SECTION 6. LOAN CAPITAL, INTEREST AND CREDIT

1.6.1. The economic essence of credit

Credit (from Latin creditum – loan, debt) is one of the most difficult categories. The condition of its historical genesis became the social income inequality in the period of primitive communal system breakdown. However the environment creation which formed the character of credit as an objective necessity was caused by the commodity-money relations establishment and development.

The common economic reason of credit existence as any other value category is a commodity production. Exactly for credit its characteristic has a foundational significance of the returned refundable value movement. The credit relations do not appear in the production process, they only mediate this process in one form or another. The role of *objective* basis of credit functioning acts the value movement in the sphere of commodity exchange. Whereby the possibility of credit relations is directly linked to the exchange equivalence which was conditioned by the economic individualization of commodity producers as owners, juristically independent persons.

Together with the objective basis there are the *specific* reasons of the credit relations establishment and functioning.

In particular the consistency which creates the opportunity of credit functioning – the temporary release of money medium and appearance of their temporary necessity in the process of movement of the enterprises' production funds. It is known that these funds in the each present moment exist simultaneously in monetary, production and commodity forms. The funds value movement presents a coherent and continuous transition from one functional form to another. This process is objectively irregular with an individual character of funds circulation and turnover on each enterprise because of the differences of the organizational and technical production characteristics and commodity realization.

The appearance of this irregularity is considered the formation of the money medium influx and reflux in the movement of as basic as circulating funds.

The scatter of basic funds circulation is conditioned by incompliance between the demand of gross lump-sum costs on their renovation and gradual character of their cost recovery in the process of amortization. As a result the enterprises can face as a temporary resources surplus accumulating in the production development funds and a demand for additional financial resources for the purposes of technical re-equipping and manufacturing building in case of their own savings insufficiency.

The movement irregularity of the enterprises' circulating funds is caused by the actual requirement in circulating funds deviation from their standards determining the minimum of the enterprise's own financial resources volume required for its normal activity. The demand of circulating funds depends on various factors specific for every enterprise: seasonality of production, character of output and consumed raw material, amount of working period, correlation between the time of production and the time of product circulation, their price level, etc.

The net working capital standard bears a unified average character. It is clear that the individuality of the enterprise's circulating funds turnover objectively conditions incompliance between the demand of circulating funds and their actual availability on present period. Whereby the enterprise can face as the circulating funds temporary surplus and the additional financial resources attraction necessity.

Consequently while some functioning producers have temporary disposable capitals the other faces an additional demand of them. For example the manufacturer didn't finish products yet for realization but in order to continue the production process he should additionally purchase the primary products, materials, to have money in order to pay a labor power or he still didn't accumulated the depreciation charges and inputs in enough volume but considers the modernization and development of its enterprise imperative.

In such a manner in the process of industrial capital circulation an objective need of monetary capital redistribution between the separate enterprises appears which is performed in the form of credit and the contradiction between temporary funds sag and necessity of their effective usage solves.

So the peculiarities of individual funds circulation of business entities and their interrelation in the process of social reproduction create the possibility of credit relations appearance. For their realization the definite economic legal conditions are required.

First of all the credit transaction nature based on temporary borrowing of a piece of property conditions the necessity of material responsibility of its participants for undertook commitments performance. It means that the enterprises and organizations entering the credit relations should be the owners of their property; either the private persons could be loan debtors if they are legally capable and have stable guaranteed sources of input.

For the second the mandatory term of credit is a conjunction of economic interests of debtee and debtor. The debtee should be equally interested in a loan granting as a debtor – in its getting. Such conjunction couldn’t be reached automatically under the presence of free financial resources of one and their demand of another. The agreement of concrete loan parameters has a fundamental importance of its security, term of crediting, amount of interest, etc. and either the presence of alternative variants of financing and funds investment.

The market economy irrefrangible law – money should be in constant circulation and perform a continuous turnover. The temporary available cash assets should be placed on a loan capital market immediately, accumulated in lending and financial institutions and then floated effectively, placed in the spheres of economy where the demand of additional financial funds exists.

There are two similar in matter meanings – credit and loan. Let’s give them the economic definitions.

Credit is a provision of funds or commodities (works, services) on the terms of subsequent return of these funds or subsequent payment of rendered goods (works, services) in due time including interests payment for their usage.

In such a manner whatever is granted for credit – money or goods (works, services) – the supposed return should be in money terms exceptionally. This is one of the main peculiarities of credit as an economic category.

The economic category – credit is virtually a meaning reflecting the economic relations of the monetary means or commodities transfer to any person on concrete terms.

The source of money loans is a loan capital.

According to the economic theory the capital (i.e. the value which brings a surplus value) could be industrial, trade and loan.

The loan capital is a money capital which is provided by its owners for loan in favor of functioning entrepreneurs and bringing income in a form of loan interest. It was generated on the basis of industrial capital circulation but it represents a special separated from it independent form of capital which characterizes by a different from industrial and trade capitals circulation.

The peculiarities of loan capital:

1. *It is a property capital.* The real expression of this property is a loan debtor’s duty to return the received loan and pay interests in due time.
2. *It is a kind of commodity.* Its purchasing capacity is in capability to function in a quality of capital and bring revenue in the form of input. A part of input – interest or loan capital cost – is a payment of its capability unlike the cost of common commodities which represents cost in monetary terms.
3. *The loan capital has a specific form of alienation.* It differs from purchase and sale where the commodity transfers simultaneously from seller to buyer and money – from buyer to seller.

Under the credit deal the loan capital transfers unilaterally: by providing the loan – from creditor to borrower, by its payment – from borrower to creditor with the interest payment.

4. *The loan capital movement.* The industrial capital takes three forms consequently – monetary, production and commodity making the following circle: M – C... P... C' – M'. The trade capital takes two forms – commodity and monetary. The loan capital is constantly in monetary form because it is connected to the monetary capital loan granting and its return with interests (M – M').

