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Автори опублікованих матеріалів несуть повну відповідальність за підбір, точність наведених фактів, цитат, економіко-статистичних даних, імен власних та інших відомостей.

Marina Bondarenko [*]

UKRAINE AND GLOBAL ECONOMY POST-TURBULENT TIMES: TOURISM ASPECT

In the article there is researched Ukraine's tourism sector development under post-crisis conditions, defined main sharp questions in the branch management by way of world economic crisis consequences, formed suggestions for improvement of Ukraine's tourism potential realization, covered perspective directions of future development in the light of modern global tendencies.
Key words: tourism, post-turbulent times, tourism management, tourism potential

В статті досліджено розвиток туристичного сектору України в посткризових умовах, визначено основні гострі питання управління галуззю через призму наслідків світової економічної кризи, сформовано пропозиції щодо покращення реалізації туристичного потенціалу України, окреслено перспективні напрямки подальшого розвитку в світлі сучасних глобальних тенденцій.
Ключові слова: туризм, пост-турбулентні часи, менеджмент туризму, туристичний потенціал

The aim of research is to study Ukraine's tourism sector development under post-crisis conditions, define main sharp questions in the branch management by way of world economic crisis consequences, form suggestions for improvement of Ukraine's tourism potential realization, cover perspective directions of future development in the light of modern global tendencies.

Used methods: SWOT-analysis, synthesis

Research topicality: tourism sector formation and development plays significant role in the economic balance renewal processes during post-crisis period. Tourism helps not only to support economic and investment activity through sustainable development postulates, discover potential of the territories, keep ecological situation but improve social part as well. Current position of Ukraine's tourism services market on international stage is unsatisfactorily taking into account its huge tourism assets. Conducted SWOT-analysis of Ukraine's tourism sector shows that destructivity of tourism product requires measures directed to development of barriers abolition system and correction according to world economy tendencies and international practices on tourism role in visitor economies.

Main results. Economic inefficiency of Ukraine's tourism sector activity requires proper approach to strategic concepts forming related to improvement of Ukraine's tourism potential realization on the international market of tourism services. According to results of Ukraine's tourism sector SWOT-analysis destruction of its tourism product needs implementation of measures directed to development of barriers liquidation system. Strong tourist flow in 2008 and insignificant economic benefits received from tourism activity covered current inefficient

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positioning of tourism sector, misbalance of tourism supply as well as big gap in culture isolation from development programs of high priority. UNWTO statistics of tourist flow and tourism receipts correlation allow to suggest that majority of people visited Ukraine pursued purpose different from tourism and during their trip used only minimal package of tourism offer mainly consisted of accommodation and catering.

Besides CIS countries the level of international community awareness about Ukraine as tourism destination is very poor. Ukraine is mostly identified with ecological-anthropogenic Chornobyl nuclear power plant disaster and sport achievements referred to FC "Dynamo", the Klichkos, Yana Klochkova. "It's hight time for Ukraine to open up, explore and slowly realize its huge potential as European player … in the presence of external support…there is a hope that some countries, bilateral and multilateral institutions… once and forever are able to eliminate consequences of relative and undesirable isolation typical for cultural sector of Ukraine during soviet and post-soviet periods on strategic and practical levels" [1, P.42-47]. The State department on tourism and resorts functioning in a body of Ministry of culture and tourism of Ukraine is called to promote our country as a deserving tourism region on tourism services international market. Main barrier in tourism business development is that the government of Ukraine doesn't consider branch priority practically. As a result Ukraine has low indicators on destination marketing and image making. To our regret, world economic recession led to reduce of branch needs financing that in its turn reflected on the intensity of international activity. Though balanced politics of tourism development can liquidate financing shortage of branch needs by the way of special funds of hybrid financing establishment and practical implementation. Holding such events as "Eurovision" and "Euro-2012" is a good opportunity for Ukraine to disclose its tourism potential for international community. There is a need to create the necessary prerequisites for international business event tourism encouragement in Ukraine. Such interaction allows to extend international relations and stimulate headway of Ukraine into international tourism market.

Internal impulses of tourism industry improvement are to be simultaneously synchronized with world development tendencies. Modern processes of economic space development have also brought corrections into questions of role and weight of culture factor in the society. It's led to the situation when meaning of culture in the West is fundamentally different from meaning of culture in Ukraine. In this case main task of culture within conditions of modern development of Europe is adjustment and exploring of culture and social-economic interaction. In the same time culture in Ukraine plays role of burdensome appendix and directed to "extinguish a fire" [1, P. 21-23]. European approach to culture development implementation in Ukraine needs definition of conceptually new demands toward state bodies activity and reform of all government sphere.

Main problems in Ukraine's tourism industry forming is hidden in the questions of management centralization and de-centralization, information vacuum, seasonal tourism supply, environmental condition, tourism and adjacent infrastructure forming and development. Uncertainty and inability of local government to form and implement clear and strategically balanced tourism development programs radically destroy any initiative. There are lack of clear motivation and innovative approach towards legal and economic drivers use that put brakes on solving of majority of questions. To increase the role of culture in the economic gradation some measures are to be taken such as forming of branch development program, exploring of influence of culture on economic life of country, implementation of programs of active interaction with other sectors of economy.

Administrative reform is to be focused on interagency collaboration on culture and tourism:

- forming clear and simple system for tourism value objects subordinatoin;
- involving group of experts in the process of legislation development and improving;
- seting up controlling leverages for normatives on environment and cultural heritage protection execution;
- monitoring of development programes and projects realization;
- operative reporting about results received and possibility to obtain current statistics for free;
- exploring international experience in the questions of efficient tourism development;
- scientific framework projects researching.

High and quick results of tourism industry economic development can be reached through balanced government policy of active assistance: definition of strategic priorities and directions of industry development and their practical implementation, creating conditions to involve investments not limited to foreign ones but activate domestic investment resources as well that would significantly accelerate process of formation of Ukraine as a country with market economy. Particular attention is to be paid to collaboration with private sector in the questions of branch problems solving and development programs research. With this aim there is a need to make available access to current information, publish achieved results, highlight branch problems, ensure measures necessary to overcome development barriers, efficiently provide free analytical and legal information on the specialized web-sites, set up consulting, improve infrastructure, establish national quality standards for services adopted to world standards, certify and categorize tourism objects.

Main driver of modern economic space caused significant changes in human development and its activity is information. Further development of tourism industry should follow tendencies and specific of informative society (wide accessibility of information, correct positioning of the country on the world arena and interesting content for international tourist flow participants). Increase of Ukraine's tourism competitiveness can be realized through a sole multilingual web-site establishment. Active involvement of media resource in the process of branch formation and development is able to make information resource accessible not only for internal use but to external media markets as well. Internet resource availability has great potential in promotion of tourism product of Ukraine. The main task of media space lies in creation of high-quality and interesting information format: tourist oriented to meet needs of tourist flow and constructive-analytical for supply chain participants [2, P. 43-45].

Integration of Ukraine into world culture space requires establishment of national institution for permanent representation and development of Ukrainian culture abroad and improve systematic information flow which would systematically represent culture of Ukraine such as British Council in Great Britain and Geothe Institute in Germany. It's reasonable to activate diplomatic corps and establish net of centers of Ukrainian culture to popularize Ukrainian language, promote Ukrainian culture and traditions, distribute information about socio and economic life, cultural, historical and nature values and abilities in the country, improve international relations in the sphere of culture. In order to improve tourists' awareness about tourism abilities of Ukraine there is a need to provide thorough marketing on government level, define main priorities of tourism development, pay more attention to branding on international markets and participation of country in international projects and programs with step-by-step highlighting of results in media. Serious work is to be done on branding or even re-branding (Chornobyl, unstable political situation) that is even more challenging.

