

SECTION 7. CREDIT AND BANK SYSTEMS. TYPES OF LOAN INSTITUTIONS

1.7.1. The meaning of credit system and its structure

The modern credit system represents the result of a long historical development and adaptation to the necessities of market economy development. There are two meanings of credit system: 1) *the whole complex of credit and settlement relations, forms and methods of crediting;* 2) *the whole complex of lending and financial institutions actively used by the state for the economy regulation.*

The credit relations are connected to the loan capital flow and include different forms of credits. The credit system as a whole complex of lending and financial institutions accumulates available monetary funds, profits and savings of different society classes and then grants them to enterprises, government and private persons. It conditions the whole mechanism of social reproduction and serves as a strong factor of production concentration and capital centralization, promotes quick mobilization of available monetary funds and their usage in the economy of country.

In the structure of financial institutes there are two basic groups: the mediators of universal profile who perform all or the major of credit and financial operations of both passive and active characters and the mediators who are specialized on some definite operations.

In other words the credit system is characterized by the whole complex of banking or other credit institutions, legal forms of organizations and approaches to the credit operations performance. There are two subsystems of the credit relations organization: within the limits of bank or nonbank institutions. Consequently there are two basic layers of credit system: banking and specialized lending and financial institutions.

1.7.2. Types of bank institutions

As was mentioned before in the modern credit system there are two subsystems are distinguished: banking and para-banking (lending and financial institutions).

The significant role for any country plays exactly banking system which performs the basic share of financial services. The banking business represents a specific form of entrepreneurial activity connected to the loan capitals attraction and distribution.

The banks create money and moreover transform them to commodities assisting economy to develop and countries to richen. Nowadays they took so important place in business that any failure in their work will collapse countries like earthquake. It is linked first of all to the fact that banks perform the major part of work of money transfer from buyers to sellers serving the system of settlements in the economy.

The better banks do their work the quicker money circulates in the economy and the greater virtue they will bring to the country helping the deals conclusion and the goods production development. But if banks stop to deliver this work the economy of any state begins to fever.

The presence of banks allows to conduct the major part of settlements in cashless form what facilitates greatly (and under the normal business conditions in banking system – accelerates) the business management.

In such a manner the banks provide the market economies with the system of channels by which money could be conveniently and quickly transferred in order to cover the needs of citizens, state and enterprises. Exactly these services rendering and also the valuables safe keeping provision at all times brought to banks the major part of their profits. Consequently the main bankers' concern around the world is to accelerate and facilitate the money flow, create new conveniences for their clients and receive for it an additional payment.

According to banks' interrelation, character of the performed functions there are *two types of banking system constitution* are distinguished: single-level (distributing, centralized) and two-level.

For the countries with administratively command mode of management the single-level banking system is featured. Its peculiarities are that all banks including central perform the analogue functions of credit and settlement business service. Though formally the system has several banks on practice the functions of commercial banks are taken by the central bank which plays the role of single credit, settlement and exchange center. All the rest banks perform their operations according to the central bank regulations.

In countries with market economy including Kazakhstan the two-level system acts for which a strict functions division of central and commercial banks is indicative.

The two-level system consists of three elements: the central bank (banking system axis); the second-tier bank and the institutions of banking infrastructure which provide informational, methodical, scientific and staff provision of banking activity (services of processing, transfer and keeping information, international systems of interbank communication, insurance structures, clearing houses, auditor services, currency trading and interbank credits centers, staff training systems for banks).

The banks are divided on two types according to specific of their functions performance: emission and non-emission.

The emission banks – central banks have a right of emission of monetary units into the circulation. In different countries they are called different: peoples, national, reserve.

The central banks are the regulating link of banking system that's why their activity is connected to the monetary circulation development; the national unit and its foreign exchange rate stability security and provision; the banking system development of different countries; the efficient and faultless settlements performance provision.

Traditional the central bank faces five major tasks. The central bank called to be:

- the emission center of the country, i.e. to use a monopoly right of banknotes issue;
- the bank of banks: to perform the operations not with commercial and industrial clients but primary with the banks of the country: to keep their cash reserves the size of which is determined legally, to grant them credits (lender of last resort), to make a control supporting the required level of standardization and professionalism in the national credit system;
- the government banker. For this it should support the state economic programs and store the state paper holdings; to grant credits and make settlement operations for the government; to keep the (official) gold and foreign exchange reserves;
- the main governmental settlement center mediating between the other banks under the cashless settlements performance based on mutual requirements and obligations (clearing) offset;
- the economy regulatory authority with money and credit methods.

