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CONSIDERATIONS ON ASSURING FINANCIAL SECURITY BEING A PART OF THE ECONOMIC SECURITY OF THE REPUBLIC OF MOLDOVA IN THE EUROPEAN INTEGRATION PROCESS

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Abstract

In the Republic of Moldova, financial security has been marked by banking fraud (2014), who "kneeled" the national economy. The most serious problem was, and is still present, the uncertainty from the banking system that was created as a result of dubious transactions and fraud from 2014, so that the financial security of the Republic of Moldova has been exposed to an imminent risk. Latest results recorded by the financial sector show that the main activity of commercial banks - financial intermediation (financing economy) - is constantly decreasing. Additionally, an important risk factor that has contributed to the worsening financial situation in the country, was the freezing of foreign financing. From the moment of signing, relations between the EU and Moldova, the later are guided by the Association Agreement EU-Moldova (AA), including DCFTA and the Association's Agenda. These acts provide for the period of 2015-2020 support the implementation of the "acquis communitaire". Taking into account the changes in the Moldova's financial security architecture, coming closer (the implementation of the Association Agreement) to the European Union is one of the most desirable solution for consolidation of the banking sector and the transformation in a safe sector for the local society and attractive to foreign investors.

Key words: *financial security, sustainable development, vulnerability, economic security, acquis communitaire, European integration.*

JEL CLASSIFICATION: F52, F36, E58

Introduction

Sustainable financial security is an integrated systemic element of the national economic security. It aims to study and to forecast a wide spectrum of determinants factors that can have an impact over stability of the financial system, being one of the key vulnerabilities of the economic security (as recent financial crisis showed).

The Republic of Moldova is not an exception. The global financial crisis, which started in the year 2007 and the banking fraud from 2014 showed serious systemic vulnerabilities and poor range of instruments for efficient banking sector supervision.

For Moldova, as any other country in the world, is very important to have a safe, sound and modern economy, in other words to have a sustainable economic security. The role of the financial sector in the process of assuring a sustainable economic security of any country cannot be overemphasized.

Republic of Moldova's financial sector have gone through turbulent times in the last 3 years. This period is characterized by – banking fraud from 2014 (aprox. 12% of GDP), bankruptcy of three banks that had about 30% of the banking system assets, massive depreciation of the national currency, double-digit inflation etc. Additionally, the attitude of the main external partners/donors became "cold" – some of them frozen or cancelled the assistance programs.

We believe that this "jump" will qualitatively solve the major problems that is aggravating Moldova's economic condition. One of this is linked to major governance failures in the recent years. The importance of this jump is also proved by the decision-making power in Moldova that turned out to be incapable to prevent banking frauds, in the same time, by billing the cost of these frauds to its citizens. [1]

Sustainable development

The theory of sustainable development is quite "fresh", since it appeared less than 100 years ago but it is always in development, because every year each country in the world is dealing with new problems. At the very beginning this concept described only the environment and sustainable use of natural resources. In 1951, International Union for the Nature Conservation tried to search reconciliation between economy and ecology. In 1970 the sustainable development concept was introduced by Barbara Mary Ward. In 1972, at the Environment Conference from Stockholm, the participants agreed for a resolution that all human activities contribute to the deterioration of the environment. The most common definition of sustainable development is *the development that meets the needs of the present without compromising the ability of future generations to meet their needs* [2, p. 322-329]. Sustainable development and all three dimensions: economic, social and environmental (Fig. 1), has become a political objective of the European Union in the Treaty of Amsterdam in 1999 [3, p. 812-817].