The loan capital and money. the loan capital exists in the form of money. However it is not money and differs from it by its quality and quantity. The qualitative difference is that money itself doesn't bring any surplus value whatever function they perform. But the loan capital is the value which brings a surplus value in the form of loan interest. The difference of loan capital from money in quantitative relation is that an aggregation of capital granted for loan exceeds the quantity of circulating money. it is explained by two reasons: first of all one and the same monetary unit can function for several times as a loan capital. For example the entrepreneur A placed money on bank deposit in amount of 10 thousand dollars, the bank granted this money for loan to the entrepreneur B in order he could pay the goods which were purchased from the entrepreneur C and the last placed this money to bank account. As a result of only these two transactions the loan capital doubled against the quantity of cash money.

In this case the quantitative difference between cash money and loan capital stock is wholly determined by the money circulation rate in the functions of circulating and payment means. It depends in its turn on the stage of credit system development.

For the second the significant part of loan capital circulates and aggregates without the usage of cash money on the basis of credit operations.

1.6.2. Functions of credit

The credit market performs a macroeconomic function. In modern economy the monetary capital mainly aggregates in the form of monetary loan capital. Thus the monetary capital accumulation is important not only in itself as a detached process but first of all from the point of view of its influence on the whole reproduction run, i.e. in macroeconomic aspect.

The function of credit is not equivalent to its essence and reflects only some definite features. Applying to credit it means that its functions should correlate to credit relations in whole – touch upon the both its subjects in equal measure but not some of them separately. Besides the functions of credit should characterize the specific of essence exhibition in all its forms and kinds. From these positions usually the redistributive function of credit and the function of cash money substitution on credit transactions are distinguished.

The redistributive function of credit. Its purpose is that by means of credit at the expense of temporary available resources of some legal and private persons the temporary demands of funds of others are satisfied. In such a manner the peculiarity of credit redistribution is that it covers only temporary available resources. But under the commercial credits there is no preliminary release of resources but in this case the credit granting is possible only under the condition of creditor's available financial resources presence and under their absence – the possibility of their borrowing under the return term.

Consequently anyway a secondary resources distribution occurs, i.e. the realization of redistributive credit function.

The distinctive feature of this credit function is that with its help not only monetary resources redistribute but commodity resources either. In the commodity form the commercial and leasing credits perform and partially supplying and international credits. The possibility of credit granting in commodity form significantly widens the limits of redistribution via the credit sphere.

The redistribution by means of credit bears mainly a productive character, i.e. the redistributed value is included into the loan debtor's economic turnover. This peculiarity is conditioned by such significant credit feature as recoverability. In order to have a possibility to return the loaned resources in due time and with loan interest payment the borrower should use the received means efficiently, invest them into the reproduction process of value expansion.

In the quality of redistributive function of credit peculiarity the direct character of redistribution could be distinguished first of all. The credit deals in most cases are concluded without representatives, the creditor and borrower contact to each other directly. However a vicarious redistribution occurs either, in particular under the indirect bank crediting, the incorporated organisation form of credit relations, etc.

The redistributive credit function covers different aspects and levels of loaned value movement. Thus the redistribution can happen between the separate territories. In credit deal the business entities take participation notwithstanding their location. In connection with this the credit resources which were mobilized in one region, district could be used for credit granting in the other region, district. Here is the *inter-territorial* redistribution occurs.

If the credit resources form in the expense of temporary available financial funds of the one sphere enterprises and then are used for crediting of another spheres thus the *interindustry* redistribution takes place. In conditions when the bank credit is the basic form of credit the interindustry redistribution is the most featured for credit form. The commercial banks having the right of free choice of clients accumulate the temporary available means of enterprises notwithstanding their department participation and these means are impersonalized in a broad stock of bank credit resources.

The enterprises of a definite sphere crediting is made at the expense of such impersonalized means, whereby the amount of credit resources mobilized in this sphere and the amount of its credit investments do not coincide as a rule.

Meanwhile the credit relations can be the base for intraindustry redistribution either. In such a manner if bank specializes on serving of the enterprises in one sphere (sectoral bank) thus the redistributed by it resources will move only within this sphere. The redistribution bears *an intraindustry* character in cases when credits which were received by the sectoral associations are distributed on the basis of recoverability between their structural units which do not have the status of legal entities.

The function of cash money substitution on credit transactions is connected with the feature of monetary circulation modern organization, its functioning mainly in cashless form. It is known that the main part of settlements and credit granting are performed through the banks. Placing and keeping money in bank the client thereby enters into the credit relations with it and in such a manner creates the conditions for the circulating cash money exchange onto the credit transactions in the form of records on bank accounts.

The function of substitution represents an exchange of real money on credit means of circulation and credit transactions.

The question about the credit functions is the most discussible in the theory of credit. The disputes regarding the quantity and content of functions are conditioned not only by the differences in credit essence rendering but either by the unity absence of methodological approaches to their analysis definition. The most often the functions of credit are identified with the functions of banks. Either the functions distinguishing is spread on the basis of separate forms of credit relations.

The result of the united methodological basis of analysis absence is the appearance of a large quantity of functions distinguished by different economists. Among them are the following most often met functions: the commodity circulation serving; the circulation cost saving; the acceleration of scientific-technological progress, etc.

The commodity circulation serving. Such types of credit money as bill, cheque, credit card which provide the exchange of cash settlements on cashless transactions facilitate and accelerate the mechanism of economic relations on domestic and international markets. The most active role in this target solution plays commercial credit as a required element of modern commodity exchange relations.

The circulation cost saving. In the process of enterprise functioning a time gap between the monetary means receipt and spending appears. Whereby not only a surplus but a lack of financial resources can arise. That's exactly why the loans got a wide distribution which gave a possibility to compensate a temporary lack of the own circulation means which are used by almost all the categories of borrowers and which provide a sufficient acceleration of capital turnover and consequently the economy of total circulation costs.