In addition to international activity great attention is to be paid to administrative-territorial reform of cities and development of modern branding programs on the territory. Significant contribution in creation of Ukraine's tourism cities image on fundamental level has been performed by Institute of Society Transformation supported by International Visegrad Fund that in 2010 has realized the project "Branding cities: experience of the Visegrad Group for Ukraine", also the Institute has established integral internet-resource www.cityukraine.info (project "Ukrainian city on the web") within the framework of MATRA KAP program of Embassy of the Netherlands in Ukraine, that allows to study international experience in branding and evaluate the administrative and territorial assets of cities in Ukraine. The uniqueness of this project lies in determination of real leverages of competitiveness increase of Ukraine's regions through implementation of successful international experience in territories development. In addition to main project aim that's been fixed as "increase of Ukraine's regions competitiveness", such approach to the positioning of the regions ultimately allows to generate permanent tourism images and form preconditions for domestic tourism development. It's known that development of tourism by way of international tourist flow increase is desirable direction of high-priority in international activity progress. However, development of domestic tourism is very important for Ukraine on its stage of qualitative international tourism product formation because insignificant changes towards infrastructure improvement and tourism supply chain development can activate domestic tourist flows and as a result to obtain economic benefits from tourism progress along with the whole region development. Involving of the population of Ukraine in the process of domestic tourism will deepen people self-identity, culture and history knowledge, encourage preservation of natural monuments, expand the geography of recreation for public and make the first contribution into the economy investment. Therefore, domestic tourism, its development and economic influence on tourism supply forming is an initial stage in shaping of tourism product of Ukraine for international markets.

In addition to administrative-territorial reform, marketing and positioning of tourist cities, it is needed to involve in branding process all educational potential, information factor and activate public activity to popularize domestic tourism.

Contemporary realities requires efficient development, and therefore the orientation on specialized integrated approaches and definition of priority directions of development, taking into account the maximum competitiveness potential [2, P. 45]. Poor performance of tourism is mainly resulted by absence of organized professional approach to the problems of industry solving. The problem can be solved in part by providing qualified personnel in all phases of execution process at the state level and private level as well. Qualified and professional approaches allow to solve problems and develop industry in the world economy in a strategic way. In this case synergy symbiosis is formed from professionals in different sectors of economy that directly or indirectly affect the tourist supply chain activity. An important role in tourism strategic development program forming plays tourists' culture. In the educational field there is a need to explore the experience of our foreign colleagues, analyze their approaches to the teaching process and generate consolidated method for teaching our students, staff and specialists. The contribution of education in domestic tourism popularization can be realized through implementation of tourism and excursion course into educational process. Students' tourism sections and volunteer groups establishment are to be initiated within education process in high and secondary schools to encourage research of Ukraine's regions tourism opportunities, develop new routes, define features of the region and the priority of its tourism specialization. Show-biz and celebrities are to be involved into process of tourism directions promotion. On government level press-tours with politicians, actors, pop-stars, journalists are to be organized to engage gradually international community in. NGOs' activity is to be coordinated to develop a common policy of interaction with local authorities and generate tactics for international market expansion.

At local levels there is a need to create conditions for private owners of tourism objects and investors to invest in recovery and reconstruction not only hotel and entertainment complexes but also in the adjoined areas and roads infrastructure. We suppose there is a need to create national concept for architectural design of building taking into account ethnographic and historical characteristics of regions and engage local architectural offices in the process of building and reconstruction in order to provide common government policy of tourism development. This approach would help to avoid the chaos and diversity of architectural forms and will emphasize and accentuate historical legacy of architecture and achievements of present time constructions without inhibition of one by other. Current condition of tourism and adjoined infrastructures requires revision and adoption to the needs of tourism demand. Creation of programs and procedures for private sector involving in reconstruction and development of infrastructure on favorable terms with granted rights guarantee will be an important step towards formation of complex tourism offer of Ukraine. The next step to be done is making an inventory of all objects needed rehabilitation or reconstruction. Thereafter database with tourism objects register along with culture, architecture, history monuments is to be generated. Interesting and tourism attractive investment projects are to be developed involving modern innovative approaches towards resource saving, environmental protection and creation of favourable conditions for investment. In order to realize all tourism potential of Ukraine and its competitiveness on international market of tourism services in a full there is a need to implement a range of measures directed to reconstruction and restructuring of sanatorio-and-spa institutions, to develop high-skilled medical staff and support modern technical equipment to be able to provide qualitative medical services in rehabilitation and treatment during low season and to form additional services related to the period of high-season. Increase of comfort level and development of adjoined infrastructures is to be supported also in potential regions providing comprehensive tourism product with involve of all available resources (climate, mineral water, mud, sea, mountains, historical and cultural heritage). Just that resorts oriented on complex and qualitative international services can stimulate international tourist flow from Western Europe to visit Ukraine.

Comprehensive approach and balanced SWOT-analysis considered all peculiarities of regional development will allow to valuate real contribution of each sector in the economy of Ukraine and its importance. First of all there is a need to analyze those branches that have a negative impact on the development of tourism supply chain and industry in general. Such approach enables to select zones that do not meet tourism needs (environmental pollution, territory overload with objects different from tourism value) and zones of high-priority development [2, P. 45]. Dynamics and preferences of tourists flow allow to determine high and low seasons, but recent trends show a gradual increase in weight of entertainment, recreational and business tourism and reduce value of medical tourism. Therefore the task of Ukraine is to create a competitive tourism product oriented on all-year-round consumption and satisfaction of tourists' needs. Such approach will promote permanent and even tourist flow formation that allows to receive regular financial revenue, extend duration of stay, and reduce high-season loading. Implementation of the supposed strategy requires proper attention to qualitative all-year-round additional services and creation of good infrastructure throughout the year including period of rains and rime.

According to analytical data we can conclude on the need of specialized areas forming according to the demands of tourists and local peculiarities of regions. This approach will allow to use current tourism resources in more uniform and rational way: to localize medical and health establishments mainly in areas distant from major recreational and leisure centers but resort, recreation and business ones closer to the popular destinations. The change of tourism supply accents can resolve problem of territory resource shortage thus strategies of tourism industry development in regions should consider the territory load factor in the area, correlation of financial, economic benefits and possible environmental effects because as it is known the environmental component of the natural resource is a long-term asset and the key of success for further development [3]. Tourism supply zoning also requires consideration of the environmental component of the territory. Environmental hazards reduces the attractiveness of the region as tourism destination and in some cases significantly limits realization of tourism potential. These regions require special approach to the tourism potential development and realization that is usually displayed in the formation of specialized tourism product referred to scientific, environmentally-anthropogenic and business directions. The main bias is to be made to qualitative services provision, implementation of programs minimizing anthropogenic impact and ecological balance renewal as well as measures preventing pollution. Particular attention should be paid to pollution in Kyiv and Odessa.

International experience of national parks can solve the problem of environment preservation and protection along with tourism attractiveness support. Complex approach to the national parks practice is used in the project of Tavriyskiy National University. The project includes not only international experience but suppose involve of innovations in investment complexity of tourism product realization [4]. Modern trends of tourism development and popularization of intimation with nature have changed tourism offer into eco-direction. There is a need to create new tourism products to develop tourism and meet tourists' needs and demands. With this purpose it is needed to establish mechanism of innovations and cooperation in the sphere of tourism service provision. This approach will allow not only satisfy tourists' needs but increase social standards of living that is an essential condition for healthy economy of the country.

Solving main ecological problems of the branch allows to determine key directions of further development:

- establishment of additional penalties for nature resource use;
- definition and establishment of environmental load limits in each individual region;
- involvement of innovative technologies into branch development process.

The main purpose of tourism complex development is forming of competitive international tourism product based on the efficiency of use of all tourism potential and innovative implementations. International practice shows that economic benefits from tourism industry development are efficient only in case of complex tourism product and suppose not only economic bonuses, qualitative development of all adjoined infrastructures but also the harmonization of ecological, socio-cultural factors and favorable atmosphere of hospitality. Currently the investment climate in Ukraine is estimated as bad. Tourism development requires solving problems of administrative, legal and regulatory, financial and economic nature, technical tourism base improvement, information support of the industry. Introduction of innovative approaches to solve these problems will allow to achieve the desired result quickly and effectively.

