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MONETARY ASPECTS OF UKRAINE'S INTEGRATION INTO THE EUROPEAN UNION

Abstract

Issues of Ukraine's integration into the EU finance and banking sector are considered. The author's suggestions are based on the fact that Ukraine is still on the early stage of integration. Therefore, now we can discuss only the main problems and the variants how to settle them. Meanwhile, they are divided into:

a) the problems of central banks immediately arousing because of entering the EU (in most cases these are procedure requirements), and

b) the problems related to improvement of national finance and banking system, its adjustment to that of West European.

The latter ones are of crucial importance, therefore the government of Ukraine should settle them notwithstanding the plans and schedules of the EU enlargement, since it is a prerequisite for the national needs of Ukraine's economy.

Key words:

Banks with foreign capital, common currency, Economic and Monetary Union, Euro-integration of Ukraine, European Central Bank, European Union, National Bank of Ukraine.

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Path to Europe: general challenges

In the face of its undeniable importance, the issue of European integration of Ukrainian finance and banking system was not comprehensively represented in our national specialized literature. It is impossible to cover this issue in this paper also, both because of physical impossibility to seize all these process-related problems, and for the most part – because of multi-variance of the very Euro-integration – the world is rapidly changing while we are at the early stage of integration process (in a certain sense we are just defining our integration intentions). Hence, it would be more reasonable to define just the main problems and variants for their resolving.

First of all one should realize that the European Union in the current status (even if to assume that the EU enlargement had already been carried out) – is not quite a «new project». It is for the most part an attempt to revert the united Europe of Roman Empire, the attempt, sporadically recurring for the period of all post-roman history. The experts may refer to the history of Charles' the Great Empire, failure projects of Richard the Lion Heart and Phillip IV the Fair. Unification of Europe by Napoleon Bonaparte under the «revolutionary sceptre» can be viewed within this perspective too. The preceding example of currency integration is also evident. Europe is highly experienced in extensive use of diverse universal currencies. It could be mentioned about Roman times, and a medieval period of usage of commonly accepted money (including Czech «tallers» allowed by Charles V as a legal instrument of payment within his Empire both in Europe and America where they were gradually transformed into «dollars») as well as practice of occupational money within extensive territory of Europe similarly by Napoleon and Hitler. Most satisfactory is an example of Latin monetary union, which was founded in 1865, and formally existed till 1927.

At present, the European Union based on Rome Treaty of 1957 concluded of six Western European counties, first so distant and now gradually enlarging and bordering our country. And now while 15 member countries constitute the European Union, the EU enlargement involves not only long-pending Malta and Cyprus but also our recent USSR partners – Baltic States (Estonia, Lithuania and Latvia) along with socialistic neighbors and colleagues – Poland, Czech Republic, Slovakia, Hungary and Slovenia. Starting from 2007 the EU enlargement with Romania and Bulgaria is expected. It is also worth mentioning about European plans of other our neighbor – Turkey. Thus, Ukraine (together with Belarus and Moldova) can really be found amidst the European Union. Anyhow, in the middle of «the European Arch» that can scarcely be considered as a positive geopolitical factor.

It is worth noting that such a significant EU enlargement may be problematic both for Ukraine and the European Union. First of all, for the reason that the key feature of the EU enlargement lies in relatively high increase in *quantity* of member states in comparison with the moderate growth of «*economic development*». The facts show that 375 billion of the present EU population will be increased by 106 billion of new member states (i.e. the growth approximates to 28%) but as regards the EU members' GDP equaling to Euro 8,9 trillion, it will be increased only by Euro 467 billion (i.e. only about 5%). The matter is that the countries entering the European Union are not only small, but also according to the European standards, *poor*: The average GDP per capita even estimated with regard of purchasing-power parity (USD 9,690) will represent less than a half of the analogical index in current member states of the European Union (USD 21,242)[1]. (Although, in due time, Spain, Greece and Portugal joined the European Union with GDP roughly equalling to these of Slovenia and Czech, which were more positive candidates in this sense)[2].