The acceleration of capital concentration. The process of capital concentration is a sufficient condition of stable economy development and a top target of any business entity. The real support of this exercise solution the loan proceeds give which allow widening the scales of production sufficiently and providing an additional input stock.

The acceleration of scientific and technological progress. Best of all this role of credit is displayed in crediting of the scientific and technological organizations activity which is featured by the bigger against the other spheres time gap between the initial capital investment and the realization of ready goods. That's why the common functioning of the most scientific centers is impossible without usage of credit money.

1.6.3. The essence and kinds of interest

The loan interest is a payment of borrower in favor of creditor for the usage of loan means. It is determined by the size of loan, its term and interest rate level.

It has several-hundred-history-old. Two milleniums B.C. already the range of natural loan types were known the interests of which were paid in kind – by means of cattle, grain, etc. the monetary loans are accompanied by the monetary form of interest. In the market economy the interests payment is a part of input transfer (revenue) by a borrower to its creditor. The creditor demands a loan payment because he gives a part of its capital (property) and looses a possibility to get its own revenue within the time of credit deal.

Let's study this essence from the points of view of Carl Marx's and John M. Keynes's theories. Marx considered that the source of interest is a surplus value. The interest reflects the relations between the creditors and borrowers. *The procent is a modified form of surplus value, a part of input generated by workers in the sphere of material production.* The significant meaning Keynes gave to a loan interest and its norm. Considering money as the most liquid property Keynes explained the loan interest collection by the fact that money owners are not intended "to part from liquidity" and for this temporary "parting from liquidity" they should be awarded by an interest getting. In such a manner according to the theory of Keynes *"the norm of interest is an award for the liquidity parting for a time period"*. The size of this interest from his point of view is determined by two factors: 1) the quantity of money and 2) the degree of "liquidity preference" of the money owners. According to the words of Keynes "the quantity of money is one more factor which in connection with liquidity preference determines an actual norm of interest under the present circumstances".

Under the credit relations examination about the interests payment it is important to understand the differences in the process of value movement. If the credit in its concluding stage is a value return thus the interest is a capital movement which is linked to the loan. The advanced capital should be not only kept in a movement but grow, increase in its size. When the bank gives a production enterprise a loan the funds movement in expanded form could be imagined as M – M – C – M1 – M2.

The first part M – M means that the bank granted a loan; M – C means that the enterprise spent it on the commodities production; C – M1 means that the enterprise realized the produced commodities; and M1 – M2 means that the enterprise returned the loan and paid an interest. That is why for creditor the movement of his loan resources eventually could be represented as M – M1.

From the represented scheme of a loan capital movement it appears that the final M2 is bigger then the initial advanced on a sum of interest. Consequently the interest should be considered as an element of credit relations.

There is a tight connection between the loan interest and revenue. It is determined in the fact that both categories represent a definite part of the created again value. However if the revenue (input) which stays disposable with the enterprise-borrower is further used as a source of the enterprise's needs satisfaction thus the loan interest as a revenue of the bank-creditor covers first of all the bank's expenses. The remain part is used for budget payments in the form of taxes, payment of dividends and contributions to the bank's funds. A part of created again value transferred to creditor serves as a definite payment to borrower for the loan usage and for the possibility of the demand of monetary means satisfaction.

Thus the interest plays role of an equivalent of credit use value. Appearing as an economic relation which occurs on the basis of credit the loan interest represents a some kind of loan value guaranteeing a rational usage of a loan cost and the stock of credit resources saving. The loan interest performs the functions of *stimulation and guaranteeing* of loan cost saving, i.e. the full funds return to the creditor.

The stimulating influence of a loan interest first of all should be considered as affection on the loan proceeds functioning in the economic organizations circulation. This function is intended on an efficient usage of a loan cost. From the position of creditor the stimulating function of a loan interest allows him to receive maximum revenue in the conditions of market competitiveness.

Under the interest examination in the function of a loan cost security guarantee and the losses avoidance (risks availability!) it is necessary to consider many factors and first of all the term of credit, its size, the availability of loan provision and the possibility of timely liabilities execution to creditors.

Under the long terms of credit the loan interest could be higher. The fact is that the loan term increase is connected to the growth of its redemption risks because of the changes of an external economic environment and a financial condition of a borrower and either because of the risks of missed profit under the interest rates fluctuation on a credit resources market. That is why usually the longer term of a loan the bigger a loan interest.

The dependence of interest level from the loan size is connected to the fact that under the bigger sums of loans the risk estimated by the creditors losses because of the borrower's indigency increases (the possibility of a simultaneous bankruptcy of several borrowers is significantly lesser than the possibility of the one borrower bankruptcy). In such a manner under the similar size of granted loans the risk of creditor is lesser in the case of the loans placement to several clients. At the same time the small loans servicing leads to a relatively higher bank's expenses and usually is unprofitable. The loans insufficiently supported by a property pawning or an undertaking by guarantor (third person) more expensive in comparison to the supported credits. The loans granted for the borrower's financial embarrassment elimination, investment credits for capital expenditures, etc have a higher risk. These circumstances are also considered in an interest rate.

The creditors determining the price of their product – credit of course consider such factor as inflation. It increases the creditor's risk, that's why in the conditions of inflation the loan interest rate grows.

If consider on a macrolevel the factors which influence on an interest policy thus they eventually come down to a demand and supply correlation for the monetary good, to the regulating role of the state central bank which tries to establish the limits of interest rate for the commercial banks in compliance with the economic situation.

To classify the types of loan interest is possible by various features: forms of credit, types of credit relations, terms and types of loans, types of transactions, and means of assessments.

The different loan interest is used under the commercial, bank and purchasing credits in compliance with loan institutions a discount rate of the central bank, bank interest, collateral loans interest are applied.

The credit value depends on the type of loan – short or long-term and also on the state bonds terms.

