

Emerging Markets Queries in Finance and Business

The impact of financial liberalization on banking system

Daniela Georgeta Beju^a, Maria-Lenuta Ciupac-Ulici^{a,*}

^a*Babes-Bolyai University, Teodor Mihali Street, no. 58-60, Cluj Napoca, 400591, Romania*

Abstract

Delicate and difficult at the same time, financial and monetary fields have always attracted attention of researchers worldwide. One of the challenges of contemporary capitalism, financial liberalization, is a process that can bring enormous benefit, but it can pose serious obstacles to development and economic prosperity. In this paper, we propose to analyze the impact of liberalization on banking system from emerging countries. The necessity to study and knowledge both the process itself and its effects on financial markets came as a result of a small number of studies and the inconclusive results regarding the impact of financial liberalization on developing countries in Central and Eastern Europe. Than rejected, financial liberalization must be accompanied by an increase in prudential policy. Too rapid liberalization in a country does not mean speed problems in an absolute sense, but in a relative sense: in many cases instability occurred because of the difference between impressive speeds of financial liberalization and very slow adjustment of the prudential provisions, banking and financial regulations, respectively monetary policy actions.

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1. Introduction

In the late 1970s and early 1980s, most developing countries were in a crisis of economic policy. Due to unfavourable circumstances and the deteriorating of economic and financial conditions, the financial system proved to have many deficiencies and it was unable to generate economic growth. Based on financial aid from

* Corresponding author. Tel.: +40.264 41 86 52; fax: +40.264 41 25 70.

E-mail address: daniela.beju@econ.ubbcluj.ro.

the World Bank and International Monetary Fund, many developing countries in Asia, Europe, Latin America and Africa have undertaken economic reforms to create a sustainable investment environment and develop the private sector through an economic system based on market mechanisms. Apparently the result of these reforms was to transform many developing economies in emerging economies, where strong economic growth is supported by private sector development and rapidly mature of stock markets. Financial liberalization was an important component of the reforms mentioned above. This is to give central banks more authority in the conduct of monetary policy, to privatize and restructure the banking sector, liberalization of interest rates, abolition of the direct extension of credit and, more generally, to develop and promote the role of financial markets in financing the economy. The main objective is to enable emerging economies to emerge from recession, and later to develop rapidly.

In the majority of the countries, banks are the most important financial institutions, since they can stimulate the economic growth. In order to ensure safe and sound banking system many authorities have regulated and restricted banking operations during a long period of time. Banking restrictions have taken diverse forms among which we mention the control of the capital flows, interest rate and credit allocation. Over the last three decades, particularly during the '80s and '90, several countries have adopted financial reforms by moving towards less financial restrictions. The measures of financial deregulation consisted in liberalization of the interest rates, abolishment of the credit control, removal of the barriers on the capital flows, elimination of the obstacles on competition among the financial institutions, privatization of the state-owned financial institutions and start up of the capital market securities.

The most important argument that supports financial liberalization is to improve financial development and get higher economic growth. Beginning with the financial liberalization and deregulation, banking systems have entered in a process of reform, consisting in elimination of the control on interest rates and credit allocation, privatization of state-controlled banks, stimulation the competition among banks and liberalization of capital flows. Financial liberalization in banking sector aimed to increase the efficiency of the banks, improve the allocation of credits, stimulate savings and, thus, attain a higher economic growth. Some studies indicate that the bank performance in emerging countries is increasing with financial and banking reforms Andrieş et al, 2011. Still, financial liberalization increases the likelihood of banking crises, especially in the conditions of very weak regulation and supervision Angkinand et. al., 2010.

In this paper we analyze the impact of financial liberalization on banking system in 4 emerging countries from Central and Eastern Europe Romania, Czech Republic, Hungary, Poland for the period of 2001-2010. The banking system in analyzed countries was liberalized in the period of 2000-2001. But this system is not fully liberalized. The paper is structured as follows. In section 2 we reviewed the prior literature on the impact of financial liberalization on banking system. Section 3 presents the empirical methodology we have applied to measure the impact of financial liberalization on banking system. In section 4 we showed the results of our empirical investigation and discussed it. Section 5 comprises the most important conclusions of our analysis.

2. Literature review

Many papers analyzed the impact of financial liberalization on bank efficiency. Their empirical obtained results are controversial. Some researchers show that financial liberalization has a positive impact on bank efficiency and productivity, while other authors consider that liberalization has a negative effect on bank efficiency, determining a decrease of this measure. Others consider that financial liberalization leads to financial crises. Munteanu and Brezeanu, 2012 say that a bank performance may be expressed from the scope of the performance measurement analysis.

Denizer et al. 2000 study the bank efficiency in pre and post-financial liberalization period. The sample includes the Turkish banks for the period 1970 – 1994. Their findings show that financial liberalization reforms were followed by a decline in bank efficiency. Koeva 2003 analyzes the impact of financial liberalization on

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