Unfortunately, GDP of Ukraine is still not high as well: the Western experts estimated it in USD 4200 per capita[3] that makes more than 18% of the average rate of the EU member countries . And this is natural since the GDP of Ukraine is lower than value added rate of such West European corporations as «Royal Dutch Shell» and «British Petroleum».

«Home Task» for the National Bank of Ukraine

It is evident that currently great differences are also present in the «United Europe» and not only on the subject of GDP. Thus, the central banks in the countries of the Eurozone are seriously anxious about considerable differences in inflationary rates. This problem will certainly become more urgent in future and will cause troubles to the central banks, since within 1996–2002 the differences in inflation rates in the EU member states and the candidate countries (even disregards the most inflationary economies of Bulgaria and Romania) made up 8 percent[4].

Generally, the EU enlargement will cause extra problems for the central banks, in such issues as free capital flow, free exchange in financial services, currency integration and financial statistics, primarily. The problems related to the settlement of these issues are rather complicated. They can be characterized as:

- the problems facing the central bank directly as a result of the EU membership (in most cases these are procedural requirements) and

[1] H. Berger. The ECB and Euro-Area Enlargement // IMF Working Paper. – 2002. – PP. 6, 8.
[2] Financial Times, Dec.10,2002. – P.4.
[3] The Milken Institute Review // A Journal of Economic Policy. – Q1, 2003. – P. 33.
[4] H.Berger.Op.cit., p. 14.

- the problems associated with the development of national financial and banking system, and its adjustment to Western-European level.

Though the last ones are much more common, they often coincide and concur as concentric interests with the objectives of the National Bank of Ukraine despite when we enter the European Union. In any case we should work on settlement of these problems.

In the process of the European integration the central bank of a certain country is involved into the following three fields of activity: joint participation with the Government in negotiations, adjustment of its organizational structure and principles of functioning in accordance with the standards of the European System of Central Banks (ESCB), and arrangement of the EU standards implementation into the banking sector. Presently participation of the National Bank of Ukraine in negotiations is mainly focused on such issues as free capital flow along with financing and budgeting. In future (after formal application for the EU membership) adjustment of organizational structure and principles of functioning of the National Bank of Ukraine in accordance with the ESCB standards is to be carried out. By this time the objective of the National Bank of Ukraine is to strengthen cooperation between the European Central Banks and national central banks – members of the ESCB. To identify the probable spheres of discussion within consultations with the ECB, the structural subdivisions of the National Bank are to prepare the list of concrete problems and schedule of technical cooperation between banks. Taking into account the practice of Poland and Baltic states, the following problems should be considered:

- legal problems (to harmonize the financial legislation with the EU principles – within these general issues the consultations on specific matters are to be held – for example, normative acts on provision, trans-border transfers, payment systems and systems for mutual settlements, bank control, trans-border procedures on insolvency recognition, the system of currency rates fixation, and management of currency reserves);
- monetary policy (identification of the problems related to guaranteeing of minimal reserves, monitoring and control over the operations with securities, security of loans, and liquidity of banking sector);
- finance and banking statistics (cooperation within updating of the register of financial institutions, modernization of the system of finance and banking statistics plus gathering and processing of information covering the interest rates);
- payment systems (rules and conditions for participation in TARGET system, security of payment systems within application of instruments for electronic payment and development of e-money systems);

- accounting and accountability (grouping of economic events in the estimating table developed by the ECB, principles of budgeting for central bank operations);
- cooperation in the field of scientific researches (theoretical and actual convergence of Ukraine's economy as a result of entering the EU and the ECB, models for import and export forecasting, technological progress and its impact on banking sector, integration within the EMU, and globalization of financial markets);
- emission of banknotes, immobilization of counterfeit notes and coins (cooperation within establishment of the System for monitoring over the counterfeit notes and coins along with the Center for analysis of counterfeit notes and coins, access to the database on counterfeit notes and coins);
- informational technologies and telecommunication systems (bilateral communication linkage between the National Bank of Ukraine and the European Central Bank, involvement in development of performance capability for future incorporation of Ukrainian inter-bank payment system into the TARGET system);
- collaboration in studying of effect of normative and legal acts on financial state of credit institutions;
- assistance in personnel training and exchange of experience: organization of conferences, seminars, training at the ECB (for instance, in legal issues, inflation forecasting and mechanisms for monetary policy, financial system, cooperation between central banks and the ECB, Euro circulation, statistics, accounting, bank control, etc.).