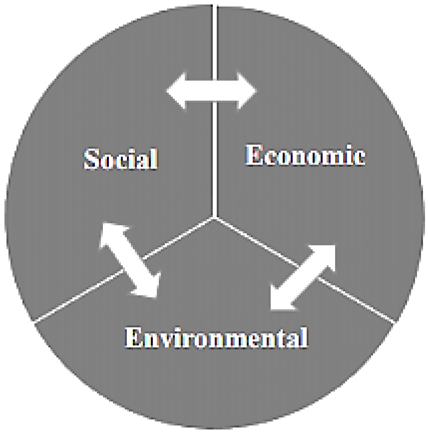

Fig. 1: Dimensions of the sustainable development
Source: [4]

Economic security

Throughout the XX century and at the beginning of the XXI century, there were formed several definitions on the basis of macroeconomic approach. The concept of economic security involves: financial security, energetic security, demographic security, informational security, etc all being very much inter-related. Generally, in the economic literature is used the synergetic definition that contains three main areas: the main state's interests, lack of vulnerabilities and the possibility to self-development.

Economic security represents a general concept, which can be subject to interpretation. However, there are several convergent approaches that allow to determine in a faithful way which countries have a higher level of economic security and which are more vulnerable.

By definition, using the macroeconomic approach, we understand that economic security "*is the economic system that enables dynamic and efficient development, resolving problems by which the state has the ability to develop and implement an economic policy independent* "[5] or "*a situation of the economy and institutions of power in which it is ensured the protection of the national interests, general social-oriented development of state, sufficient military potential, even in case of less favourable development of the internal and external processes*". [6] We believe that we can generalize the definition and reduce to three basic conditions: (1) the conditions necessary for survival; (2) the mitigation of threats and vulnerabilities; (3) improve or at least maintain sustainable economic situation.

Relevant for the monitoring of national economic security is the security of the financial-monetary system- financial security - which is determined by the integrity, stability, growth,

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competitiveness, and provides sufficient financial base for economic and social policies in order to ensure national security, and the development and protection of the national interests. [7, p.40]

The Republic of Moldova's financial security

After the large banking crisis from 2014, banking sector reforms had a period of tempering and of recover. In the last year, banking sector reforms recorded an ascending evolution mainly because the support from the international partners (International Monetary Fund, World Bank, European Union, etc.) In the same time, the positive results have not been felt yet – the main banks' activity – allocating efficiently the financial resources – is continuously shrinking.

