

**Athens Institute for Education and Research
ATINER**



**ATINER's Conference Paper Series
CBC2015-1854**

Financial Intermediaries Contribute to BRICS

**Irina Z. Yarygina
Professor
Financial University under the Government of the
Russian Federation
Russia**

An Introduction to
ATINER's Conference Paper Series

ATINER started to publish this conference papers series in 2012. It includes only the papers submitted for publication after they were presented at one of the conferences organized by our Institute every year. This paper has been peer reviewed by at least two academic members of ATINER.

Dr. Gregory T. Papanikos
President
Athens Institute for Education and Research

This paper should be cited as follows:

Yarygina, I., Z. (2016). " Financial Intermediaries Contribute to BRICS ",
Athens: ATINER'S Conference Paper Series, No: **CBC2015-1854.**

Athens Institute for Education and Research
8 Valaoritou Street, Kolonaki, 10671 Athens, Greece
Tel: + 30 210 3634210 Fax: + 30 210 3634209 Email: info@atiner.gr URL:
www.atiner.gr

URL Conference Papers Series: www.atiner.gr/papers.htm

Printed in Athens, Greece by the Athens Institute for Education and Research. All rights reserved. Reproduction is allowed for non-commercial purposes if the source is fully acknowledged.

ISSN: 2241-2891

23/03/2016

Financial Intermediaries Contribute to BRICS

Irina Z. Yarygina

Professor

**Financial University under the Government of the Russian Federation
Russia**

Abstract

Article deals with important issues within the international economic relations and displays the role of financial institutions as intermediaries that supply clients with financial instruments and contribute to successful development within BRICS.

Keywords: Banking Instruments, Banks, International Economic Relations.

Introduction

Actually, within BRICS¹ countries strategic importance is placed on mutual economic developments. Financial institutions play special role in the process. There is no denying the fact, that effective banking strategy depends on accurate assessment of common problems and a search for mutual solutions to increase quality of life in member countries. From experience, fast liberation of financial-economic relationships leads to decline in some areas of economy, including strategically important ones and to slowdown of government regulation of key industrial areas, which leads to increase of bank speculations and high risk level of economic environment. To find the way in turbulence is the main task for the government that has to use different vehicles, intergovernmental monetary and fiscal measures including.

Literature Review

The theory of fiscal federalism identifies main functions for the public sector: macroeconomic stabilization, income distribution and resource allocation (Oates 1999). The problem of fiscal decentralization in developing countries are carefully studied by Fukasaku and de Mello (1998), Manor et al. (1999), that tried to give reason to the restructuring of government and market functions. Some scholars within the public choice school consider that decentralization tends to increase health competition among jurisdictions (Brennan and Buchanan 1980, Breton 1989). Anyway, in globalized economy developing countries (Ahmad 1997) require the mechanism of intergovernmental grants transfers. Thus, the intergovernmental financial institutions can contribute to it, supplying the country-members with unconditional, conditional and equalization grants (Brosio 2000).

There is no denying the fact, that only international experience can provide useful methods for policy makers (Bird and Vaillancourt 1998), but the approach of [laissez-faire](#) or market fundamentalism has a weak potential to solve most economic and social problems (Stiglitz 1998). Market fundamentalism was popularized by [Soros](#) (1998), which trusts in a free market mechanism. That is a privilege of a genius, but practice has proved the approach of [Stiglitz](#) (1998), who criticized the International Monetary Fund (IMF), advocating a set of policies which is generally referred to the market fundamentalism, "based on an incorrect understanding of economic theory and as an inadequate interpretation of the historical data".

The correct understanding means reasonable regulation and cooperation in solving mutual problems and meeting new challenges. There is an on-going process of reengineering international cooperation within globalized economic environment. The speed of cooperation depends on macro and microeconomic factors, as well as participation in the global market, supply of the products and

¹ BRICS: abbreviation for Brazil, Russia, India, China, South Africa.

political support. Mutual aims of any government are linked with economic and social developments, as well as successful production, safe banking, financial stability and effective debt management that are the main feature of globalization. The goals can be reached within BRICS cooperation.

Research Methods

The study of financial institutions' role within BRICS was based on complex research methods, based on gathering and analyzing data, needed to answer the research goal.