Entrance criteria: formal and essential

Apparently, the Program for the EU membership outlined in President's Memorandum to the Supreme Council necessitates more focusing on these issues. With respect to this, the criteria for the EU membership should be examined more carefully. At this stage of the EU enlargement, the conditions for member states and candidates were determined at the summit meeting of the European Council in June 1993. It was decided that the next EU enlargement would take place as soon as the candidate countries from Central and Eastern Europe meet all the economic and political commitments. This refers to the establishment of effective market economy able to face the competition on the common European market, and entering into commitments such as gaining common goals of the European Economic and Monetary Union – EMU. Treaty on the European Union enforced on November 1, 1993, defines the criteria for candidate countries at the next stage of integration, to be precise – at the stage of entering the EMU. The criteria are the same as for member countries, and are applied to stability of prices, long-term interest rates, exchange currency rates, budget deficit, national debt and independence of the Central Bank. The above-mentioned convergence criteria were also ratified at the summits of the European Council in Madrid (1995) and Luxembourg (1997). Although in future these criteria may be changed, the economists (first of all, Robert Mandel, Nobel Prize winner), who developed the theory of «optimal currency areas» (constituting the framework for Euro-area), defined some fundamental, principal criteria for such integration. They include necessity for highly open economy, close business relations between partner countries, and correlation of economic cycles developing in certain countries with the cycle which is peculiar to a principal economic potential of integration[5].

From this perspective Ukraine has rather substantial degree of economic openness, it is to a great extent involved into international labor division, and integrally meets the requirements of the present world economy (at least as far as quantitative coefficients are concerned). The rate of our trade relations with the EU member states is somewhat lower, since their share in foreign trade of Ukraine makes only 21%. Nonetheless, some scientists, such as J. Frankel and A. Rose point out that within the system of international economic relations the trade affairs stand for «endogenous variables» therefore remaining stable while the rate of currency integration increases[6]. As a consequence, on the one hand, expansion of our trade relations with the EU members will motivate our integration into the European Union and, on the other hand, the very currency integration will lead to closer trade relations with the EU partners in future.

The same interrelation is typical for synchronization of economic cycles. This is also worth noting in view of the fact that the degree of correlation of national economic cycles with the common European trends in the EU countries (the coefficient is equal to 0.77) exceeds the equivalent for the candidate countries (0.29)[7]. The corresponding coefficient is definitely lower, since our economy is not oriented at the «European schedule» yet.

Even though, within the existing relations with the European partner countries we are not able to be dispense with so-called «American aid», implying that US dollars constitute an important share for European payments, although these are the European partners who dictate the medium for payment. Yet, a positive tendency can be observed: a share of Euro payments from the EU countries increased from 13 to 21% while our payments in Euro to the EU countries - relatively from 25 to 35 %. And this was mainly due to the share of US dollar. In the meantime, in general payment turnover of Ukraine the share of Euro varies

[5] Optimum Currency Areas. New Analytical and Policy Developments. Ed. By M.I.Blejer, J.A.Frenkel and others. – IMF, 1997. – P. 9-10.
[6] Ibid., P. 67.
[7] H. Berger. Op. cit., p. 16.

within 5% while the interests of Euro-integration require 20% as a minimum (taking into account the increase of trade turnover with the Euro-partners).

Therefore, qualitative transformations of the structure of payments with the EU partners to increase the Euro payments (perhaps – and along with hryvna as we did practice already the payments with the EU candidate countries) are imperative. Actually, the transformations of the structure of payments will result in modification of the structure of our currency reserves as well. The next stage would be quotation of hryvna towards Euro instead of dollar («basket of currencies», noticeably loaded with dollar and Euro can become an intermediary stage).