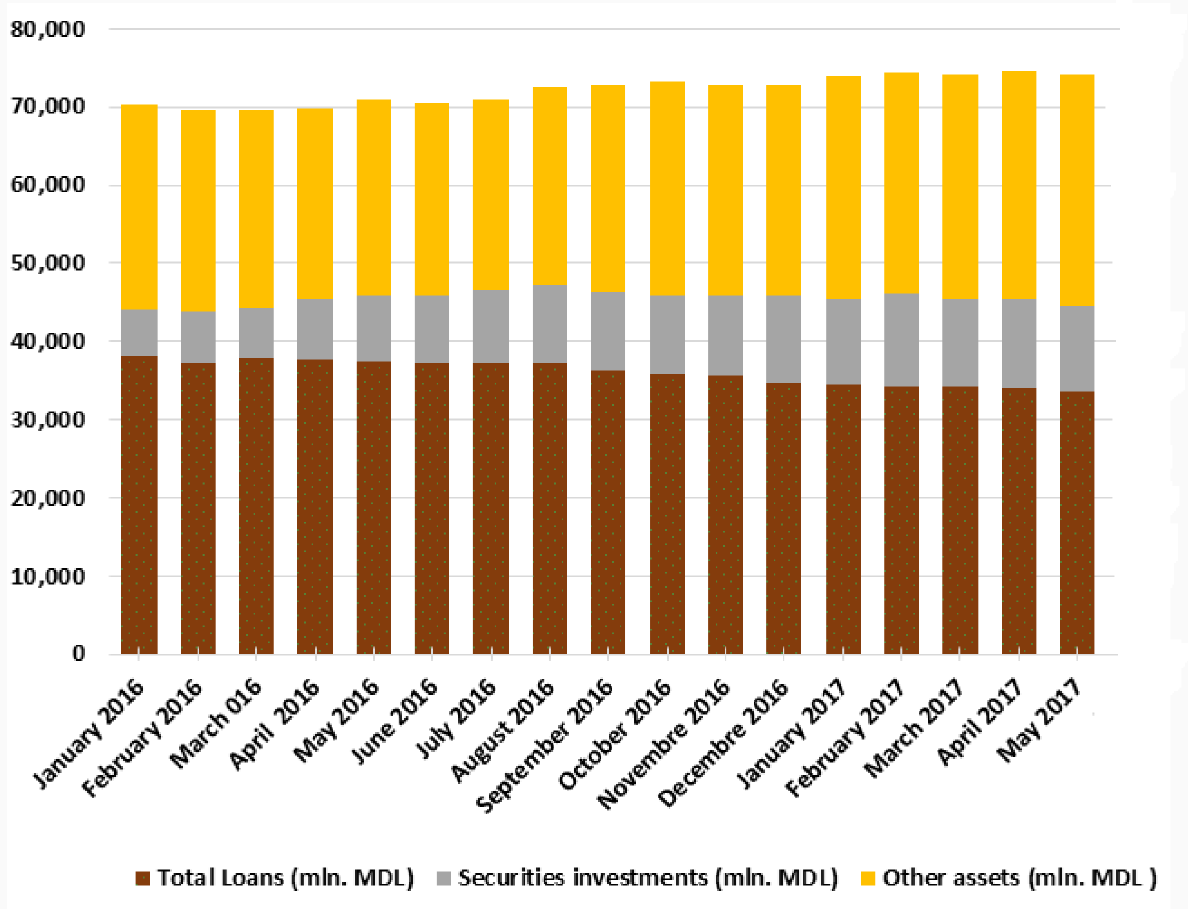

Fig. 2: The total volume of loans

Source: [8]

A sustainable intermediation is grounded on the trust of banks in investors and on businesses trust in the economy's "health". Indeed, for Moldova's authorities, after the 2014 banking fraud, restoring the credibility in front of Moldovan society and foreign partners was, by far, the biggest challenge. And it still takes time and effort, requiring an uncompromising acknowledgement of all deficiencies that led to the banking crisis, in the first instance, and a credible plan to tackle them. Moldova suffers considerably from low financial intermediation, which can undermine long-term economic prospective and investment activity.

Despite this "quite serious" problems, Republic of Moldova managed to come back quickly and to avoid state bankruptcy. On the one hand, the social obligations have been met (salaries in the budgetary sector were paid timely). On the other hand, National Bank of Moldova (NBM) has done a great job and returned inflation quite quickly back to the level targeted and the banking sector has remained, relatively stable. As the economic environment moves into a more neutral phase, there is more space to address profound structural reforms – one of which is jumping from Basel I to Basel III.

Additionally, the small size of the Moldova's economy transforms the banking sector less attractive for the large, sound, financially capable foreign institutional investors. More than this, currently, the banks with the highest potential to attract investors are the banks under special supervision regime. Moldova Agroindbank, Moldinconbank and Victoriabank are the biggest banks in the sector and systemic important ones. Large bank failures can have devastating effects on both, particularly financial system and economy as a whole. This ambiguous situation, can represent one of the main reasons of decreased attractiveness of the sector.

Moldova's sustainable financial security in the process of European Integration

The relations between the Republic of Moldova and the European Union (EU) are complex. Beginning with 2014 and fully entered into force on July 1, 2016, within the framework of the EU-Moldova Association Agreement (AA), these relations became more multifarious.

The new framework structure is characterized by innovation and ambitiousness. The new legislation has to be fully implemented into the national legislation until 2020. For the financial sector, EU-MD AA has a whole chapter in which the main requirement is to "jump" from Basel I to Basel III. The new requirements come to strengthen the capital and liquidity rules with the goal of promoting a more resilient banking sector.

A strong, sound and resilient financial sector is one of the main conditions for a sustainable economic security, as banks are the nucleus for credit intermediation for the real economy. That is why the Republic of Moldova engaged in transposing into the national legislation all the international legislation – Basel III requirements.