Mostly used were qualitative and mixed methods. Within these categories, more specific approaches, including an array of options, case studies, self-reporting and surveys were applied. The mixed methods of research, that included contextual understanding like interviews or observations, were combined with facts and statistics that contributed to the investigation of the subject on multiple levels, gaining different views and a comprehensive look at the research. An applied mixed methodology led us to the integration of different theories and ideas.

While carrying out the qualitative research, there was a goal to explore specific phenomena, not to prove a prediction, according to qualitative research methods. The assessment of interviews, focus groups and observation of main developments and contract arrangements were also used to collect data. Used qualitative methods provided rich, contextual explorations of the topic that is culturally meaningful.

Research Results

Research proves that banks of emerging markets are in a race towards "fast profits" and cut down on traditional operations (project financing, loans, etc). Vast amount of operations is attributable to expatriation of capital into offshore zones. Absences of banking in ex-Soviet countries support for economic development lead to manufacturing decline of 65%. However, in countries with government involvement and gradual market transformation-economy recovered faster (Belorussia, Kazakhstan and Uzbekistan). Use of reasonable government regulation of economy, as a whole, is a vital condition of development and formation of new approach to the realisation of commercial relationships and aids development of international banking. Effective cooperation between participants of BRICS countries is also influenced by the amount of government support given to economy during formation of market relationships. Under growing economic co-operation manufacturing feel pressure from their clients that require quality goods and services and from competition which are able to offer better quality at a lower price. Sensible regulation of inter-state relationships encourage economic co-operation. In its tern, creation of common legislation base which provides effective banking

servicing of BRICS economy, will create stable foundation for collaboration. Establishment of essential conditions for interaction between credit institutions requires time and political power.

The analysis of current developments of emerging markets has proved that financial institutions are able to support economy sectors during growth of partnership by backing economic interest of countries and encouraging trade development which increases cooperation. Banking support for the least protected market participants - SMEs - driver and buffer of any economy will create favourable conditions for effective economic operations, creating employment, production of goods that are under market demand. Effective global cooperation of BRICS countries connected with necessary design of common banking support strategic developments. Consequently, creation of a reasonable international strategy is possible by using holistic analysis of economic demands of each member-country. Reality has shown that absence of economic forecasting in banking activity leads to negative consequences. For example, "tax holiday" policy, granted to banks by state of Brazil when dealing with foreign investors caused overproduction of cars, which created stagnation of number of economical segments. According to world practice, it is important to provide legal coverage for property of economic partners - a key business component taking into consideration specifics of each country. Formation of mutual economic strategy increases importance of banking intermediary, especially in the area of financial risk management, liquidity financing and management of financial capital. Country's economic development depends on the level of banking business involvement, attributable to customers and market partners.

Rating of market demands of BRICS member countries shows that implementation of joint growth programme demands long-term financing, project financing, inclusive of syndicates and constant information flow in all segments of economy. Effective relationships between entities are built on foundation of common economic interests and governmental support. Expertise of many countries from Central and Eastern Europe (CEE) has proved that public support and substantial banking activity desire to minimise change and promote progressive actions in restoration of economic ties.

During the formation of a mutual economic strategy it is important to consider the experience of CEE countries which overcome the consequences of market reforms in the economy, which showed that countries are not concerned with prospect of banking reform, but how they are going to be implemented in reality. In this regard, presence of objectivity in progressive actions towards available financial resources is very important. Governments support of entrepreneurs who are dealing in area of international trade, unification of banking activity and policies will create favourable conditions for economic cooperation within BRICS.

Growth of economic ties of member-countries based on common values and development goals suggests a long-term strategic alliance of private credit institutions in the field of international trade, taking into account customer flexibility. Sound financial management, modernisation of banking technology

will also contribute to the development of the BRICS market. Support of the balance of interests of public and private structures, growing capacity of joint investment financing, strengthening the legal framework and improving the legal support of business processes also contributes to the development of economic cooperation of economic entities. In addition, banks' activities supporting economic cooperation among BRICS countries should be transparent and accessible to the customer, regardless of the place of accreditation if their business activities executed in the economic environment of these countries. Currently, one of the important directions of banks - participants of international economic cooperation is a support programme of trade relations ("Trade - Finance Promotion"), which assists customers in selecting contractors for international cooperation. Currently, SMEs of BRICS member-countries have to apply adverse cooperation schemes, including an advance payment for imports. In other cases, the completion of foreign trade contracts is prevented by excessive pricing conditions for underwriting and insurance payments. In this regard, using interstate status, a number of banks-members of the BRICS can help to achieve favourable agreements with banks' exporters to improve the conditions for international cooperation.