Path to common currency

The problem of changes in monetary policy is also rather complicated since the EU rules on this issue are rigid, and leave no chances to the EU member states to pursue their own national policies. This refers to the new EU member states primarily, since the «old» ones had been gradually elaborating the common monetary policy in the course of many years. Thereto, the order of decision-making by the European Central Bank that was in force up to that moment also represented a certain compromise between the interests of different countries. However, the extension of Euro-area and because of a possible disturbance in rotation of the ECB management as a result of appointment of Jean Claude Trichet as a Governor the worked-out system can be upset.

Despite the fact that at present the question covering restrictions imposed on monetary regime of the EU newcomers is not settled yet, some principles have already been declared: obviously, the final goal is elimination of national currencies and transition to Euro. In addition, the new member states would be treated by the same convergence criteria rated by the Article 121 of the Protocol on convergence criteria. Furthermore, it is stipulated for a country to be at least a two-year member of Exchange Rate Mechanism (so-called ERM-2) plus it should not experience an exceeding tightness of exchange currency.

The conditions of new ERM-2 are stipulated in the Amsterdam Resolution of the European Council (June, 1997) and Agreement on the ECB and Central Banks of non-member countries of the European area (September, 1998). It is stipulated that central exchange rates of Euro and national currencies will be established and adjusted by the ECB together with relevant central banks. Temporary exchange fluctuations within 15 % are acceptable and can be achieved by national central banks through unlimited interventions on the currency market to maintain the exchange rate within the established limits. Thus, a new mechanism is consistent with a wide range of currency systems, conflicting only with the three of them: 1) the one not having an approved central rate with respect to Euro, 2) crawling peg and 3) a peg to any other currency except for Euro.

It is worth noting that the candidate country will have to transfer from fixed exchange rate to Euro (as penultimate stage of convergence), and for the period of two-year «trial term» it will not be able to manipulate the exchange rate of national currency independently (for example, with the intention to increase the competitiveness of national manufacturers). That is why it is essential to pay minimal attention to the issues of monetary policy during the transitional period. At present the system of flexible currency rate facilitates Ukraine's entering the European Union. Joining the ECB necessitates primary correlation of hryvna and Euro within the system of the ECB for the period of two years.

As it was mentioned before, the mechanism for exchange rate coordination enables the exchange rate of hryvna to maintain at par within +/- 15%. These requirements are easy to meet. The wide range of divergences from the parity rate would secure a considerable autonomy of the monetary policy, and would allow its implementation in accordance with the criteria of Maastricht Treaty on inflationary rates. Once the prospects of the European Monetary Union membership become more evident, the transition to the system of fixed exchange rate would be more feasible. Although, the monetary policy, which is likely to be implemented prior to transition to the fixed exchange rate of hryvna, it should secure the interest rate of the National Bank of Ukraine, which would not continually exceed that of the European Central bank. However, one should remember that a due low inflationary rate as a result of high interest rates would be accompanied by relatively high exchange rate of hryvna.

Establishment of parity at such a high rate would mean a poorer competitive position for Ukraine, which can get worse due to inflationary phenomena concerned with introduction of lower interest rates of the ECB after joining the Economic and Monetary Union. The preference in the fixed exchange rate (and as a consequence – a preference in parity) is based on realistic assumptions on degree of inflows of foreign capital.

Once discussing the issues of currency, it would be reasonable to focus our attention on the fact that Ukrainian and world cycles in this field do not converge.

Our way to creation and later on – stabilization of our national currency was rather long and difficult. So at the moment, rejoiced with the work done, we can refer to the Russian poet V. Mayakovskyy:

«Solid money makes solid positions:
a link between farming and industrial subdivisions!»

Successful introduction of our national currency exposed quite different world tendencies such as:

- formation of common Euro currency;
- several months ago the African countries were united into the African Economic Union to effect establishment of common currency – Afro;

- analogical tendencies are also developed in Asia where the prospects of transition to common currency are discussed (the plans for internationalization of Japanese yen lately were expanded by Chinese plan for stage-by-stage creation of «Asian dollar»).