Innovative approach towards creation of specialized recreational free zones in the regions of high-priority development could become one of the driving levers of development not only to tourism but also attract foreign currency, solve a number of economic, social and environmental challenges: extend and recover material base, reduce unemployment, improve life standards, establish cooperation of all infrastructures, protect and preserve environment. Due to lack of national experience in the creation of free recreation zone it is useful to use foreign experience, provide pilot projects based on local zones (such as cluster areas). With the aim to develop tourism component of Crimea authors Y. Slyva, O. Mishina and A. Korinkova offer to create tourism and recreation economic zones within currently formed recreational areas that have already had formulated tourism infrastructure [5]. To our opinion, such approach of the scientists is inefficient and oriented on short-term goals that can lead to overloading of present regions instead of other territories tourism potential covering. We believe that tourism and recreation zones are to be created on the base of new directions of high-priority in order to develop region and attract investments. Such an approach will allow to eliminate tourism development barriers quickly and improve the general economic attractiveness of the territory. Investment can contribute into transport infrastructure and communications, expansion of HORECA and spa facilities as well as preservation and protection of historical and tourism heritage.

Processes of innovation implementation in tourism should take into account the following items [6, P.66]:

- creation of favorable legislation basis to implement innovations in tourism;
- formation of tourism clusters and provision of interaction with all participants of the process through network of bureaus on information, finance, legislation, business, marketing, education;
- introduction of financial instruments to stimulate innovation activities;
- support of innovation activity on the government level;
- support of research projects in terms of disclosure of innovation and investment potential of regions;
- development of potential tourism regions.

Development of green tourism in Ukraine is a modern and effective tool for rural territories progress that can not only reveal the tourist potential but also increase employment, create jobs, raise living standards, stimulate business activity and small businesses process in rural areas; development of village infrastructure, nature and culture heritage, and increase of cultural and educational level of the local population as well as enlarge of revenue to local budgets. Control over activity and development of rural tourism in Ukraine has to be proper coordinated on the government level: questions related to tourism are to be directed to the authority of the Ministry of Culture and Tourism, general development of rural areas should be undertaken by the Ministry of Agriculture and business activity development is to be under the patronage of the Ministry of Economy within frames of entrepreneurship development programs.

Administrative reform is to be focused on Ministry interaction on culture and tourism questions:

- creation of simple and clear system of tourism objects subordination;
- involving expert groups in the process of legislation and development;
- creation of supervisory bodies for control on execution of environment and culture protection standards;
- monitoring of projects realization and programs development;
- prompt reporting of the results and free accessibility to current statistics in the public domains;
- exploring international experience in the field of effectiveness of tourism development;
- promotion of scientific framework projects.

Strategic concepts of Ukraine's tourism industry development are to be focused on:

- increase of international tourist flow to Ukraine and popularization of domestic tourism;
- maximal satisfaction of international tourist flow's needs;
- compliance of tourism services and products to international standards;
- implementation of innovations to optimize and rationalize processing and protect environment;
- meeting current postulates of sustainable development;
- efficient use of recreation funds and tourism potential;

- solving social-and-economic problems through engage of labor resource in tourism;
- balanced development of the territories and stimulation of further development.

Reduce of negative manifestation of number of factors and solving the most problems can be achieved by measures related mainly to the governmental responsibility:

- improvement of legislation of tourism industry development and its infrastructure through appropriate legal documents adoption;
- tourism and resorts development programs for short-, medium- and long-term periods with allocation of priorities;
- adequate tourism infrastructure provision for final football championship of Europe in 2012 that will take place in Ukraine;
- creation of favourable conditions to attract investments and implementation of real stimulating leverages for tourism and resort infrastructure building and reconstruction;
- creation of appropriate conditions for inbound-international and domestic tourism development;
- harmonization of national standards in accordance with international standards and improvement of tourism services quality;
- potential tourism areas development;
- stimulation of new perspectives in tourism in the framework of sustainable development;
- hotel business development;
- creation of unified database of tourism resources of Ukraine and control of their rational use and protection;
- permanent analysis of international tourism services market;
- promotion and distribution tourism information about Ukraine and its opportunities on international and domestic markets;
- strengthening positive image of Ukraine and formation of effective marketing strategy for major foreign markets;
- expansion of international tourism cooperation at bilateral and multilateral levels including the relevant government authorities from foreign countries and within frameworks of international tourism organizations;
- intensification of European integration processes in tourism sphere;
- tourism stimulation in depressive regions, encouraging new job creation and extension of temporary employment in the tourism sector;
- creation safe conditions for travel, personal safety of tourists, ensure providing prompt medical, technical and legal assistance to tourists.

On the basis of this research we propose and recommend measures that are able to improve efficiency of tourism complex of Ukraine:

- system approach to tourism development strategy implementation;
- development of plans for tourism areas progress;
- tax allowance for tourism subjects in the areas of high-priority development;
- development of finance instruments in the context of low interest loans for tourism activity stimulation;
- tourism product of Ukraine promotion on domestic and international markets;
- branding of Ukraine as tourism destination;
- network creation of tourism information centers at places with potential tourists (subway, railway stations, central squares);
- creation of favourable surrounding for clear business activity;
- introducing expense item in the state budget for purposes of tourism and adjoined in-

frastructures development. It should be something like cumulative item based on a pro rata basis according to the urgency of question with further strict report of spent means that should be promulgated in media. (It is useful to involve representatives from opposition government to commission on control);

- indication of territories of high-priority development considering international tourism market trends for further implementation of investments;
- popularization of voluntary process via creation of initiative groups with educational orientation to highlight the role of tourism to local residents;
- orientation of educational programs on practical experience and realization of tourism potential;
- increase tourists' ethics and tolerance through coverage of national and religious peculiarities of regions and development of informative-educational tours;
- infrastructure development for disabled people needs;
- improvement of procedure for local and national status approval of resorts;
- unification of registry of tourism resources of Ukraine;
- development of diversified ecological load norms and implementation of tax for use of nature tourism resource;
- creation of tourism product on cluster background;
- creation of unified electronic tourism database, full tourism guide for participants of the tourism supply chaine;
- additional services extension in rural areas;
- rural tourism branding.

To promote efficiency of tourism services on global international market, increase interest in tourism infrastructure development of both economic subjects either public or private, meet current needs of tourist flow, establish service quality level and its correlation with price policy – it is needed to provide careful approach towards target program of system development and management creation. The strategic concept of international competitiveness of tourism industry covers necessity to generate an integrated tourism product formed out of symbiotic result of cultural, ecological, socio-economic and investment policies of the government.

Tourism strategy of Ukraine is to be complex and includes all aspects of world cultural and economical development and consider:

- budget support of culture;
- charity and philanthropy promotion;
- reform of bodies related to culture management and implementation of simple and clear mechanisms of culture projects financing;
- protection of national tourism industry while ensure openness and integrity of cultural space of Ukraine.

Strategic concepts of tourism development should include following principals of contemporary development:

- sustainable development;
- competitiveness;
- cultural heritage;
- evenness.

It is needed to analyze geography and consumer demand of tourist flows and formulate proposals for more even distribution of tourist flow to satisfy this principle. Following this strategy will help in the nearest future to get insignificant progress in the development of tourism industry and its promotion into international market. Preconditions for effective public management are to be created through implementation of staged and consolidated plan of regional development, creation of tourism clusters, development and implementation of investment projects with involving of new technologies, support of "government-entrepreneur"dialogue.

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POST CRISIS SERVICE INNOVATION DEVELOPMENT

У статті проаналізовані основні тенденції розвитку сфери послуг, досліджено роль та специфічні риси інновацій у сфері послуг, визначені основні чинники розвитку інновацій у сфері послуг у посткризовий період.

Ключові слова: інновація, інноваційний процес, сфера послуг, зростання, розвиток.

This article analyses service sector development and growth, describes the role and specific features of service innovation, defines the main drivers of service innovation development at post-crisis period.

Key words: service innovation, innovation process, service sector, growth, development.

The services sector is becoming increasingly important for economic development in many countries. Services offer an important contribution to economic growth and employment. Because innovation is among the key drivers of growth and development, innovation in service sector has become an important topic for global economic development. Yet there was limited knowledge about its theoretical base and its empirical dimensions - services have been largely overlooked in economic, industrial and innovation research. The field of services innovation studies has expanded, with two main results of significance here. It has been recognised that many services are active in the innovation process, not merely passive recipients of others' innovations and the importance of non-technological elements of service innovation has been accepted. This resulted in a growing importance of general characteristics of service sector innovation better understanding and defining its impact on the global economic development.

The aim of our research is to characterize the specific features of service innovation development at post crisis period. The aim is concreticised in following tasks: to analise service sector development and growth; to describe the role and specific features of service innovation; to define the main drivers of service innovation development at post-crisis period.