One of the most important trends of banks is to provide payment guarantees to exporters, ensuring pre-export financing and cooperation with insurance companies. It seems appropriate for BRICS financial institutions to move towards the development of exports/imports activities of economic entities and to provide customers and their counterparties a variety of banking services on the agreed "flexible" terms of cooperation, namely: provision of documentary operations, organisation of the bank syndicate to finance exporters/importers, financial market transactions, advising stakeholders, assist clients in calculating the limits for dealings with exporters and importers, confirmation of letters of credit and guarantees, issuance of guarantees and counter-guarantees, use of interstate opportunities, taking into account documentary instruments, promissory notes, drafts, etc.

To maximise demand of member-countries, financial institutions, mostly banks, are expedient to: acceptance of drafts drawn by exporters/importers, finance exporters against documentary letters of credit issued by reputable banks, to provide the agreed overdrafts, to ensure the implementation of credit lines for exporters/importers, financing of drafts drawn by exporters or financing of documents against acceptance, financing of collection documents with recourse to the borrower, provide trade financing against contract documentation, accepted by the bank of the importer, financing of goods supply in the initial stage of the implementation of contracts (for up to 180 days), financing of importers/exporters, financing of the fulfilment of contractual obligations, financing documents against acceptance, implement pre-export funding. Given currency specifics of balance of payments of some member countries of the BRICS, banks need to provide specialised services to business entities in the national currencies of their countries, namely: payment services for clearing payments, maintain multicurrency account with the possibility of strengthening account liquidity in national currencies from the

surplus balances on other accounts, manage clients' short-term liquidity in the national currencies of the BRICS countries, manage accounts in national currencies through telecommunication systems, maintain the "escrow" accounts. Considerable attention of the banks should be given to their corporate clients: advise on monetary and financial conditions and payment of exports/imports contracts in national currencies, currency regulation and currency control in the member countries of the BRICS, organisation of short and medium term financing of commercial transactions in national currencies, including syndicated loans, hedge currency risks, to carry out currency arbitrage, provide trust operations in national currencies and other currencies on behalf of their clients.

An important component of creating a common economic space of the BRICS countries is a presence of special interstate deal insurance programme with involvement of government agencies for export insurance and guarantee of international operations. Specialised agencies of the BRICS countries are able to effectively promote multilateral cooperation for business partners.

Banks involvement in encouraging formation of joint leasing companies with the participation or support of the state will also promote cooperation. An important area of international cooperation is discounted (governments-sponsored) financing of innovative and knowledge-intensive projects, as well as socio-economic programmes: environmental protection, infrastructure development, energy - supply and health programmes, etc. At the same time an important role of the banks is within a modernisation and engineering support, as well as in the opening of joint credit lines in order to ensure the economic benefits and enhance the living standards of countries-members of the BRICS. In turn, the formation of the multilateral clearing system can stimulate the formation of BRICS' payment system and their monetary cooperation that will contribute to amelioration of a global financial infrastructure.

Analysis and Discussion

Actually, market participants assess the role of public institutions in modern economy: either it is a "pilot star" of the risky market or a bureaucratic vehicle that enforces economic entities for non-profit behavior. What is it? History has given examples of a reasonable contribution of governments to economic progress. The experience of countries, bridged over transformations, pushes forward the idea of fruitful correlation of public and private entities, achieving economic development and profitable activity.

Actually, the government of the Russian Federation is keeping the way of economic supervision not for the sake of reforms but in order to improve standard of living. Starting from the 90s of the 20th century Russia entered the period of reforms. Within next fifteen years the market economy and its transparency has been growing, as well as standards of living have been improved as a result of a reasonable state participation in economic developments.

International experience has been approved by the Russian Federation that states as following:

1. Uncontrolled market can bring any country to social tension, polarization and unemployment. Based on international experience reasonable measures have contributed to the positive effect on price formation and structure of the economic development. The world economic crisis has also proved the hypothesis of the predominate role of the state in regulation of the market economy.
2. Market participants are doing their best in achieving short-term results, guided by "selfish" demand of profit that sometimes contradict the socio-economic interest. Thus, it is impossible to back totally on the "wheels" of the market.
3. Spontaneous change of the market economy is linked with financial discrepancies and accompanied by systemic and functional risks. To ensure social demand under these circumstances public institutions cannot, but support private entities to manage risks.
4. Public supervision does not mean involvement into activities of private entities - intention is to challenge society interests, such as:
 - economic growth, production increase, development of innovations, improvement of supply and demand structure;
 - decrease of unemployment rate, support of price level;
 - social responsibility: respect of regulation and profitable activity within the market environment.