Facing the above, only two ways for further development exist: (1) to support and develop national currency or (2) to hasten the acceding to the new tendencies on common currencies (which are rather precarious though at the moment).

It is exceptionally crucial for Ukraine to make the right choice. Indeed, many but not all the EU countries joined (Great Britain, Sweden and Denmark, in particular) the Euro system. Most probably the candidate countries will not hasten too.

As soon as we decide to transit to the common currency, the new challenges will arise, like:

- Is it necessary to get prepared for transition to the common currency immediately after entering the EU or should we take time to think?
- In any case – whatever strategy should be chosen: to enter successively and stage-by-stage or else by one-moment immobilization of circulating notes?

But these are not the only problems. Some politics suggest choosing circuitous way – through Euro-Asian Economic Integration. As a result, additional problems emerge. One point is when the EU entry is the objective of all participants of the Euro-Asian integration – then it is possible to try to implement a common program; but in case it is not? Is it rational enough to discuss seriously the European integration of the Central Asian countries or even Russia? Russia seems to have quite special plans, to establish equal partnership relations with the EU.

Subsequently, is it provided for every participating country of the Euro-Asian Union to enter the European Union all together (in this case making it reasonable to hold mutual negotiations) or one by one (then why to take this intermediary step?). Finally, what will be the common currency for the Euro-Asian Economic Union? As practice shows, most probably the ruble will be proposed. In this case, additional problems will arise, for instance:

- the ruble will be shared, that is to say «new edition» of «transferable ruble» of the CEA period;
- otherwise this will be still, regardless any discussions, just a Russian ruble – as it was proposed in the union of Russia and Byelorussia?

If the matter is in the latter variant, it will be logical enough to suggest transition to more stable and foreseeable hryvna.

Since the above questions ought to be discussed by politicians, let us return to theoretical problems of currency integration. Thereby, it would be sensible to draw the readers' attention to the so-called Balassa-Samuelson effect. In accordance with this theory (which was put into practice), close trade integration leads primarily to increase of labor productivity in export sector (the demand for products of this sector is increased more intensively).

Consequently, this causes more intensive rise in wages within these sectors. However, such factors as migration of labor and solidarity of trade unions (wherever present) finally lead to leveling of wages increase rate in all sectors including non-export ones, where the increase in productivity is less intensive. Thus, surpassing rise in wages in non-export sectors is a result of such a disproportion.

Moreover, this tendency is additionally enhanced by demand of non-export services as a consequence of relative rise in paying capacity of population.

The logical result is constant increase of actual exchange rate. Accordingly, the trade integration may lead to substantial difficulties for us in currency integration because of the necessity in regular maneuvering between increasing of nominal exchange rate (which would hardly stimulate our export sectors) on the one hand, and a threat in growth of inflation which can go beyond the EU criteria – on the other.

Likewise, the problem will become more urgent since the anticipated[8] maintenance of Balassa-Samuelson effect will seriously complicate the process of integration in transitional economies into the European mechanism for coordination of exchange rates and soon after – integration into European Union. The earlier EU members did not experience any related difficulties since the membership in the above mechanism was not compulsory while the European Monetary Union did not exist at all. The newcomers will have to restrict and afterwards – to repudiate their national monetary policies.

Therefore, it is essential to take into account that within the common monetary policy a very open economy (typical for Ukraine) with export structure different from that of other partner countries (which is also characteristic for Ukraine in comparison with the EU countries) will result in more extensive losses as compared to the «closed economies» with analogical structure of export, yet national monetary policies.

[8] See: Обзор экономического положения Европы // Организация объединенных наций, Европейская экономическая комиссия. – 2001.-№1. – С. 271, 281.
H.Berger. Op.cit.,15-16.