Theoretical and methodological basement of our research is taken from the information and statistic data given in reports and investigations which were conducted within Organization of Economic Cooperation and Development,, World Bank, European Union, World Trade Organization. We also used some theoretical material from Hollanders, Alban Fisher, Leif B. Methlie, Per E. Pedersen, Zhang Bo, Zhang Xiao-lin.

Economic growth and global competitiveness are increasingly driven by knowledge, innovation is vital for countries' post-crisis growth, according to the World Bank. The Bank urges countries to focus on key priorities for sustainable growth by ensuring that resources for innovation are not cut as part of fiscal consolidation, but are used more efficiently, and by approaching the crisis as an opportunity to change policies that would protect Research and Development (R&D) and investment in human capital [3].

The 'Europe 2020 Strategy. A strategy for smart, sustainable and inclusive growth puts for-

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ward a dynamic vision of an effective social market for the 21st century [9]. It identify three priorities: Smart Growth to develop an economy based on knowledge and innovation; Sustainable Growth to promote greener and more competitive economy; Inclusive Growth to foster a high-employment economy delivering social and territorial cohesion. In all these chapters service sector and service innovation with play the key role, as it is largely market driven and pioneered by private commercial enterprises, in particular business-to-business services. These firms create value by building "intelligence" into the design and modelling of the processes, networks, and customers they serve. By better understanding how to transform their customers' working practices, these service firms will play a key role in delivering the smart growth highlighted in the Europe 2020 Strategy.

The official statistics on services in Europe are based on the NACE classification. This classification makes it difficult to fully capture the phenomenon of the rapidly growing service economy because it does not adequately reflect the role of services in the economy and their increasing interactions with the other sectors. According to Eurostat, the terms "service industry", "service sector" or simply "services" are generally used to refer to economic activities covered by Sections G to U of NACE revision 2 (see Table 1).

Table 1
Service sectors according to NACE classification

[8]

Section	Description
G	Wholesale and retail trade
H	Hotels and restaurants
I	Transport, storage and communications
J	Financial intermediation
K	Real estate, renting and business activities
L	Public Administration and defence; compulsory social security
M	Education
N	Health and social work
O	Other community, social and personal service activities
P	Activities of private household as employers and undifferentiated production activities of private households
Q	Extraterritorial organizations and bodies

Boosting innovation in service industries is central to improving the performance of the service sector. The sector has traditionally been seen as less innovative than manufacturing and as playing only a supportive role in the innovation system. As a result, national innovation policies have paid scant attention to services, and service-sector firms have not been active participants in government-sponsored innovation programmes. Recent work confirms, however, that services are more innovative than previously thought; indeed, in some areas, they are more innovative than the average manufacturing industry. In fact, knowledge-intensive business services play an increasingly dynamic and pivotal role in the knowledgebased economy.

Innovation surveys suggest that service-sector firms innovate for many of the same reasons as manufacturing firms: to increase market share, to improve service quality and to expand product or service range. However, how innovation occurs in the service sector is less well understood. Compared to manufacturing, most innovations in services appear to be non-technical and result from small, incremental changes in processes and procedures that do not require much formal research and development (R&D) [1].

The analysis of service sector development during last decade allows us to define some characteristic features of this process:

- the economies are increasingly services-oriented. That is, they are increasingly dominated by industries that aim to deliver help, utility or care, and experience, information or other intellectual content. Most of their value added is intangible rather than incorporated in a physical product. The service economy has grown rapidly in recent years. Growth in the share of market services is apparent in almost all OECD countries, with the exception of some in eastern Europe (the Czech Republic, Hungary and the Slovak Republic) that have undergone significant structural reforms [10]. As you can see from the Table 2 the worlds annual export change in 2010 is 8%, the same indicatar of im;ort is equal 9% . It is important to stress attention on that fact that the highest indicator of services trade is observed in Asia – 21% of export and 20% of import.

Table 2
World services Trade by region and selected Countries (US$ billions and %)

[7]

	EXPORTS				IMPORTS			
	Value US$B 2010	2010 Share %	Annual change %		Value US$B 2010	2010 Share %	Annual change %	
			2009	2010			2009	2010
World	**3.665**	**100**	**-12**	**8**	**3,505**	**100**	**-11**	**9**
North America	**599**	**16,3**	**-8**	**9**	**471**	**13,4**	**-11**	**9**
U.S.	515	14,1	-7	8	358	10,2	-9	742,4
Canada	66	1,8	-	15	89	2,5	-8	15
Central and South America	**111**	**3**	**-8**	**11**	**135**	**3,9**	**-9**	**23**
Brazil	30	0,8	-9	15	60	1,7	-1	35
Europe	**1,724**	**47**	**-14**	**2**	**1,504**	**42,9**	**-13**	**1**
EU 27	1,553	42,4	-15	2	1,394	39,8	-13	1
Germany	230	6,3	12	2	256	7,3	-12	1
France	140	3,8	-14	1	126	3,6	-10	0
Italy	97	2,6	-	3	108	3,1	-	1
U.K.	227	6,2	-19	0	156	4,5	-19	1
C.I.S	**78**	**2,1**	**-17**	**10**	**105**	**3**	**-19**	**14**
Russia	44	1,2	-19	6	70	2	-20	18
Africa	**86**	**2,3**	**-9**	**11**	**141**	**4**	**-12**	**12**
Middle East	**103**	**2,8**	**-3**	**9**	**185**	**5,3**	**-8**	**9**
Asia	**963**	**26,3**	**-11**	**21**	**961**	**27,4**	**-10**	**20**
China	170	4,6	-12	32	192	5,5	0	22
Japan	138	3,8	-14	9	155	4,4	-12	6
India	110	3	-13	-	117	3,3	-9	-
NIEs	**343**	**9,4**	**-**	**-**	**277**	**7,9**	**-**	**-**

- over the past decade, services have been the main driver of economic growth. Two sectors, wholesale and retail trade and business services, make large contributions to GDP growth. Wholesale and retail trade generated over a quarter of output growth in many countries, and more than a third in Mexico, Poland, Spain, Sweden and the United States. Business services accounted on average for a third or more of output growth and more than two-thirds in Belgium, Hungary and Japan. This is partly due to the prominent size of these sectors in national economies, but also to their sharp rises in output [10].

- growth in business services has benefited from recent changes in corporate management: increased investment in intangible activities, growing emphasis on knowledge management, renewed focus on core competencies, outsourcing of some activities and greater reliance on external service providers [2, p. 16]. In the manufacturing sector, services previously produced in house are increasingly obtained via outsourcing. By the mid-1990s, services accounted for nearly 25% of the value added embodied in final demand for manufactured goods in most countries for which data are available, compared to 15% or less in the early 1970s. The rise in embodied services was particularly strong in Australia, Japan and the Netherlands, it was less marked in Canada and the United States [10]. In most countries, the manufacturing sector now relies more heavily on telecommunications, business and computer services with a view to stimulating greater productivity. Manufacturing firms have also moved more and more to link products and services as a central element of their broad competitive strategy. They are providing product-service packages, in which products and services are linked together in one package for clients, and selling solutions rather than what are traditionally thought of as products [10].

- the service sector also makes sizeable contributions to job creation (Figure 1). Across the OECD, most employment growth in the 1990s was due to services, in particular business services, which generated more than half of all employment growth in most countries and often compensated for job losses in manufacturing. Within the service sector, the largest relative job growth was in wholesale and retail trade and business services. In the 1990s, the former supported more than half of employment growth in Eastern Europe (Hungary, Poland and the Slovak Republic), Canada, Denmark, Korea, Spain and the United Kingdom. The latter were a significant source of employment growth in Europe (Belgium, France, Italy, Netherlands and Portugal), the Nordic countries (Finland, Norway and Sweden) and Japan [10].