The loan interest in the relations between a payer and receiver represents as an interest rate. There are the following types of interest rates:

- Fixed which stay unchanged within the whole term of a loan usage;
- Floating which could be changed within the whole term of credit and deposit agreement validity depending on a monetary market condition, forming demand and supply on credit resources and either on the conditions of economy and borrower's finances.

According to the method of interest charging they are devided onto the simple and complicated.

The method of simple interests charge. Simple interests are the interests charged on the sum of loan indebtedness. For their charging the following formula is used:

$$S_p = \frac{P \times I \times t}{K \times 100}$$

where Sp is the sum of interests (revenue);

I is an annual interest rate;

t is a number of days of interest charge;

K is a number of days in a calendar year (365 or 366);

P is a loan original amount (of contribution).

The method of complicated interests charge. The complicated interests are the interests which are charged not only on the sum of loan indebtedness (credit) but also on the sum of revenues from the charged interests. For the interest payments charge under the credits and deposits the following formula is used:

$$S_P = S - P = P \times \left[1 + \frac{I \times j}{100 \times k}\right]^n - P$$

where I is an annual interest rate;

j is a number of calendar days in the period according to the results of which the bank performs a capitalization of the charged interests;

K is a number of days in a calendar year (365 or 366);

P is a loan original amount (of contribution).

n is a number of transactions of the charged interests capitalization operations within the whole term;

Sp is the sum of interests (revenue).

Under the interests usage in Kazakhstan the number of days and months is conditionally taken as 30 and the number of days in a year – 360. In a month which has 31 days the 31^{st} date is not considered but in February the rest for the last dates repeats as much as doesn't sufficient to 30.

The necessity of compound computation of interest could be caused by different reasons. For the National Bank it was important to exclude the efficient revenue getting by the second-tier banks under the auction credits refinancing which are granted under the one interest rate but for different terms. For this purpose the National Bank before the interest charges introduction according to the method of complicated interests was forced to set several official various discount rates of credits for 1, 3 and 9 months. With a transfer to the complicated interests a single discount rate has been set.

The loan interest size is based on credit resources value and margin, i.e additional charges required for the loan institutions revenue formation. Whereby the interest size depends not on the additional resources market value but on a real. The differences between the market and real values of resources are explained by the fact that the commercial banks have a norm of mandatory reserves and the special interests attributing methods are used and also by the actual taxation system peculiarities.

An interest margin in a concrete bank should cover the bank expenses and provide a relevant income. Whereby the inflation impact and bank risks are considered.

The loan institutions apply an interest of passive and active transactions. The passive transactions are the clients' sources attraction on bank accounts. The banks pay a relevant interests to these transactions.

According to active transactions the banks collect interests for granted loans. Of course the sum of interests received by the loan institutions is more than the sum of interests paid by them according to passive operations. The difference represents an income of the loan institutions by means of which their expenses are covered and revenue created.

The loan charge rate could be set on the whole period of crediting or in floating form (the foreign banks call it "roll-over"). The floating loan value changes according to the rates fluctuation on the loan capitals market.

An important factor which determines the cost of attracted and placed on a loan market resources is an interest-rate policy of the National Bank of RK. Under its adoption the National Bank tries to solve the contradictory tasks: from one hand to create the conditions for the full-value market in a loan sphere, from the other – to avoid a crisis fall of production because of the loan resources lack on enterprises which are not able to adapt for the market conditions.

It should be noted that the market doesn't like the steady fixed interest rates which were applied everywhere till 1991. Thus in 1991 the former State Bank used a little level of rates in the limits of 3-8%. Consequently the new created commercial banks set the higher interest on the demand and supply basis but usually not higher 25% per annum.

For example the average bank rates in 1991 were on the level of 17.2% and according to the deposits – in the limits of 9%. From 1992 the NB RK abstained from the direct restrictions (excluding the loan resources refinancing) and in the conditions of "shocking therapy" a sharp price rise occured. For 1992 the general interest level increased in 3.8 times, to the end of 1993 the loan interests exceeded 240. To March of 1994 the interest rates of the National Bank grew to 300 and then fell in the end of the year to 230, further they began to decrease smoothly and to the end of 2004 reached 7%.

The fluctuation of interest rates' level is a natural phenomenon, however here the loan capitals market development should be considered. The loan interest is also applied for the regulation of loan relations with commercial banks. It is supposed that the credit tightening will limit the opportunities of the resources attraction and will force the borrowers to solve their financial problems by means of production efficiency development and reduction of production cost. However this measure doesn't show any required impact.

Nevertheless the trend of discount rates in 1992-1995 didn't allow making it positive, i.e. it doesn't fall below the inflation level. If the inflation rate for a year exceeds an annual interest rate for the loan thus for creditor there is no use to grant loans for long terms because they return in the form of depreciated money. But nevertheless in 1992-1994 the banks abstained from the interest rate elevation to the positive value fearing the cost-push inflation expansion. If an interest rate was set on the level of the inflation average rate in 1993 – 1 000% thus the prime cost (value) of the enterpises' products would grow as much as to cause the more fall of production.

The commercial banks intend to show flexibility in the interest-rate policy applying the different mechanisms of interests charge taking into account the concrete conditions of loan operation. They consider a conjuncture on a loan capitals market in particular under the deposits organization of entities and persons. The interest size usually set according to the deposit amount, term on which it is placed and also according to the term within which a depositor would likes to get payment for the granted to bank loan resources.

The loan interest as an economic category performs two functions: a) redistribution of the enterprises' part of income or private persons' sector revenue; b) production regulation by means of rational loan capitals distribution between the enterprises and fields. The interest is a moving motive of the available monetary capitals and incomes transformation into the loan capital and an important though not single motive of credits distribution in the fields and enterprises, sometimes it serves as a mean of risk insurance from money devaluation.

1.6.4. The origin of loan resources forming

The resources of commercial banks represent the whole complex of their own and attracted funds used for active operations performing.