Monetary policy: European orientation

While discussing the common monetary policy for the European Union, the conditional character of this term should be emphasized. After resignation of German Minister of Finances in March, 1999 the governments of Euro-area avoid any debates on supporting economic growth through exchange rate while the European Central Bank deeply disapproves such ideas. As is well known, the official policy of the ECB involves orientation towards no special strategy. Until recently the monetary policy of the ECB was based on two pillars: targeting of M3 rates rise and more expansive indicators of «real economy»[9]. (However, nowadays such strategy is more criticized, and requirements for transition to direct inflationary targeting are demanded)[10]. It is necessary to proceed a rather difficult path of transition to such principles of monetary policy; still we have already advanced the inflationary targeting. Separate periods of negative inflation (which was even defined as deflation) have rather clearly demonstrated the necessity for transition to the policy of targeting. However, in the given case it is possible to talk about certain concurrence with the Euro-tendencies but on a lower convolution of macroeconomic development. Last year Ukrainian economists in cooperation with economists from Western and Eastern Europe were much concerned with negative inflation and outline of possible *deflation – i.e. the long-term decrease in prices caused by compression of money supply*. Therefore, the problem of complicated combat against inflation grows to be more urgent while the opportunity to carry out a strong monetary policy by the Central Bank of the EU with no common government turns out to be vital[11]. Hence, it is essential to mind the long-range outlooks when discussing the problems of monetary policy. Even though the common government can be considered as a long-term prospect for the European Union (although it is precipitated considering the problem of common European Constitution or Convention which, similar to common European currency, as it is generally agreed by its supporters, will motivate the «common European understanding»[12]), most EU member states face the actual prospect to lose control over the monetary policy. As a matter of fact, reformation of suffrage for the ECB involves the possibility for 5 member states having the highest GDP to control the decisions taken by the Central Bank after a new EU enlargement[13].

Ukraine's efforts towards Euro-integration call for additional measures to be taken apart from transformation of monetary policy in terms of inflationary targeting. In the specialists' forecasts, a successful transition to Euro-area is

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9 Financial Times, Dec. 9, P.2.
10 Ibid., Dec. 6, 2002, P. 5; Dec. 17, 2002, P. 13; The Wall Street Journal Europe, Dec. 16, 2002, P. 1, etc.
11 Financial Times, Nov. 4, 2002, P. 15.
12 Europe Convening. – 12th Frankfurt European Banking Congress, 2002, P. 33.
13 Financial Times, Dec. 11, 2002, P. 4.

possible only under securing of disinflation, high stability of exchange rate and relative stability of interest rates for credits[14].

New targets are facing the monetary instruments either. Direct refinancing of commercial banks requires both – short-term and middle-term refinancing. In order not to focus on this subject, it is important to emphasize seriousness of this task, and impossibility to handle it with rapid simplified measures. In no way this means for incumbent central bank a primitive provision of commercial banks with basic resources and credit risks liability. Long-term refinancing needs more careful examination as well. It is important to mind that in all over the world, including the EU countries it is secured through funds market.

Thus, we face the ***problem of funds market development***. Although this issue claims no special attention, it would be rather practicable to underline some tendencies typical for the EU.

As early as in November 2000, Baron Alexandre Lamfalussy, a well-known financier (ex-president of the Bank for International Settlements), in his report recommended developing of the New European legislation on regulation of financial risks. In half of a year (February, 2001) more concrete suggestions were made in the new report, involving formation of common European (within the European Union) authority for supervision on funds markets. This idea was a subject of wide discussion for specialists.

Moreover, it was supported lately not only by officials of the Euro-Commission but also by market participants, such as influential group of financiers, known as «Eurofin Group» (co-managed by Jacques de Larosier – ex-chief executive of IMF and Governor of the Bank of France). At the same time, the necessity for establishment of common integrated financial market till the end of 2005 (which requires implementation of 42 new laws) is discussed since according to the experts' estimates this will bring about extra 1.1% to the GDP of the EU countries within next decade and will reduce the cost of required capital for corporative sector by 0.5%[15]. As a consequence, the problem of integration of common EU banking and funds market most probably will be more urgent in the nearest future.