- Services also make a major contribution to labour productivity growth. While the service sector has traditionally been viewed as a sector with poor productivity growth, measurement problems are to some extent responsible: services output is difficult to define, and changes in services quality are hard to measure. Market services, however, account for the bulk of labour productivity growth in many OECD countries, including Germany, the United Kingdom and the United States. The manufacturing sector remains important in some of the newer member countries, including Hungary, Korea and Poland, which had the highest levels of labour productivity growth. In other countries, increases in total labour productivity tend to be driven by the service sector

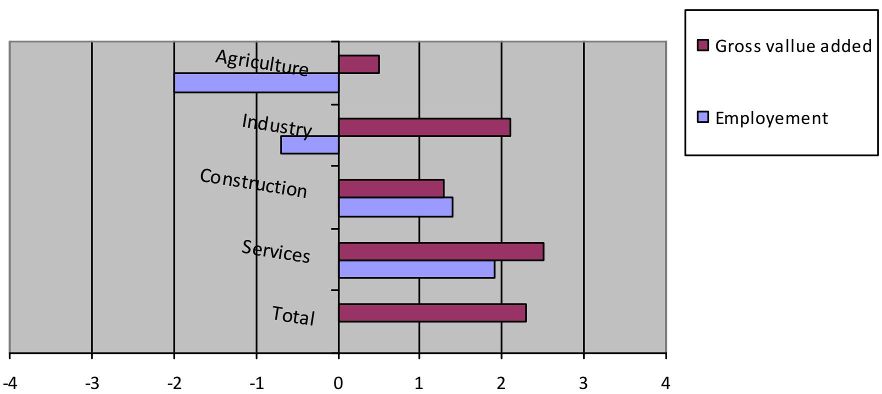

Figure 1 Annual growth rates of employement and gross domestic product by sectors, EU27, 1995-2008

[10]. The growing contribution of market services to productivity is linked both to their growing share in total value added and to a strong rise in their labour productivity.

- The so-called knowledge-based market services have been particularly important: post and telecommunications, finance and insurance, and business services. These sectors tend to have the largest investments in R&D among service-sector industries, as illustrated below, and the greatest reliance on highly skilled workers. The share of knowledge-based market services in total value added increased. Growth was particularly marked in Eastern Europe (Hungary and the Slovak Republic), Iceland, Luxembourg, Netherlands and the United States [10]. Much of this growth derived from business services, which grew faster than post and telecommunications or finance and insurance (Table 3).

Table 3

Main data regarding knowledge intensive services in the EU25 (1995-2005)

Sectors	NACE	Value added			Employment		
		Thousand million Euro (*) 2005	Relative % 1995	Relative % 2005	Thousand 2005	Relative % 1995	Relative % 2005
Knowladge intensive services (KIS)	61/62/64/J/K/M/N/o.92	4729,2	42,5	45,9	70688,4	30,30 p.	34,8
High-tech knowladge intensive services (HTKIS)	64/72/73	489,3	3,7	4,8	6765,4	2,8	3,3
Knowladge intensive business services (KIS)	72/73/74.1t4	711,4	5,4	6,9	12259,7	4,5	6

The service sector produces "intangible" goods, some well known—government, health, education—and some quite new—modern communications, information, and business services. Producing services tends to require relatively less natural capital and more human capital than producing agricultural or industrial goods. As a result demand has grown for more educated workers, prompting countries to invest more in education—an overall benefit to their people. Another benefit of the growing service sector is that by using fewer natural resources than agriculture or industry, it puts less pressure on the local, regional, and global environment. Conserving natural capital and building up human capital may help global development become more environmentally and socially sustainable. Growth of the service sector will not, however, be a miracle solution to the problem of sustainability, because agricultural and industrial growth are also necessary to meet the needs of the growing world population [3]. The economic importance of services means that improvements in European living standards are likely to depend more and more on productivity improvements in services rather than in manufacturing (Figure 2).

Financial intermediation, real estate, renting and business activities (NACE J and K) proved to be the most dynamic service sectors in terms of employment as well as value added. Figure 2 shows that both growth rates are higher than the overall rates for all services. In 1995-2007 they have experienced annual growth rates higher than the service sector as a whole, thus increasing their share in services employment (from 17.5% in 1995 to 21.7% in 2007) and value added (from 35.7% in 1995 to 39.2% in 2007). In contrast, public-related services (NACE L to P) have been loosing positions during the last 12 years.

"Business services" (NACE codes 71 to 74) were the most important service category in

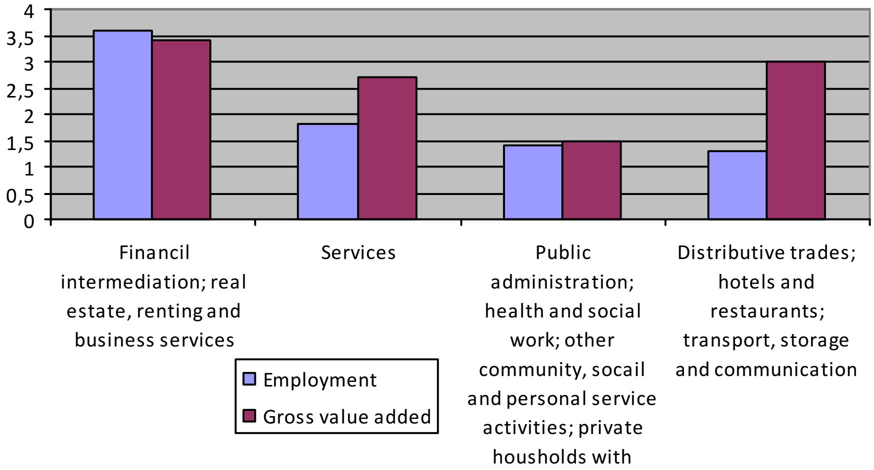

Figure 2 Annual growth rates of employment and gross value added by service sectors in the EU27, 1995-2007

terms of value added in the European economy in 2005, while it ranked second in terms of employment after distributive trades. This sector has increased its share in EU25 value added by 2.6% in the last decade, and by 3.3% in the case of employment. Luxembourg, Netherlands, United Kingdom, Belgium, France, Germany and Italy are the most specialised countries in business services employment relative to EU25, while Cyprus, Estonia and Latvia are lagging behind [7]. "Other business activities" (NACE 74) represent the category that contains the bulk of business services, both in terms of value added and employment. This category comprises very heterogeneous activities, ranging from operative services, such as security activities or industrial cleaning to intensive services requiring highly qualified human capital, including advanced consultancy services. More than 18 million people were engaged in such service activities in 2005, and their share in employment increased from 6.4% to 9.0% out of all employment [7]. This is important to bear in mind when reflecting on how and in which sectors innovation could best contribute to more jobs and value creation in Europe.

The role of all these services in the development of post-crisis economy is difficult to predict, especially to calculate the exact date of the impact on employment and gross value added, but there is no doubt that service sector innovation will play sagnificant role in global economic development. To confirm this idea we made an attempt to analyse such aspects of this problem, as: the role of innovation (both in service sector and manufacture); understanding of service innovation essence and its differences with the industrial ones.

Innovation has been recognised as a key to growth, but the role of service-sector innovation has long been under-appreciated. This is due to some extent to the difficulty of measuring innovation in the service sector, a patchwork of different industries with significantly different innovation processes. R&D expenditures are often employed as a proxy for innovation, although they measure just one input into the innovation process. An increasing number of innovation surveys, however, have made it clear that expenditure on R&D is only one element of firms' expenditures on innovation. Even in manufacturing, R&D generally amounts to only about half of total investment in innovation but in services the share is even smaller. Other components of innovation appear more important for services, where most innovation is linked to changes in processes, organisational arrangements and markets. There is evidence that innovative activity in services is organisational and disembodied in nature so that it escapes standard measures of innovation [1].

Our present understanding of innovation is primarily an understanding of "manufacturing" innovation. Hence the Oslo Manual (1997) gives a clear definition of technological product and process innovation, where the term "product" is used to cover both goods and services. Service innovation may be technological innovations but are often non-technological innovation too. Service innovations are the creation of new knowledge or information, or new ways of handling things or persons, they are often small adjustments of procedures and thus incremental and rarely radical [10].

The term service innovation is used to refer to several things. These include [1], [4, p. 14]:

1. Innovation in services, in service products – new or improved service products (commodities or public services). Often this is contrasted with "technological innovation", though service products can have technological elements. This sense of service innovation is closely related to Service design and "new service development".