To credit resources of commercial banks considered:

- the own bank resources;
- the attracted resources.

A special form of bank resources represent *own bank resources (means)*. The own means having a definite legal basis and functional definition is a financial base of bank development which allows to perform the compensatory payments in favor of depositors and creditors in case of loss occurrence and banks bankruptcy; to support the volume and types of operations according to the bank's targets.

In a composition of own bank resources the following are distinguished:

- authorised;
- reserve;
- special-purpose funds;
- reserves of securities, loans, etc.;
- other special funds;
- undistributed within a year profit.

The basic element of the own bank means is a authorised fund.

The authorised fund (capital) of bank is fully formed by the expense of its participants' investment (entities and persons) and serves as their liabilities cover. It creates an economic basis of existence and is a mandatory condition of the bank foundation as a legal entity. The size of authorised fund and the order of its formation are determined by the bank's statute. The sum of authorized capital is not limited legislatively but in order to provide its stability the National Bank set a minimum size.

The reserve fund. Its size is set by the percentage to the authorized fund (in amount not less than 15%). The source of its formation is the deductions from profit, it is intended for coverage of possible bank losses under the conducted by it transactions and for its functioning stability provision. The reserve fund existence is a mandatory liability for all the banks legislated in the Laws "About the joint stock companies" and "About the banks and bank activity".

The special-purpose funds are formed as a result of net income distribution disposable for bank and reflect the process of net income usage for the definite purposes.

The reserves of securities, loans and other assets are created for the purpose of risks coverage under the separate bank operations and in such a manner the banks stability provision by means of their losses redemption in the expense of accumulated reserves. The size of these reserves shows from one side a quality of bank assets structure and from the other – bank's factor of safety especially in regard to reserve funds accumulated from net income (for example the first group loan loss provision).

The banks form the other special funds either by means of amortization charges: asset depreciation, low-value and short-lived items depreciation and also the funds of economic stimulation created from income. To the special bank funds are considered either the means got from the revaluation of fixed assets conducted by the decisions of government; funds through stock sales of the bank to their first owners above the notional value, etc.

The undistributed profit is an income of commercial bank clear from all the payments and contributions.

The basic part of the banks' resources constitute the *attracted resources (means)* which cover from 80 to 90% of all the monetary means demand for the active bank operations performance. The maximum size of attracted means depends on the bank's own capital. In different countries the various correlation normative standards between the own capital and attracted means exist. These standards fluctuate from 1:10 to 1:100. For example in Switzerland this correlation is 1:12 and in Japan – 1:83.

In the countries with developed market relations the share of own means in the composition of resources is determined in 15-20% what allows providing the enough bank's stability and steadiness. The own capital of Kazakhstani banks constitutes not more than 10%. The structure of banks' resources in regard to some separate commercial banks is various what is explained by their individual peculiarities.

The main share of credit resources the commercial banks form by means of passive operations, attracted means. Their essence consists of different types of investment attraction, getting credits from other banks, the own paper holdings emission and also conduction of other operations as a result of which the bank resources grow.

All the attracted resources by their accumulation mean could grouped as follows:

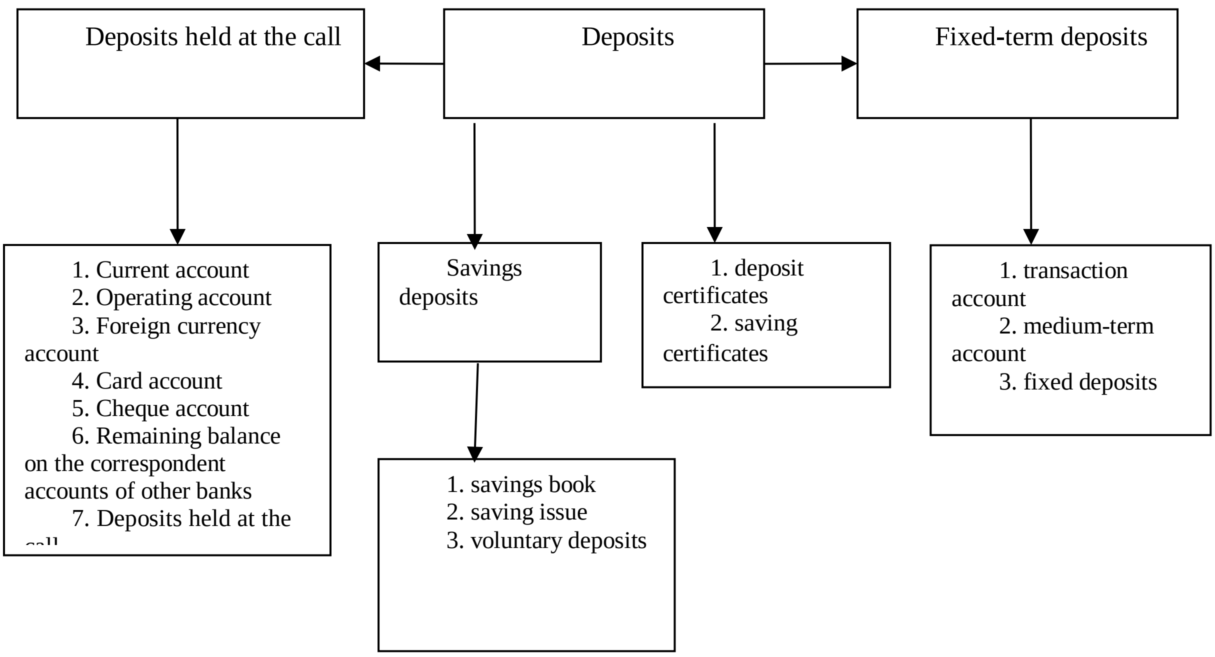
- deposit;
- non-deposit.

The bigger part of attracted resources of commercial banks consists of deposits, i.e. the monetary means placed to bank by clients – private and legal persons: enterprises, partnerships, joint stock companies to the definite accounts and which are used by them in compliance to the account regime and bank legislation.