There is no denying the fact, that the challenge of any government is the efficiency of macroeconomic supervision, provision of flexible rates for the economic growth, improvement of legislation, unification of business standards and increase of living standards.

Main problems to be solved by any government are:

- insurance of economic development;
- stimulation of public private partnership;
- reasonable regulations.

Actually, Russian Federation is adapting to international standards, taking into consideration current economic environment that contributes to easy business contacts. To ensure positive developments Russian State Duma adopts laws on the market development and its supervision that protect economic entities make their activity transparent.

New challenges for public and private entities within the market are linked with responsibility of its activity: financing and insurance of export credits, production/promotion of goods and services, intellectual property and innovations.

Private entities of the Russian Federation take into consideration the international experience: special attention is to be paid to the early European capitalism in Germany, for example, has proved the effectiveness of a centralized control over prices, quality of goods and services, tax and rates regulation.

The historic "merry-go-round" produces lessons that should be put into local environment in accordance with its specificity. For example, there is a variety of proportion of monopolist and liberalism in different states and sometimes the necessity of state regulation of economy is considered to be doubtless. At the same time the succession of economic cycles shows that self-curing of the recession is impossible without public finance involvement. More than that, during the crisis the ties between the state and its entities deepens. Within the economic break-downs or sustainable development any state bears responsibility for its economic and social background. Public authorities have a vast range of instruments to influence the situation: taxation, monetary policy, legislation, etc. For example, the government of the Russian Federation pays great attention to implementation of efficient fiscal policy initiating the economic growth, such as:

- state expenses on social programs;
- maintenance of strategic development;
- reasonable taxation.

The main challenge of the government of Russia is to improve living-standards of its population, backed by the economic growth. An important role in providing financial support plays financial intermediaries banks. At the same time an efficient banking strategy depends on the adequate estimation of economic peculiarity of its clients. Practice shows that speculative banking activity makes great problems: cutback of production, abrupt economic deregulation, etc. Being in pursuit of fast earning, private banks often cut down traditional banking and capital outflow to offshore zones starts to grow.

Reasonable regulation and supervision of the banking sector helps to reinstate economic background that is reinforced by international cooperation. At the same time, efficient international cooperation of private and public entities depends on instruments of economic and financial support.

There is no denying the fact that market participants are under pressure of client's demand of high quality goods and services and the competitors are able to offer consumers goods of a better price and quality. Under these circumstances, equal treatment of all market participants and transparent determination of general principles of activities can push forward international cooperation. Unified legislative base, efficient bank support of economic entities creates steady background for regional cooperation within the integrated economic area.

However, formation of effective conditions for cooperation takes time. In general, underdeveloped countries are too enthusiastic and they underestimate

the period of adoption to the level of the industrial growth. At the same time he points out the lack of a "political will" that usually spoils the situation.

European bank for reconstruction and development experts conclude, that, for example, the some of the commonwealth of independent states members are facing considerable decline of standards of living. This fact requires immediate action within the programs of international economic cooperation of the countries that have deep economic and cultural roots. Some of the post-soviet countries are suffering from bankruptcy, mergers, acquisitions, lack of resources, etc. Solid banking support can help to recover. Regional programs of public support of non-protected participants of the market of SME, for example, create favorable conditions for enterprises, capable to reach economic goals with public support. Unification of financial and banking rules helps to implement efficient support of SME's activity and effective international cooperation is connected with the unanimous international banking strategy. Putting it into action depends on a complex analysis of economic demands and challenges of market participants. The lack of economic estimation of the environmental peculiarities leads to harmful consequences. For example, "tax holidays" for foreign investors evoked an over-production of automobiles in Brasilia and caused stagnation of some branches of economy.

The analysis confirms also, that there is a stable tendency within the emerging financial markets: mergers of institutions, based on different motives. In general, the possibility of future profits is the most common motive for a merger. Firms will perform certain measures if it is the most profitable way of enhancing capacity, entering new product or geographic areas, acquiring new knowledge or skills or reallocating assets into the control of the most efficient managers or owners. Pautler (2003) suggested motives for mergers and acquisitions include efficiencies, financial and tax benefits, market power effects, management greed, obtaining a good buy and stakeholder expropriation.