2. Innovation in service processes – new or improved ways of designing and producing services. This may include innovation in service delivery systems, though often this will be regarded instead as a service product innovation. Innovation of this sort may be technological, technique- or expertise-based, or a matter of work organization (e.g. restructuring work between professionals and paraprofessionals).

3. Innovation in service firms, organizations, and industries – organizational innovations, as well as service product and process innovations, and the management of innovation processes, within service organizations.

A helpful definition comes from Finland's research agency, TEKES: Service innovation is a new or significantly improved service concept that is taken into practice. It can be for example a new customer interaction channel, a distribution system or a technological concept or a combination of them. A service innovation always includes replicable elements that can be identified and systematically reproduced in other cases or environments. The replicable element can be the service outcome or the service process as such or a part of them. A service innovation benefits both the service producer and customers and it improves its developer's competitive edge. …A service innovation is a service product or service process that is based on some technology or systematic method. In services however, the innovation does not necessarily relate to the novelty of the technology itself but the innovation often lies in the non-technological areas. Service innovations can for instance be new solutions in the customer interface, new distribution methods, novel application of technology in the service process, new forms of operation with the supply chain or new ways to organize and manage services [4, p. 16]

Most researchers agree that innovation in service firms has a different character than in manufacturing. Innovations in service industries are often non-technological. They mostly involve small and incremental changes in processes and procedures. Many service innovations are not very radical and have often already been implemented in or by other service organisations. Some researches have characterised the process of service innovation as a "reverse product cycle" in which a firm first adopts new technology (e.g. ICT) to improve the efficiency of an existing process; next, the improved process generates a significant improvement in the quality and delivery of the services provided; and finally the new technology provides the basis for an entirely new service, usually in a different field. Others suggest that innovation in services is mostly non-technical and occurs with small and incremental improvement in processes and procedures [1; 6, p. 7].

Service innovation is quite different from the model manufacturing innovation, which is mainly determined by their characteristics in production [11]. In the production process of manufacturing industry, the customer only is the accepter and the user of final product, and doesn't participate in the production and transmission, neither have the correlation with the manufacturers, and therefore from a standpoint of customer participancy this process is known as 'the independent production process'. While in the production process of service industry, the customers positively participate in the entire production and the transmission process, and has the massive correlations with the staff, so the process is one kind of 'the cooperative production'.

By contrasting 'independent production' and 'cooperative production', we will find the differences between service industry and the manufacturing industry in nature, which result in the significant difference between the two innovations processes. This is profoundly manifested in the following ways [11]:

1. Service innovation may adopt different forms. First, the innovation in the manufacturing industry in product and process mainly aims at the visible product, which leads to obvious innovation result; But in the service industry, in fact, product and the process innovation is invisible, which only contains the method and the process. However, this kind of invisible innovation is often not perceptible. Although the technology plays an important role in modern services, it is not the necessary condition for service innovation, because the product and process innovation in service industry can take place without any technical factors. Second, special innovation for special customers and custom-made service innovation widely exist in the service industry. Compared with the innovation in manufacturing industry, it is obviously unable to duplicate, but it is indeed an extremely universal and important innovation form in the service industry, which makes the old and narrow innovation concept-innovation means duplication to a degree-widened.

2. Service innovation can be organized in different ways. First, usually the service innovation never or seldom contain R&D or innovation department, and often there isn't any official R&D department related to manufacturing industry significance. Besides, the way R&D department and innovation department conduct is quite different from the innovation in the manufacturing industry innovation. R&D activities in the service innovation tends to analysis concept, mainly taking the social sciences as the foundation, while R&D activities in the manufacturing industry are mainly based on the natural sciences; Next, the service innovation carries on the organization through the complex correlation pattern, which is different from the linear mode in the traditional manufacturing industry innovation, in which the service innovation is a complex process where the different behaviors and the different departments are mutually dependent. For example, in order to develop a new safe product in a bigger scale, only when the lawyers, calculators, IT experts, sales personnel and customers to work together and depend on each other, the process can be completed.

To further characterize service innovation, we shall discuss some of the main differences with innovation in manufacturing which will include: object of innovation, degree of novelty and dimension of newness.

Object of innovation. In manufacturing, innovation can be classified by two basicforms: changes in the things (products, goods) which an organization offers, and changes in the ways in which they are created and delivered. Traditionally, these changes are termed as 'product' and 'process' innovation. In services, the dividing line between product and process innovation tends to be blurred. Because of the simultaneity of services, product- and process innovations usually coincide. New services often go together with new patterns of distribution, client interaction, quality control and assurance, etc [4, p. 17].

Degree of novelty. Service innovation involves the creation and introduction of a new offering or delivery process. An innovation can be viewed in terms of the degree of novelty, ranging from a totally new, discontinuous innovation to a service involving simple line extensions or minor adaptations/adjustments that are of an evolutionary nature. As in manufacturing, the degree of novelty can be applied to characterize service innovations. Radical innovations and incremental new services represent opposite ends of the newness spectrum (this could be interpreted as the difference between revolution and evolution):

- Radical/revolution: The complete system of characteristics and competences that make up a service is replaced by another system of characteristics and competences, or a completely new service is introduced, causing the old service to vanish.

- Incremental/evolution: Characteristics are replaced or added without changing the service essentially, the service is changed marginally only. This can entail new elements that were previously not perceived, encountered or utilized by customers. This could also include developing a solution for a specific problem in cooperation with the client [4, p.17-18].

Dimension of newness. Apart from the degree of novelty, innovations can be described along several dimensions of newness, the most common of which include measures of newness to the developing firm, to the outside world or to both of these. First, a service innovation can be new to the developing firm. In this case, a new service exploits a service concept which already existed elsewhere, but is totally new to the developing firm. On the contrary, a service innovation can be new to the outside world. In this case, newness refers to the perception by new customers and/or competitors who are confronted with previously unfamiliar offerings [4, p. 18].

Innovation surveys do not cover the full spectrum of innovation models, but they do suggest that few firms engage in only one type of innovation. Generally product, process and organisational innovation occurs together. In the CIS3 Survey, between 60% and 90% of innovative firms introduced new products on the market; between one-third and two-thirds also introduced new processes (Figure 3, 4).

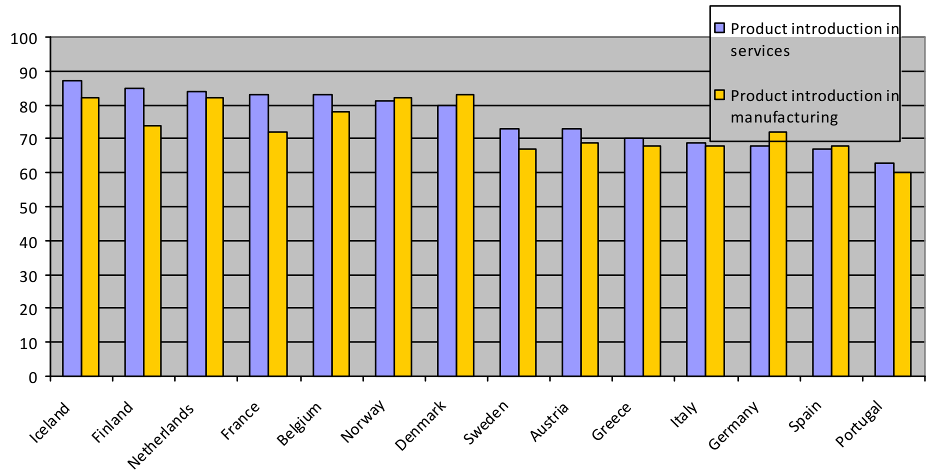

Figure 3 Product innovation in service and manufacturing sectors (as a % of all innovative firms)

Although product innovation is more frequent, many innovative firms engage in both types of innovation. Moreover, the innovation surveys indicate that:

- firms in both the manufacturing and service sectors engage in product innovation;

- in many countries, innovative service firms are more likely than innovative manufac-