The modern bank practice is characterized by a big variety of deposits and deposit accounts. It is conditioned by the banks' intend to satisfy the demand of different groups of clients in banking services most fully and attract their savings and available monetary capitals to bank accounts.

The deposit (holding) is the monetary means (cash or cashless, in the national or any other currency) placed to bank by their owner for saving on the definite conditions. The operations linked to the monetary means attraction in the holdings are called *deposit*. For bank holding are the main type of passive operations and consequently the main resource for active credit operations conduction.

On drawing 1 the deposit resources of commercial banks are represented.



Drawing 1. The deposit resources of commercial banks

According to the economic substance the deposits could be divided on groups:

- at call including the remaining balance on current and operating accounts;
- fixed-term deposits;
- savings deposits;
- paper holdings.

The deposits either could be classified according to the other peculiarities: terms, types of depositors, conditions of placement and withdrawal, paid interests, possibility of privileges getting in regard to active operations, etc.

Deposits held at the call. Are intended for the current settlements performance and at any time could be fully or partially called. The deposits withdrawal is possible either in cash or in cashless form.

To the deposits held at the call in the native banking practice the following refer:

- Funds kept on current and operating accounts of the state, joint stock companies, various small commercial structures;
- Municipal funds and the funds on the accounts of local budgets;
- Foreign currency accounts;
- Card accounts;
- Cheque accounts;
- Remaining balance on the correspondent accounts of other banks;
- Deposits held at the call.

Opening the accounts for clients the bank uses the remaining balance for active credit operations conduction.

The advantage of deposits held at the call for their owners is their high liquidity. Money on such accounts could be placed and withdrawn according to the economic and other operations performance reflected in monetary terms. The main disadvantage is an interest payment absence or very little interest.

In such a manner the features of deposits held at the call could be characterized as follows:

- Money placement and withdrawal could be performed at any time without any limitations;
- Account’s owner pays a bank fee for the account usage in the form of fixed monthly rate or in percentage to the debit turnover on account;
- For the money medium keeping on the deposits held at the call the bank pays small interests or do not pay at all (resources in settlements);
- Money withdrawal occurs either in cash or by means of settlement documents issue.

The deposits held at the call are unstable in their nature what limits the sphere of their usage by the commercial banks. By this reason the owners of deposits receive a little interest or don’t have it at all. In the conditions of grown up competition of the funds attraction the commercial banks tend to attract clients and stimulate the growth in customer deposits held at the call by the additional services rendering for the accounts owners and also by the improvement in their service.

The fixed-term deposits represent the most stable part of deposit resources – the monetary means placed on the deposit accounts for a strictly defined term with an interest payment. Their payment rate depends on the deposit size and term.

The fact that the owner of the fixed-term deposit can dispose it only after the fixed term expiry doesn’t exclude the possibility of an advanced monetary means getting. However in this case the client receives the lesser interest. The bank is interested in the fixed-term deposits attraction because of their stability which allows it to dispose the means of depositors within a long time period.

The significant features of the fixed-term deposits:

- They couldn’t be used for settlements and the settlement documents are not issued on them;
- The funds on them circulate slowly;
- The fixed interest is paid;

• In case of advanced money withdrawal the depository has to notify its serving bank.

A definite role in the bank resources is played by *savings deposits* of the population, in particular the deposits of intended purpose. They are placed and withdrawn in a full or partial amount, do not have a fixed term and are certified by a savings book issue. These could be the deposits payments of which are confined to the vacations, date of birth, so called New Year deposits. These kinds of deposits are especially popular in the industrially developed countries.

The **saving deposits** are characterized by:

• the absence of fixed term of saving of the monetary means;

• no need of notification about the money withdrawal;

• under the money placement and withdrawal a saving book is required which reflects money flow.

In the native banking practice the saving deposits could be opened only for private persons. Abroad such accounts could be opened either for noncommercial organizations and business firms.

The saving deposits allow free monetary means placement and withdrawal and basically are used for payroll accounting, pensions' payment, regular payments. These deposits have a minimum interest rate. In western practice these deposits could be "linked" to the fixed-term deposits for an automatic balance support in case of funds lack for settlements performance according to this account.

These deposits have their own benefits and disadvantages for banks. The essence is that thanks to them the unapplied population incomes are mobilized which transfer to a production capital. Their disadvantages is in a necessity to pay a high interest and an amenability of these deposits to economical, political, psychological factors what increase the threat of the funds quick outflow from these accounts and bank liquidity loss.

Under the examination if this question it is necessary either to note that the deposit policy of the native commercial banks begins to apply the instruments of foreign states – it is a deposit certificate issued on a presenter which can circulate on a market as any other value document. *The certificate* is a written confirmation of an emitting bank about the monetary means deposit which certifies the right of depositor or his legal successor to get after the fixed term expiry the sum of deposit and its interest.

Initially they were implemented into the circulation in 1961 by one of the US banks. The deposits' owners are granted with special personalized certificates which include the time to run and an interest rate.

The certificate deposit is a written confirmation about a depositing in bank a definite quite big sum of money where the term of its obligatory bank re-purchase and the size of paid extra charge are noted. Thus the American banks issue the certificates deposit on an amount not less than 100 thousand US dollars and the British banks – from 50 thousand to 250 thousand pounds sterling.

The certificates deposits are issued only to the legal entities. They could be personalized and to bearer. The certificates deposits are issued by banks under the fixed in an agreement interest, on a concrete term or at call.

For private persons the saving certificates are used issued by banks on a fixed term or at call.

The advantages of certificates deposits: first of all against the other instruments of the deposit policy it is an object of a stock-market game and consequently its owner can estimate the additional profit extraction in a result of favorable market change. For the second in case of the government's intention to freeze the enterprises deposits the certificate purchase which has a free circulation on a market will give to its owner some freedom of manoeuvre. In this situation the certificate becomes an alternative mean of payment.