Common banking area

However, the issues of banking Euro-integration claim more detailed analysis. Practically, the Directive of the European Parliament and Council as of March 20, 2000 is determinant in *establishment and further activity of financial intermediaries*. Basically it entails:

[14] Alternative Monetary Regimes in entry to EMU // Bank of Estonia, Tallin, 2002, P. 187.
[15] Ibid.,Dec. 4, 2002, P. 11.

- **interdiction of discrimination** towards establishment and rendering of services founded on national identity or the non-EU origin;
- **elimination of barriers between member countries in regulations** intended for activity of financial intermediaries;
- **stipulation of equal financial requirements for financial intermediaries and common basic standards on equity basis of financial intermediaries;**
- **coordination of liberalization measures on bank services with that on capital flows;**
- **official recognition of the licenses issued to financial intermediaries by national authorities to be valid within the Community** rather than just within a single country as it was before.

The same Directive implies banking supervision based on consolidation. The same objectives are facing our national banking supervision. At present 24 of 30 Basel principles of banking supervision are fulfilled by Ukraine. Ukraine enthusiastically arranges transition to supervision over the adequacy of banking capital in accordance with the new agreement on this issue known as *Basel-2*. It would be reasonable to remind that *Basel-1* covered two sections: (1) definition of capital and (2) structure of risk weights. Consecutively, *Basel-2* is based on three mutually reinforced pillars: (i) minimal capital requirements, (ii) supervisory review process and (iii) market discipline.

In 1998 a capital measurement system commonly referred as the *Basel Capital Accord* provided for the implementation of a minimum capital standard of 8% by the end of 1992. Since 1988, this framework has been progressively introduced in more than 100 countries of the world including Ukraine. Nevertheless, despite its undeniable success, the practice of capital accord coefficient revealed some shortcomings. The main is in insufficiently accurate risk measurement. The updated version of the Basel Capital Accord provides a flexible structure in which banks subjecting to supervisory review will adopt approaches which best fit their level of sophistication and their risk profile. This problem is old for Ukraine though not adequately settled – the problem of internal credit ratings and financial intermediaries, which gather data for a credit history of a debtor to provide all the financial intermediaries with. Therefore, it is crucial to accelerate its development.

The amendments made in the Capital Accord by the Basel Committee had the most positive, and at the same time, most negative effect for Ukraine's banking sector and Ukrainian economy in general, specifically – strengthening and even intensification of differentiation into developed countries and less developed countries. Within this context, Ukraine, including its national banks and other financial and non-financial institutions, will definitely benefit in present more than in the future. Banking supervision over internal assessment process calls for essential transformations to be made in the very system of supervision.

Primarily – in technical resources, organizational structure, skilled personnel, and the system of its training. Liability of banking supervision over internal assessment process is rather disputable. Banks are independent institutions in Ukraine and are liable for their activity; therefore, it would be not feasible to convey bank's liability on banking supervision in any sector, internal assessment system in particular.

In the process of our integration into the European Union this problem will develop into pressing one. It would be compulsory for banking management to be more specialized and, as a consequence of such risks measurement, their monitoring and risks management will no more be of interest for a small group of experts at Risks Departments: henceforward all of these issues are to be examined by top managers of banking institutions.

To meet the requirements of Euro-Directive, proper allowance must be made for minimum capital requirements coming into effect in a month, specifically:

Euro 5 million – for national banks

Euro 3 million – for regional banks

Euro 1 million – for cooperative banks

The restrictions whenever imposed in Ukraine on foreign capital investments into the banking system were gradually eliminated long ago, namely:

- 15% of limit for a quota of foreign investments in the overall capital of banking system;
- 35% of maximum for owner's funds (which impeded establishment of affiliate banks);
- putting the off-shore investments under a ban;
- investment authorization for only «first-rate» banks.