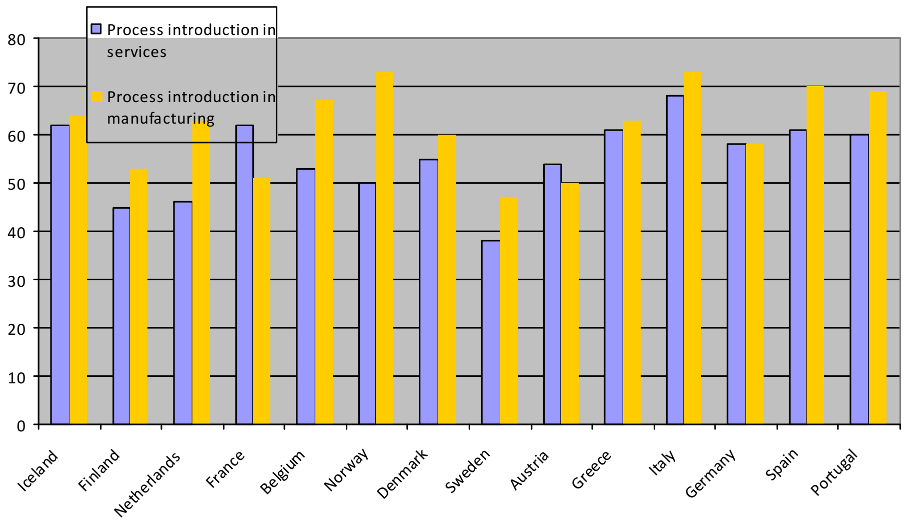

Figure 4 Process innovation in service and manufacturing sectors (as a % of all innovative firms)

turing firms to introduce new products;

- the largest differences between service firms and manufacturing firms relate to process innovations, which were reported more frequently by manufacturing firms [1].

As it was mentioned above, one of the main problem in defining the influence of service sector innovation proceses to the global development and growth is connected with some difficulties in measuring servoce innovation. The Service Sector Innovation Index (SSII) is a first attempt to define an aggregate index of the innovation performance in the service sector [5]. Using a selection of 12 indicators of the 29 innovation indicators used in the 2008 European Innovation Scoreboard (EIS) a separate composite indicator measuring innovation performance for services and industry was constructed and tested. There were following indicators for services and industry:

• EIS 2.1.1 Business R&D expenditures (% of GDP)
• EIS 2.1.3 Non-R&D innovation expenditures (% of turnover)
• EIS 2.2.1 SMEs innovating in-house (% of SMEs)
• EIS 2.2.2 Innovative SMEs collaborating with others (% of SMEs)
• EIS 2.2.3 Firm renewal (SME entries plus exits) (% of SMEs)
• EIS 3.1.1 SMEs introducing product or process innovations (% of SMEs)
• EIS 3.1.2 SMES introducing marketing or organisational innovation (% of SMEs)
• EIS 3.1.3 Resource efficiency innovators, unweighted average of: Share of innovators where innovation has significantly reduced labour costs (% of firms) and Share of innovators where innovation has significantly reduced the use of materials and energy (% of firms)
• EIS 3.2.5 New-to-market sales (% of turnover)
• EIS 3.2.6 New-to-firm sales (% of turnover)

Indicators for services only:
• EIS 3.2.2 Employment in knowledge-intensive services (% of workforce)
• EIS 3.2.4 Knowledge-intensive services exports (% of total services exports)

Indicators for industry only:
• EIS 3.2.1 Employment in medium-high and high-tech manufacturing (% of workforce)
• EIS 3.2.3 Medium and high-tech manufacturing exports (% of total exports).

According to this system of indiators we may conclude that: the best overall innovation performer in services is Luxembourg, followed by Greece and Germany. Some of Europe's better performers in the European Innovation Scoreboard, such as the Netherlands, do not achieve comparable results in the SSII. On the other side, some new Member States that present lower levels as regards the overall EIS perform relatively well in terms of service sector innovation. Greece is also performing quite well, but it should be noted that despite improvements in the CIS survey, CIS data are not yet fully able to capture innovation performance in services. A comparison between the relative importance of innovation performance in service and manufacturing sectors shows particular differences between European countries. In this respect, for some particular services-driven economies, such as Luxembourg and Greece, innovation performance in service firms ranks higher than that of the manufacturing industry. In other countries, like Austria and the Netherlands, innovation performance in services and manufacturing is about the same. In a number of countries, including most notably Slovakia, Belgium and Finland, innovation performance in manufacturing is remarkable higher than in services (Table 4).

Table 4
Innovation performance in service and manufacturing sectors at national level

Note: the calculation of the Services SSII (Service Sector innovation index) and the manu-

Country	Services SSII	Rank Services SSII	Manufacturing SSII	Rank Manufacturing SSII
Luxemburg	0,75	1	0,45	12
Greece	0,67	2	0,47	11
Germany	0.66	3	0,84	1
Austria	0,64	4	0,63	2
Estonia	0,63	5	0,51	9
Cyprus	0,62	6	0,57	5
Ireland	0,6	7	0,57	5
Portugal	0,54	8	0,49	10
Belgium	0,52	9	0,6	4
Finland	0,51	10	0,61	3
Chech republic	0,5	11	0,55	7
Denmark	0,47	12	0,53	8
Netherlands	0,44	13	0,44	14
Spain	0,41	14	0,37	16
Romania	0,39	15	0,44	14
Poland	0,31	16	0,35	18
Slovakia	0,3	17	0,45	12
Hungary	0,25	18	0,37	16
Latvia	0,25	18	0,09	21
Lithuania	0,24	20	0,35	18
Bulgaria	0,21	21	0,3	20

facturing SSII are very different, therefore a dirrect comparisson cannot be made. [7]

One clear difference between innovation in services and manufacturing is that services appear to rely less on R&D as a key driver of innovation. Although R&D is only one element of innovation in manufacturing, investments in R&D are closely correlated with innovative performance. In countries with higher levels of business R&D as a share of gross domestic product (GDP), the share of innovative firms is also larger [1]. In many countries, the R&D intensity of the service sector is less than 10% that of the manufacturing sector. This does not mean that R&D is not important to service-sector firms, but that other factors may also play a significant role in service-sector innovation. In spite of the fact that the service sector relies less on R&D for innovation, service-sector investments in R&D appear to be rising. Between 1990 and 2001, service-sector R&D increased at an average annual rate of 12% across OECD member countries, compared to approximately 3% in manufacturing [10].

Large differences between growth rates in services and manufacturing are most pronounced in countries such as France, Germany, Japan, Netherlands, Spain and the United States [10].While it is clear that a portion of the rapid growth in service-sector R&D is a statistical artifact reflecting better measurement of R&D in the service sector and a possible reclassification of some R&D-intensive firms from manufacturing to services (as their service activities have expanded), it also appears to reflect real increases in R&D by service-sector firms, driven by competitive demands or by increased outsourcing of R&D by manufacturing firms and government.

Moreover, R&D appears to have grown faster than value added in services, reflecting its increased importance. R&D spending as a share of value added (R&D intensity) in services is still considerably below that in manufacturing. Whereas R&D spending in the manufacturing sector is above 1% of total value added in half of all OECD member countries for which data are available — and 2% or more of value added in seven countries — R&D intensity in the service sector remains below 0.5% in most countries [10]. However, available statistics indicate that R&D intensity in services has increased quickly in most OECD member countries, even in many in which manufacturing R&D intensity has declined. Denmark, Iceland, Sweden and the United States show relatively high R&D intensity in the service sector (more than 1%) and high rates of growth, as each added a half-point or more of R&D intensity during the decade. In Australia, Norway and Portugal, R&D intensities in services and manufacturing are about equal [10].

Service-sector R&D remains highly concentrated. In most countries, business services and post and telecommunications account for more than three-quarters of R&D intensity. Within these broad categories, computer and related services, R&D services and telecommunications services account for almost the entirety. These three sectors, and computer and related services in particular, account for most of the growth in R&D intensity over the last decade. In Germany, Korea, Netherlands and Portugal, R&D intensity in the computer and related services industry increased more than 25% annually in recent years, and the Korean R&D service sector has seen increases of the order of 75% a year [10]. This highlights the fact that service-sector R&D varies considerably across industries, as is also the case in manufacturing.

The widespread correlation exists between the service and the manufacturing industry, and the development of many service departments relies on the manufacturing industry, these departments mainly provide such service support as finance, advertisement, sale, consultation, communication for the manufacturing industry. Similarly, to smoothly develop, the manufacturing industry counts on service industry as well , and at the same time the conformity of all the service factor and the effective use is helpful to promote the quality of manufacturing industry product and its market competition, which mainly displays as follows [11]:

1. Service technology has improved reaction time in the manufacturing industry. The success of manufacturing industry lies in a faster response, the stronger customer product as well as less cycle times, while these all depend on the service conformity and making the most use of the relevant service technology, such as the technology in marketing and advertisement and so on.