The saving certificates are intended for the private persons. The term of fixed saving certificates circulation can exceed one year (can constitute three years). If the term of money receipt by this certificate is expired thus such certificate becomes a document on demand. The bank is obliged to pay the noted there sum on the first owner's demand. The saving certificates are issued only to private persons.

The deposit and saving certificates is possible to present for payment before the fixed term expiration if it is foreseen by their purchase agreement. In this case bank pays an interest for the actual term of the funds usage. For commercial bank the advantages of these resources accumulation forms consist of that the big sums go into the disposal of bank for strictly fixed term and increase in such a manner the most stable part of credit resources.

Apart from the certificates division on deposit and saving depending on the depositors categories the certificates could be determined by the other features:

1. by the mean of issue:

– issued one-time;
– issued in series.

2. by the mean of execution:

– personalized;
– to bearer.

The certificate owner can concede a right of demand according to the certificate to the other person. Under the certificate to bearer this transmission is performed by a simple handing over, under the personalized – registered on a back-page by a reciprocal contract (by means of handover note (cession)). Under the monetary sums withdrawal maturity the certificate owner should present it to the bank together with a replication which contains the mean of certificate redemption.

According to the Law of the Republic of Kazakhstan “About the securities market” dated from July 2, 2003 №461 the depositary receipts issue is allowed in the country (certificates deposits).

The nondeposit sources of funds attraction. To the most widely-spread forms of such means attraction belong:

• contracting of loans on an interbank market;
• bond issuance.

The main purpose of these operations is an improvement of bank liquidity.

The interbank loans is a type of term credits the owners of which are commercial banks.

The commercial banks as any legal entities have a right of their own paper holdings issue for the purpose of funds increase. The native banks for the most part issue bonds.

The funds which bank receives in the form of loans or by means of its own debt obligations sale on a monetary market are the nondeposit attracted funds. They differ from the deposits first of all by a nonpersonalized character, i.e. they are not associated with a concrete bank client and purchased on a market on a competitive basis; and for the second the initiative of these funds attraction belongs to bank itself.

Mainly such resources are used by big banks. The nondeposit funds are purchased on large sums and they are considered as the operations of a wholesale character.

1.6.5. Forms of credit

The credit could be commercial and banking. They differ by a composition of participants, objects of loans, dynamics, interest rates and spheres of functioning. The maximum development in Kazakhstan got a banking credit, the commercial credit is less spread because of its specific peculiarities.

The commercial credit *is a credit granted by one functioning enterprises to the other in the form of commodities sale with payment delay.* It is granted under the debitor’s liabilities (purchaser’s) to redeem both the principal amount of a loan and charged interests.

The commercial credit application requires from a seller a sufficient reserve capital presence in case of the receipts delays from the debitors.

There are five basic means of the commercial credit granting:

1) bill mean;
2) open account;

3) discount in case of due term payment;
4) seasonal loan;
5) consignment.

In most cases the commercial credit granting is made by bill mean. *The bill is a single bond of a bill drawer to pay in due time a definite sum of money to the bill owner.*

The object of commercial credit is a commodity capital. It serves directly the industrial capital turnover, the goods movement from the sphere of production to the sphere of purchase. The peculiarity of commercial credit is that a loan capital here is linked to an industrial. The purpose of commercial credit is to accelerate the goods realization and concluded in it profit. Its interest which is included into the commodity cost and the sum of bill is lower than in banking credit the purpose of which is a loan profit getting.

The size of this credit is limited by an amount of reserve capitals of industrial and trade entrepreneurs. These capitals transfer is possible only in the directions determined by the terms of a deal: from entrepreneurs on whose enterprises the means of production are created to entrepreneurs on whose enterprises they are used or from commodities' producers to trade firms who realize them.

The banking credit *is a credit granted by lending and financial institutions (banks, funds, associations) to any business entities (private entrepreneurs, enterprises, organizations) in the form of monetary loans.* **The banking credit** is one of the most spread forms of credit relations in economy the object of which is the process of monetary means loan transfer. The banking credit is exceptionally granted by the credit and financial organizations which have a license on such operations conduction from the National Bank. The role of borrower the legal persons play, the instrument of credit relations is a credit agreement. The profit from this form of credit the bank gets in the form of loan or bank interest.

This type of credit gets over the limits of commercial credit because it is not limited by direction, terms and sums of credit deals. The sphere of its usage is wider: commercial credit serves only the goods turnover; banking – and capital accumulation transferring to it a part of monetary profits and savings of all the society classes.

The exchange of commercial bill on banking makes credit more elastic, widens its scales, rises provision. The dynamics of banking and commercial credit are different. The volume of the last increases with the growth of production and commodity circulation and decreases with their fall. The demand and offer on it rise in the periods of industrial growths and falls under the crises.

Under the influence of crises the production and realization of commodities decrease and the demand on banking credit for the debts payment rises. In the period of recovery and rise the volume of actual capital growth, increases the demand on banking loans for the production purposes. Hence the doubleness of banking credit appears which plays simultaneously as capital lending when the borrowers use it for the functioning capital volume increase and as an imprest – payment means required for the liabilities discharge.

A conventional division of banking credit on an imprest and capital lending on the basis of social capital reproduction depends on character of the loans usage by a borrower and their influence on a functioning capital volume. From the point of view of the individual capital reproduction the banking credit is divided according to loan security: money and capital and shows the different credit influence on a borrower's capital volume.

Under the credit on security of goods, bills, paper holdings the borrower doesn't receive an additional capital from bank. For him it is an imprest. But when the debtor gets an unsecured credit from bank he purchases an additional capital. Such credit represents a capital loan. Notwithstanding a domination of banking credit in modern conditions a tendency of the commercial credit role increase appeared.