In some countries these tasks of central banks are enshrined in legislation. Thus the monopoly on the national monetary unit emission gives the central bank an opportunity to control the liquidity of credit institutions. In Germany for example notwithstanding the fact that in the law about the German federal bank the mechanism of monetary stock growth upper limit setting is not stipulated the regulating instruments of already circulated money are determined.

As bank of banks the head bank gives to credit institutions an opportunity of refinancing. Whereby it has a right to restrict the commercial banks in credit means. The two types of central bank operations with credit institutions are most popular: purchase and sale of cheques and bills (including treasure bills) and pledge operations with paper holdings, bills and collection orders.

A significant role of the country's banking system functioning plays the central bank's character of making control. However in Great Britain within the decades until 1979 the control of the second-tier banking system activity from the main bank's side wasn't enshrined in legislation and was quite liberal. The German federal bank facilitates the control by a special federal authority of banking control. Considering that the last doesn't have a necessary structure of agents thus it relies on the central bank branch network. The English national bank against German performs this function only in limited volume (banking control is passed to the Ministry

of Finance); but in a new law project the transmission of a major part of rights of banking control is under consideration.

Under these five tasks execution the central bank basically performs three main functions: regulating, controlling and informational research.

To the first function the circulating monetary stock regulation is referred. It is reached by means of decrease or increase of cash and cashless emission and the discount policy conduction, policy of minimal reserves, open market and also foreign exchange policy.

The regulating function is closely connected to controlling. The central bank gets vast information about one or another bank condition for example under the policy of minimal reserves or rediscounting conduction. The controlling function includes the definition of correlation to the requirements of the banking system qualitative composition, i.e. the credit institutions admission procedure on the national banking market. Besides it includes the development of the required for credit institutions set of economic coefficients and norms and their control.

To all central banks the informational research function is typical, i.e. the function of scientific research statistical information centre. Whereby in many countries this function is formalized in legislation. Thus the German federal bank is obliged to give the recommendations to federal government if required and also to provide it with the information about the credit system development.

In the law about the national bank this function has a great significance: it is supposed that the bank should public its decisions in a special amendment to one of central magazines. For example the Austrian national bank has the prominent rights of information access. It has a right to request the documents about the separate credit institutions activity, to set the terms and reporting form of commercial banks. On the basis of these data the central bank carries out an anonymous statistical analysis and presents the information to the highest instance of governmental authorities and international organizations if required.

The central bank having, analyzing and publishing the objective information about the situation in money and credit sphere can respond promptly on global and local economic processes. The choice of directed money and credit policy in whole depends on the information assessment fidelity. The decision making about the additional issue of monetary means by the central bank emission board is based on an appropriate economic situation analyses in the country in order to give the recommendations and coordinate the governmental authorities activity.

The informational research function offers also the advisory activity. In a manner of information exchange and for consultations the central banks conduct the meetings, conferences including on international level. The functions of head bank often interweave, from one the other comes if it requires the end of purpose or the solution of some definite task.

The two-level banking system is based on the interbank relations establishment in two planes: in vertical and horizontal directions. In vertical direction – the relations of subordination between the central bank as directing which manages the center and lower layers – commercial and specialized banks; in horizontal direction – the level playing field for different lower layers. Whereby the division of administrative and operational functions occurs which are linked to the economy servicing. The central bank stays the bank of banks in the real sense of the word only for two categories of clients – commercial and specialized banks and machinery of government, where the functions of bank of bank and money and credit regulation become prevailing.

To the non-emission banks the second-tier banks refer. They are *commercial (universal)* and *specialized* banks.

The commercial banks are typical to any economic formation. They deal with crediting and financing of industry and trade at the expense of monetary capitals attracted in the form of deposits and by means of their own shares and bonds issue. These banks refill their resources also by means of borrowing from the emission banks. Accumulating the monetary capitals temporary released in the process of production and circulation and available means of

population the commercial banks transfer them to loans in favor of functioning enterprises. In other words via these banks the capital redistribution occurs between the different business spheres. The commercial banks create the credit means of circulation opening current accounts for their borrowers. By means of them the cashless settlements under the central bank correspondent accounts occur. The objective tendency distinguishes of the commercial banks merger into the monopolies and their wide introduction in to the industry and other spheres of production.

Such banks are the multifunctional institutions acting in different sectors of the loan capital market. The big commercial banks render to clients a full range of services including credits, deposits, settlements, etc. By this they differ from the specialized institutions which are limited by definite functions. Traditionally they play the role of the credit system base layer.