At present the only requirement is Euro 10 million of minimal capital for a newly established bank. However, this can hardly be interpreted as restriction since nowadays a real bank needs a heavier capital. Moreover, though it wasn't pointed out in the proposals submitted by Ukraine to the Secretariat of the WTO in December 2001, it was provided in further negotiations to empower foreign banks to found non-capitalized affiliations, which would be supervised in close cooperation with supervisory authorities from the country of headquarter location. These are the requirements for Ukraine's entering both to the WTO and the European Union. The later «normally emphasized the stipulation to establish direct bank affiliations, which is to be submitted in Ukraine's proposals to the WTO. Negotiations with the European Commission made it obvious that otherwise the EU will obstruct Ukraine's entering the WTO, and entering the Agreement on financial services in particular»[16]. Indeed, one may disagree with such approach but whatever the case may be, the European Union is considered to be a «common banking area»; for that reason it is the liberalization of foreign banks' access to national market that will make Ukraine's way to the EU. However, such prospects of Ukraine are predominantly sussed and are considered to be a threat for national banking system. Although this theme is rather extensive, some of its aspects need more focusing.

It is a common opinion that establishment of non-capitalized affiliations may noticeably intensify foreign banks' access to the financial market of Ukraine. Meanwhile, the analysis of other transitional economies' development brings about rather ambiguous conclusions on such interrelation. In point of fact, decision-making of foreign banks on access to the markets in such countries and the extent of necessary investments are based on availability of global clients at the market and prospects of a banking sector in a recipient country. Within technical perspective, the license for foreign affiliations facilitates the procedure of opening of banking institutions, and expands the potential volumes of credits allowed by such institutions (since the capital of parent bank is much heavier than that of affiliations abroad). Along with that, the supervision over operation of such institutions and the procedure of decision-making on banking services (credits primarily) becomes more problematical.

Analysis of the world practice may be of help in forecasting of certain positive effects of foreign affiliations' access to the market of banking services in Ukraine. First of all, establishment of non-capitalized affiliations in positive environment significantly intensifies attraction of foreign banks to financial market of Ukraine. Consequently, this will improve transactional services in banking system, reduce their terms, expand the range of services and develop technologies for their rendering. Expectantly, presence of Western banks will stimulate development of national banks in terms of competition and expansion of servicing system. Moreover, licensing of non-capitalized affiliations will increase the volumes of credit allowance by such institutions (the capital of parent banks is much heavier than that of affiliations abroad)

Hopefully, unlike the current situation, allocation of licenses to foreign affiliations in Ukraine will motivate foreign capital attraction to national economy, its banking sector in particular. Nonetheless, this factor cannot be self-sufficient since the main reason for restraining of access of foreign banks to the market of Ukraine is poor investment climate in general and high risk of activity.

In fact, Euro 10 million of investments to access the market of Ukraine cannot restrain major Western banks. Therefore, the number of foreign banks affiliations in Ukraine will increase progressively at the expense of 1) banks from countries with analogical sovereign credit rating (such as Russia and Kazakhstan) plus 2) average western banks. The former ones would be interested in

[16] Українсько-європейський журнал міжнародного та порівняльного права. – 2002. – Т. 1. – Вип. 3. – С. 56.

accompanying of their clients, especially in operations of privatization. The later ones would focus more on efforts to take advantage of Ukrainian capital and play the currency market (within the assumption of liberalization of currency market of Ukraine) rather than on crediting. The intermediary access of Western banks to the market of Ukraine through affiliations of East European banks owned by Western capital is probable too. In several years the affiliations of major banks are expected to appear on the market of Ukraine.

In general, as our long practice shows, expansion of foreign banks is our expectation rather than a real threat. Still, taking into account geographical structure of such investments, these are the European investors who have the leading positions. Thus, in early 2003 the overall volume of foreign investments into the banking sector of Ukraine makes USD 207.6 million that is 13,57% of the total of banking capital. The share of the EU countries in these investments approximates to 40 % and the total share of European countries (excluding Russia) – nearly 65%. Most significant are investors from Austria – 17,2%, Poland – 13,4%, Switzerland – 10,7%, France – 5,4% and UK – 4,3 and this also guarantees our successful integration into the European Union.

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