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Journal of Banking & Finance 24 (2000) 507–524

Journal of
BANKING &
FINANCE

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Financial system development in transition economies

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Abstract

This paper provides an overview of the major issues with respect to financial system development in transition economies, which were discussed at a conference in Groningen, the Netherlands, December 1997. After a brief remark on the role of financial system design during economic transition, the paper focuses on the role of stock markets in the process of financial intermediation with emphasis on the role of regulations in these markets, the role of deposit insurance to improve bank system stability, and the importance of an independent central bank, measurement issues relating to central bank independence and its impact on inflation and growth. © 2000 Elsevier Science B.V. All rights reserved.

JEL classification: G20; G28; G33; E58; P34

Keywords: Financial systems; Transition; Regulation; Bank runs; Central banks

1. Introduction

This special issue of the Journal of Banking and Finance (JBF) contains a set of six papers on the theme of ‘financial system development in transition economies’. The papers were carefully selected from approximately 20 presentations, which were delivered at an international conference under the

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above theme at the University of Groningen, the Netherlands, in December 1997.¹

In general, the conference dealt with a variety of issues of special importance to transition economies. Most of these issues neither have been fully resolved to date in policy circles, nor in theoretical and empirical research. In this paper we provide a brief overview of the major issues that were discussed at the conference. The overview goes beyond the six selected papers in this special issue by focusing on those salient ideas that attracted heated debate among policy makers and practitioners, as well as academics at the conference. We formalise and structure these ideas in the context of the most extant literature, as discussed below.

This overview paper is structured as follows. Section 2 provides a brief remark on the role of financial system design in the process of financial restructuring during economic development and transition. The discussion then focuses on the role of stock markets in enhancing the process of financial intermediation in transition economies, in Section 3, emphasizing the role of regulations in these markets. Section 4 examines the role of establishing deposit insurance in order to improve bank system stability. Section 5 presents an overview of the discussion on the importance of an independent central bank, designed to reduce macroeconomic and financial instability in these economies, and of the measurement issues relating to central bank independence and its impact on inflation and growth. The paper ends with some concluding remarks.

The selected papers provide the most challenging contributions on the conference theme. In this context, therefore, this special issue can be seen as a follow-up of an earlier one entitled ‘banks and capital markets in former centrally planned countries: their role in establishing a market economy’, which appeared in this journal (*JBF*, Vol. 17, No. 5, 1993).

2. Financial systems in transition

In recent years, financial system development has gained increasing attention, both in academic and policy circles. In particular, the subject has been discussed in the context of the developments in transition economies. Until recently, these countries did not really have a financial system. Financial transactions were just part of the planning system. When these countries

¹ The paper by Kairys et al. was not presented in Groningen. This paper was added to the set of selected conference papers during the editing process, since in our view it complements the discussion on the role of regulating stock markets in transition economies in the other two papers in this special issue.

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