The tangle of functions of different credit institutions types and the popularity of universal type of bank creates the known difficulties for the definition of the meanings “bank” and “bank activity”. More often the main characteristic of bank activity is considered the deposits taking and credits granting.

The specialized banks differ by the directions:

1. **By purposes** – basically oriented on one-two types of services for the most of their clients. They are investment banks (crediting the investment projects), innovative banks (granting credits for the projects which promote the scientific-technological progress) and real estate banks (granting credits against security of immovable property).

The investment banks deal with financing and long-term crediting of different fields mainly industry, trade and transport. Via the investment banks a significant part of basic stock demands of industrial and other enterprises is satisfied. The development of this credit system layer is characteristic for the modern market economies. Against the commercial banks the investment banks mobilize their resources vast majority by means of their own shares and bonds issue and either by means of credits getting from the commercial banks. At the same time they play active role in the issue and placement of the industrial and other companies’ shares.

The real estate banks grant the long-term loans against security of immovable property – land and buildings. They accumulate the resources by means of special type paper holdings issue – mortgage bonds the provision of which serves the affected in banks property. The clients of the real estate banks are farmers, population and sometimes entrepreneurs.

2. **By fields** – specialized on different fields of economy or population serving (construction, agriculture, etc.).

Apart from banks in credit system there are also *the specialized financial institutions* (SFI) or para-banks. They appear only where the gap of some services satisfaction on monetary market exists, for example the attraction of small savings or the paper holdings of the population placement. Their activity includes a small number of banking operations (usually one or two) the performance of which requires a license. These institutes include first of all financial, trust and insurance companies, private pension funds, credit unions and cooperatives, loan in savings associations, investment funds, lombards and other institutions. They accumulate the means of population and legal entities, extend credits of enterprises and citizens, mediate on the interbank credit market, perform the trust operations.

SFI has a possibility to mobilize the resources for a long term, that’s why they can allow a long-term investment. In comparison to the commercial banks they do not have a right to perform the deposit (care of securities on special accounts), settlement operations. SFI began to take a special place on a monetary market for a variety of reasons:

- the growth of population profits;
- the paper holdings market development;
- the specialized services development which are rendered by para-banks.

The specialized financial institutes perform the following functions:

- The population savings *accumulation by means of various paper holdings issue.*
- *The redeployment* of resources:

- at the expense of real estate credits granting;
- by means of the bonded loans purchase;
- via the consumer credits granting;
- by means of credit mutual assistance.

1.7.3. Specialized loan-financial institutions

The specialized loan-financial institutions appeared in the XIXth century. For a long time they played in the money and credit sphere a subordinate role and were after the commercial banks, however their role rose sharply in the countries with market economy after the World War Second. From one side it happened because of the operations meaning strengthening on which these organizations specialized, and from the other – in consequence of these financially strengthened specialized institutes penetration in the commercial banks' sphere of activity. The example is pension funds the capitals of which increased a lot for the last decades and on West they are one of the biggest buyers of the paper holdings.

The investment funds perform an emission founders' activity, i.e. conduct the operations of the paper holdings issue and distribution on the securities market earning a profit on it. They do not have a right to accept the deposits and as a rule attract the capitals by means of their own shares sale or at the expense of commercial banks' credit. Their own capital they use for the long-term crediting of different sectors of economy. In Kazakhstan they are not great.

A significant place in the credit system is taken by a vast group of *savings institutions*. They attract small savings and incomes which without help of credit system would not function as capital. There are various types of savings institutions: savings-banks, loan in savings associations, credit cooperatives.

For insurance companies a specific form of funds attraction is characteristic – the insurance policies sale. The received incomes they invest into the bonds and shares of other companies, consolidated stocks. They also grant the long-term credits to the enterprises and state. In future their growth is expected on 3.5 times.

The pension funds differ by organization and management, by the assets structure. Thus we have the insured funds (managed by insurance companies) and non-insured (managed by the enterprises or under their letters of attorney – by banks), funded (their funds are invested into the paper holdings) and non-funded (pensions are paid from the current inputs and revenues), etc.

The investment companies place among the small holders their obligations (shares of stock) and use the received funds for the paper holding purchase of different sectors of economy. The small investors gladly buy the obligations of investment companies because thanks to great diversification (investment of capital into the various enterprises) the known assets distribution is reached, the danger of savings loss decreases due to the firms' bankruptcy in whose shares the capital is invested.

The comprehension questions

1. *Uncover the meaning of the modern credit system.*
2. *How the credit system of Kazakhstan looks like?*
3. *Determine the structure of banking system.*
4. *How the lending and financial institutions and banks differ from each other?*