sector, and the non-banking financial sector. The distinctive features of national security in the financial sector are balance, resistance to internal and external threats, guaranteed ability of the state to form, to safeguard and to use the financial resources in order to maintain social-economic development and service the financial obligations.

Taking into consideration the current state of financial security of Ukraine, public authorities must take measures aimed not only at improvement of its performance, but also at overall economic stabilization and recovery of economic growth. Rationalization of imports, implemented primarily through optimization of energy consumption, increased exports at the expense of technological and organizational advancement, promotion of advanced development of high tech industries, de-shadowing of economy, restructuring or writing-off (by certain obligations vectors) debts, legalization and involvement of “shadow” foreign exchange capital in banking transactions, is hereby of special importance. As to the financial security, several steps are being taken by the state.

The Law of Ukraine “On preventing financial catastrophe and creating preconditions for economic growth in Ukraine” (2014) provides a number of measures to eliminate tax avoidance schemes, to increase the state revenue, to cut spending, and to reduce the budget deficit. However, there are certain issues that require further analysis and finding the solutions. They include decentralization of power and corresponding decentralization of budgets, optimization of budgetary spending, good budget implementation, and increase in transparency of public finances.

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