In terms of efficiencies firms and banking institutions of BRICS can combine their operations through mergers of firm's/bank's assets in an effort to reduce production costs, increase outputs, improve product quality, acquire new technology and/or produce new products. Aside from the new and improved products and output possibilities, mergers can create a market for corporate control which can safeguard against inefficient management. This can be made possible by reallocating resources from firms with inefficient management to firms with efficient management especially in turbulent ages. This helps to keep profits stable and reduce the risks. Another motive that Pautler (2003) refers to is stakeholder expropriation where shareholders gain at the expense of stakeholders. An example of this would be if a firm is looking to be acquired in order to escape financial problems or to back out of unfavorable labor contracts.

One of the basic motives for BRICS mergers is the consolidation of ownership. In advanced market economies this can be seen through takeovers in CEE. There is no denying the fact that takeovers help to solve corporate governance problems. More importantly for financiers Jensen and Ruback

(1983) found that due to the merger the firms' values actually increases in the process, suggesting that profits may increase afterwards.

An important factor of mergers is that they require a liquid capital market in order for the bidder to have access to large amounts of capital in the short term in order to manage it in common interests. The only one thing worthwhile mentioning: according to Rosen (2006) acquisitions and mergers announced in a hot merger market can end up having declines in the bidder's stock price in the long run. This can be tempting for managers to make bad acquisitions if they are rewarded with short term performances. Assistance of banks in client's activity within will also expand the economic ties.

Conclusions

The results of the study provide a strong case for inter banking within BRICS economic developments that should be taken into consideration while constructing economic and political approach to a global infrastructure. Economic needs and mutual interests are certainly a step in the right direction of cooperation. However, the setting of needs depends on banking and finance. It is strongly recommended to take into consideration the international experience and to introduce the required instruments to be successful within BRICS banking.

Presented results of the study can benefit regulators and banks by providing new instruments for economic cooperation with BRICS.

A further novel concept introduced in this study is the use of techniques to distinguish between short-term and long-term relationship and to formulate corporate strategy, based on real requirements of legal entities.

The concept could also be generalized in future studies to BRICS and other countries as well and their entities in assessing probabilities of cooperation.

Finally, insight is provided into how the mutual interests have been affected by economic needs of BRICS.

References

- Ahmad E (1997) Intergovernmental transfers - an international perspective. In E Ahmad (Eds.), *Financing Decentralized Expenditures. An International Comparison of Grants*. Cheltenham: Edward Elgar.
- Basel Committee on Banking Supervision (2008) *Consultative Proposals to Strengthen the Resilience of the Banking Sector*. Announced by the Basel Committee, December 2008.
- Bird R, Vaillancourt F (1998) *Fiscal Decentralization in Developing Countries*. Cambridge: Cambridge University Press.
- Brennan G, Buchanan JM (1980) *The Power To Tax: Foundations of a Fiscal Constitution*. New York: Cambridge University Press.
- Breton A (1989) The growth of competitive governments. *Canadian Journal of*

Economics 22.

- Brosio G (2000) *Decentralisation in Africa. The African Department*. Washington DC.: International Monetary Fund.
- Fukasaku K, de Mello Jr L (1999), *Fiscal Decentralisation in Emerging Economies. Governance Issues*. Paris: OECD, Development Centre.
- Jensen MC, Ruback RS (1983) The market for corporate control: the scientific evidence. *Journal of Financial Economics* 11(1).
- Manor J (1999) *The Political Economy of Democratic Decentralization*. Washington DC.: The World Bank.
- Oates W (1999) An essay on fiscal federalism. *Journal of Economic Literature* 37(3).
- Pautler PA (2003) Evidence on mergers and acquisitions. *Antitrust Bulletin* 48: 119-207.
- Rosen RJ (2006) Merger momentum and investor sentiment: the stock market reaction to merger announcements. *The Journal of Business* 79(2).
- Soros G (1998) *The Crisis of Global Capitalism: The Crisis of Global Capitalism*. New York: Public Affairs. [ISBN 978-1-891620-27-0](https://www.amazon.com/dp/0812916207)
- Stiglitz J (1998) *Redefining the Role of the State - What should it do? How should it do it? And how should These Decisions be Made?* Paper presented at the 10th Anniversary of MITI Research Institute, March, Tokyo.