The objective of the reforms is to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spillover from the financial sector to the real economy. [9, p. 6]

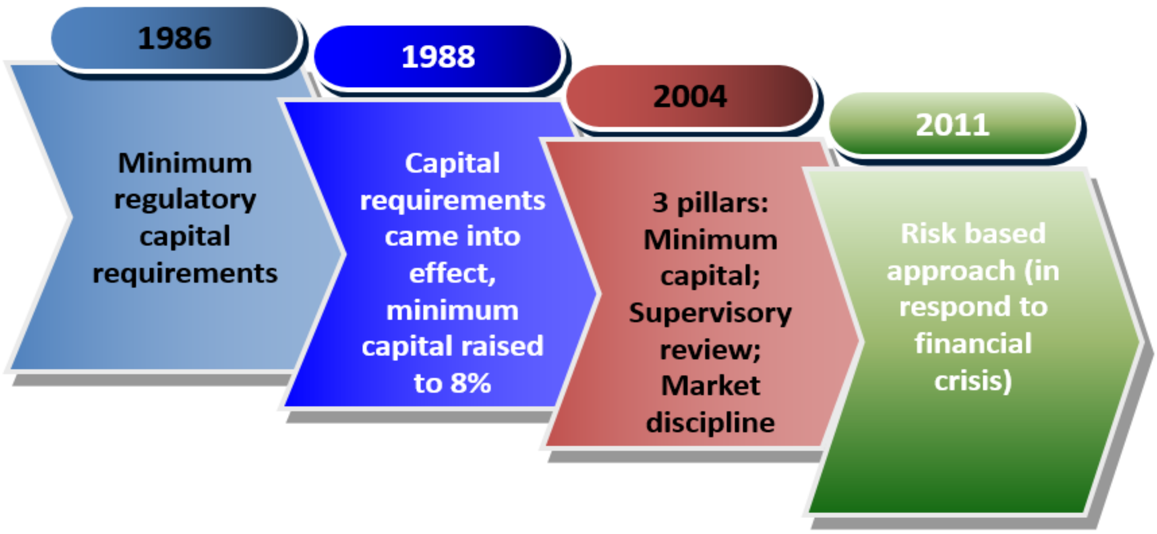

Fig 2: Changes in the Basel requirements
Source: Elaborated by the author based on [9]

One of the most important lessons learnt after the global financial crisis (2008) is the need to have a more strengthened capital framework for a better risk coverage. Basel III has as the main objective to consolidate the stability of the banking sector through application of more exigent requirements having as a goal to increase the system's capacity to absorb shocks as well as to reduce the risk of failure. The new Basel III capital standards are expected to be widely adopted over the coming few years

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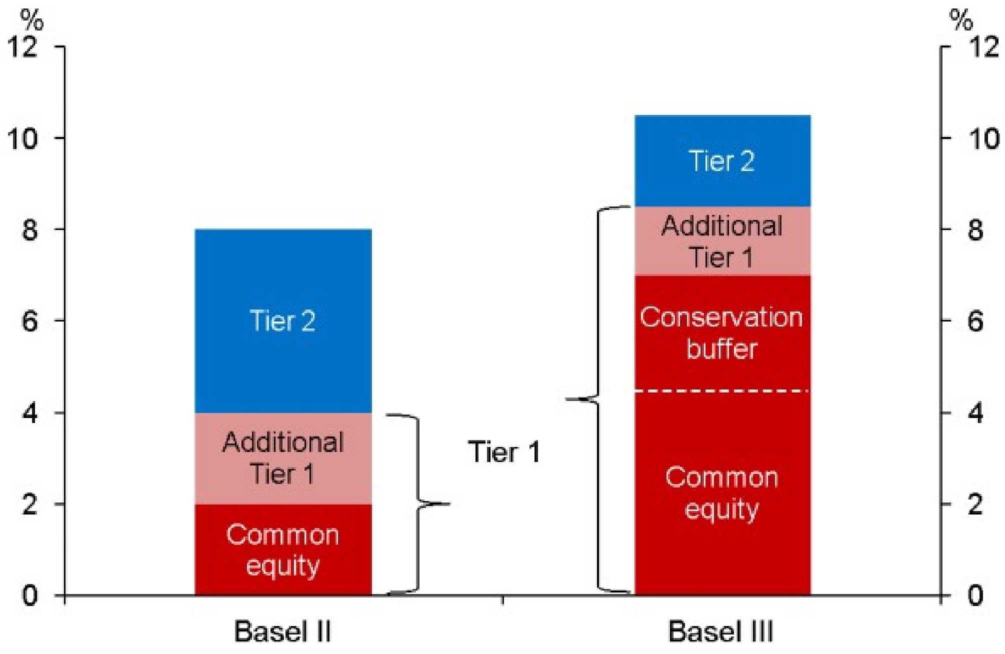