The banking credit is classified by:

1. Maturity.

The short-term loans are granted for a temporary lack of own circulating funds of a borrower compensation. The term is to a year. The interest rate to these loans is inversely proportional to the term of credit reimbursement. The short-term loan serves the sphere of circulation.

The medium-term loans are granted for the term of 1-3 years for the production purposes and of commercial character.

The long-term loans are used for investment purposes. They serve the basic assets flow differing by a large amount of the transferred credit resources. They are used under the crediting of reconstruction, technical re-equipment, new building on the enterprises of all the spheres of activity. A special development the long-term loans got in a capital construction, fuel and energy complex. An average maturity is from 3 to 5 years.

The call loans are refundable in a fixed term after an official notice from creditor receipt (the maturity is not specified initially).

2. Method of repayment.

The loans paid down by a lumpsum payment from a borrower's side. This traditional form of short-term loans return is an optimal because it doesn't require the usage of differentiated percentage mechanism.

The loans paid down by installments within the whole term of credit agreement validity. The concrete terms of return are determined by an agreement. They are always used under the long-term loans.

3. Means of loan interest collection.

Loans the interests of which are paid at the moment of their full settlement.

Loans the interests of which are paid by the borrower's uniform series within the whole term of credit agreement validity.

Loans the interests of which are deducted by bank at the moment of an immediate loan granting to a borrower.

4. Means of loan granting.

The back-to-back loans directed to the borrower's operating account for his own expenses compensation including of advance character.

The commercial loans. In this case the loans are granted for an immediate payment of cash and settlement documents presented to a borrower for payment.

5. Means of crediting.

The one-time loans granted in term and sum stipulated in an agreement between the parties.

The credit line is a legally registered commitment of bank to borrower to grant him for the definite time period the loans within the agreed limits.

The credit lines could be:

- revolving – a solid bank commitment to grant a loan to a client who suffers a temporary lack of circulating funds. The borrower paying a part of credit can estimate a new loan getting under the fixed limits and terms of an agreement validity;
- seasonal – granted by bank if the firm periodically faces the lack of circulating funds connected to the seasonal cycling or the necessity of stock forming on warehouses.

6. Types of interest rates.

The credits with fixed interest rate are set on the whole period of crediting and not a subject to revision. In this case the borrower accepts the obligations to pay the interests under the permanent agreed rate for the loan usage regardless of changes on run of IR market. The fixed interest rates are used under the short-term crediting.

The floating interest rates. They constantly change according to the situation forming on credit and financial market.

The stepped rates are subject to review regularly. They are used in the period of strong inflation.

7. Credit number.

The credits granted by one bank.

The syndicated loans granted by two or more creditors who united into the syndicate to one borrower.

The parallel loans. In this case each bank negotiates to borrower separately and then after agreement with client the terms of deal the general agreement is concluded.

8. Provision availability.

The good faith loans. The only form of their return provision is a credit agreement. This type of credit doesn't have a concrete provision that is why it is granted as a rule to the first-class creditworthiness clients with whom the bank has the longtime relations and to whom it doesn't have any complaints regarding the previous loans.

The loans on overdraft are granted under the usage of transactional account opened to clients with whom the bank has the longtime trust relations and to enterprises with exceptionally high credit reputation.

The security agreement. The property as security (movable or immovable) means that the creditor-chargeholder has a right to realize this property if the liability wouldn't be performed. The security should provide not only the return of sum but the related interests and penalties payment either according to an agreement foreseen in case of its outperformance.

The contract of suretyship. According to it the surety is obliged to creditor of other person (borrower, debtor) to be liable for the obligations performance of the last. The borrower and surety are liable to creditor as the solidary obligors.

The guarantee. It is a special type of surety agreement for the obligations provision between the legal entities. The guarantor could be any legal entity which is stable in financial plan.

The credit risk insurance. The enterprise-borrower concludes with an insurance company an insurance agreement where it is foreseen that in case of credit nonredemption within the set term an insurer pays to bank which granted credit compensation in amount of 50-90% from an unsatisfied by a borrower credit sum including the interests for its usage.

9. Lending purpose.

The loans of generic character are used by a borrower at its own convenience for any requirements of financial fund satisfaction.

The special-purpose loans suppose the borrowers necessity to use granted by bank resources exceptionally for targets solution determined by the terms of credit agreement.

The mortgage loans. They are granted for housing purchase or construction and either for land purchase. These credits are granted by banks and specialized financial institutions. The credit is paid by installments and its interest fluctuates from 15 to 30% per annum.

There are several types of credits: consumer, agricultural, real estate, state and international.

<u>The consumer credit</u> represents a type of commercial credit (the goods sale on a deferred-payment basis via the retail shops) and banking credit (consumption loans). Essentially its objects are the durable goods and variable services. The maximum term of consumer credit is 3 years. This credit became an essential element of realization at the expense of future profit of the population because its purchasing power is limited and the goods sale is connected to chronic difficulties. For the consumer credit usage as a rule the high interests are collected (in USA - 20% per annum and more, in France together with commissions to 35%) which are paid from the population profits and play as a secondary form of the national profit distribution in favor of monopolies. *The consumer credit is either granted in the form of long-term bank loans to private persons for the real estate purchase or construction (residential loan).*

<u>The state credit</u> is a whole complex of credit relations in which the role of borrower or creditor plays state and local government authorities in regard to citizenhood and legal entities. The traditional form of this credit is the government loans issue which withdraw from 1/3 (USA) to 2/3 (FRG) of the market resources of loan capitals for the budget deficit coverage. The government loans are the second after the taxes source of state profit used for its functions performance.

<u>The international credit</u> bears both private and state characters reflecting the loan capital flow in the sphere of international, economic and currency and financial relations.

The comprehension questions

1. *Uncover the reasons of credit genesis as an economic category.*
2. *What basic functions of credit do you know?*
3. *How the simple interests are charged?*
4. *In what cases the compound interests are charged?*
5. *What types of credits do you know and what is their essence?*