Fig. 3: Basel III versus Basel II capital requirements
Source: [10]

These new standards will improve the risk management, will increase the transparency requirements and will address the problems of the systemic important banks.

Sustainable financial security can be assured through pro-active implementation of a prudential supervision of the financial system using **risk-based approach, forward-looking approach – focused on prevention supervision and judgement-led approach**. Risk-based approach. The regulating authority is focusing on those banks and issues (activities, problems) that pose the greatest risk to the stability of the country financial system. The regulator aims to supervision increases in line with the risk poses. Where the regulator judges that there increased risks to bank, it will be supervised more intensively until the relevant risks decrease to an acceptable level. Such a risk based approach should ensure that supervisory resources are always focused on the areas where they are likely to be most effective in enhancing financial stability (and create high value added). Forward-looking, focused on prevention supervision, approach. The regulator assesses banks not just against current risks, but also against those that could plausibly arise in the future. The regulator should identify risks and problems at early stage and take timely appropriate supervisory actions (including early intervention regime). The regulator should achieve that banks would be open and straightforward in their dialogue with the regulating authority, taking the initiative to raise of possible prudential concern at an early stage. The regulator, for its part, should respond proportionately, trust can be fostered on both sides. Judgment-led approach. The focus of supervision "will go well beyond" assessing compliance with rules (supervisors must identify bank "creative compliance" with rules, masked the riskiness of activities). Supervisors need to assess whether banks are safe and sound, and whether they meet, and are likely to continue meet, the prudential requirements. Supervisors will thus reach judgment on the risks that a bank poses and how to address any shortcomings

CONCLUSION

Basel III implementation in Moldova’s banking sector means one of those crucial instruments for assuring a sustainable financial security. The new requirements come to protect banks, to improve the overall situation of the banking system, to protect the public money, to protect deponents and to assure conditions that real economy will have access to a healthy lending that will encourage innovation and progress.

Having a modern and efficient regulatory and supervisory framework means an immediate positive impact over the financial security and mainly: (1) it would be strengthened banking sector’s resilience, that will reduce the probability of bank’s failure and this will contribute to greater stability and confidence of this sector in Moldova; (2) Moldova will be recognized internationally as working according to international standards (Basel III, not Basel I (1988)); it will contribute to the attraction of foreign investors; to development of new financial products and services; (3) Regulatory capital shall cover all bank’s risks (operational, market, concentration, reputational, strategic, related-party, fraud risks, etc.) (4) Internal governance and risk management practices shall be strengthened in banks (NBM seeks to make banks well-managed, well-capitalized and more resilient); (5) More responsibility and accountability shall be moved to banks (bank top managers&owners must have the ultimate and overall responsibility for the sound business conduct; integrity; self-assessment, assessment of suitability of bank’s managers firstly should be done by banks, etc.); (6) Transparency of bank’s activity and banking supervision shall increase (banks&supervisors should disclose more information); (7) Banking supervisors shall, more actively, cooperate with all stakeholders: foreign supervisors, external auditors, real estate valuators, other public institutions.

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