2. Services become the important source which makes business enterprise competition ability and profits. Some manufacturers may provide the more development opportunities for the enterprises through big scale sales and the support system. When selling their equipment, many manufacturer find that they are able to get more profits by providing the training service for the customer enterprise, and in fact earlier IBM has turned their attention to software, network and the communication connection service, which all means the service is the important origin to promote the enterprise value and profits, and the service factor is becoming the key weapon to compete for the large-scale manufacture enterprises.

3. Services reduce the cost, but meantime increase the product value. In the modern manufacturing industry, the contribution of the basic merchandise is usually smaller than the value which is increased by various services of exterior or inside the business enterprise. 75% the entire cost which makes the business enterprise as well as higher proportion of the increment constitutes to forming the service activity, therefore reasonable choice and exploitation's serving will effectively decline the cost and enhance the additional value of product.

4. Manufacturers attain the profit from the exterior service innovation. At present the service business enterprise has become an important innovation. It has enormously improved the service quality, the scope and the flexibility and produced many new products of much innovation, so the customers (including manufacturers) can benefit from the competition.

5. Service supports international operation of manufacturers. An outstanding realm where the service technique influences manufacturing industry is in the international operation in manufacturing industry. To a large extent, the multinational manufacturing business enterprise acquires its scale economy depending on its service ability, the ability in the technique transfer, marketing, finance, logistics etc., but not on manufacturing factories to acquire its scale economy.

The connection between service industry and the manufacturing industry is becoming more and more closely, which is mainly manifested in the fact that the services which are put in the manufacturing industry is rapidly increasing, and meanwhile but outside the outside enterprise activities of the manufacturing industry also helps the emerging service industry to develop, thus promoting the service industry with the manufacturing industry to develop in integrating (Table 5).

Table 5

Percentage of EU27 enterprises that introduced a product or process innovation

	Product and/or Process innovation	Product innovation	Process innovation
	All enterprises		
Manufacturing	42,1	30,22	31,3
Services	33,1	22,2	23,8
KIBS	46,8	37,2	33
Services, excl. KIBS	29,9	19,7	22,6
	All product and process innovators		
Manufacturing		69,9	71,2
Services		63,6	71,7
KIBS		78	71,4
Services, excl. KIBS		60,7	74,2

The industrial may promote its competition by integrating, achieving the coordinated development of all the industries. In the current economical development, the integrating development between the modern manufacturing industry and service industry mainly lies in the fact that the service industry tries to infiltrate the manufacturing industry, special production service industry, which is related to the process of production, directly acts on process of manufacturing industry. Both of them develop in integrating in the following main three aspects [11]:

1. Integrating development in interior industry. At present, many manufactures of enterprises have merged with services, and the work management also has extended from the domain of manufacture to the service. The economic activities of someenterprises have even changed the manufacturing center into the service center. In many famous multinational corporations, service industry has a larger proportion in output value and profits, and so it is very difficult to judge whether it is a manufacturing industry or a service industry.

2. Integrating development in industrial chains. In fact, the time which is spent in manufacturing a product is much less, while most of the is spent on the stages, such as R&B, purc-

hase, storage, operation, sale, and post-sale service, the operation of each industrial chain more depends on production service industry, and the efficiency of the service industry has a great effect on the entire chain.

3. Integrating development among the regions. It is also called colony development where the manufacturing industry and service industry work together in a specific region. Such production service industry as finance, the insurance, class, education training and so on works together with the manufacturing industry, makes up the service strut system of the industrial colony, and help industry colony make a healthy development.

Characteristic of the main specific features of service innovation development allows us to summarise the main drivers of its growth [10]:

- Embodied knowledge is a key driver of innovation in the service sector.

Investment and equipment are a main source of innovation in service-sector firms. The service sector has traditionally furnished the bulk of tangible investments in buildings, structures and equipment. It accounts for the largest share of economic output, and its investment intensity (ratio of gross fixed capital formation to gross value added) has been substantially higher than that of the manufacturing sector over the past decades. Services such as transport and communication are highly capital-intensive owing to their large investments in infrastructure. Others, such as wholesale and retail trade or financial and business services, are becoming more capital-intensive over time.

- Human capital remains a cornerstone of services innovation.

Skills upgrading and human capital are pillars of the innovation process, especially in knowledgebased economies. Reliance on human capital is crucial in the labour-intensive services sector. Employment in services is no longer considered low-skilled and low-paid, and the shift in employment towards services cannot be regarded as a move towards less desirable employment. With the increasing involvement of highly skilled workers, growth in service employment accelerated solidly. The shift towards more high-skill jobs and the increase in activity has increased the risks of shortages and misallocations. At present, while some of the best-paid and most high-skill jobs are in services, many low-skill jobs remain. The share of employees with higher education is larger in market services than in manufacturing. In Finland, more than one employee out of three in the service sector is a university graduate, compared to one out of four in manufacturing. In many countries the share of highly skilled employees in manufacturing is often less than half of the share in services. The gap is particularly striking in Greece, Luxembourg, Portugal and Sweden.

- Entrepreneurship is a key driver of services innovation.

The process of firm entry and exit plays a significant role in productivity growth by reallocating resources from units with lower productivity to units with higher productivity. Recent studies indicate that in Europe between 12% and 19% of all non-agricultural firms enter or exit the market every year. This process of creative destruction facilitates innovation and the adoption of new technology. Research demonstrates several additional points: entries and exits are highly correlated, illustrating a process of search and experimentation, but entries exceed exits in most countries; new firms typically start small and do not survive very long, but those that do usually grow rapidly over time. Entrepreneurship plays an important role in service-sector innovation. First, firm renewal is generally more intense in services than in manufacturing. In particular, entries are substantially higher in dynamic service sectors, such as business services or ICT-related industries, than in mature industries. Second, innovation surveys indicate that new firms account for a larger share of innovative firms in the service sector than in manufacturing (Sweden, Denmark). In countries with lower rates of new firm entry, however (e.g. Austria, Italy and Portugal), the difference between the service and manufacturing sectors is smaller or even reversed. This may highlight the strong role of an innovative service sector in business dynamism and, beyond a threshold of entries, a shift in firm creation towards innovative service activities. Nevertheless, there appear to be limits to the ability of entrepreneurship to improve innovative performance in the service sector. To some extent, the ability of new firms to innovate is conditioned by the general economic environment in which they operate. In more innovative economies, new firms need to be more innovative to compete and to integrate into the supply chains of established, and often larger, firms. In less innovative economies, the incentives for new firms to innovate may be weaker. Results of the CIS3 Survey provide some support for this hypothesis: countries with higher overall levels of innovation (i.e. larger shares of firms reporting the introduction of an innovation) tended to have higher levels of innovation among new firms; countries with low innovative density, such as Greece, Italy and Spain, had the lowest innovative density among small firms. In the cases of Greece and Italy, new firms were less innovative than the general population of service firms. Interestingly, while the innovative density of new service-sector firms is higher than that of established firms in most countries, the same trend does not hold true in manufacturing.

Conclusions. As indicated, the service sector is of growing importance in the world economy. Productivity and employment growth are highly dependent on the success of service industries, and services are strong drivers of recent economic growth in most OECD economies. Services are increasingly knowledge-based, innovative and drivers of growth. Service-sector firms in general are less likely to innovate than manufacturing firms, but they are becoming more innovative and knowledge-intensive, and services such as financial intermediation and business services show aboveaverage levels of innovation. Service-sector innovation derives less from investments in formal R&D and draws more extensively on acquisition of knowledge from outside sources that is acquired through purchases of equipment and intellectual property, as well as via collaboration.

Human resource development is especially important to service firms, given their high reliance on highly skilled and highly educated workers, as well as indications that a lack of highly skilled personnel is a major impediment to service innovation in most OECD economies.

The role of newly established firms in innovative activity is greater in services than in manufacturing, so that entrepreneurship is also a key driver of service innovation. Nonetheless, small firms tend to be less innovative than larger firms.

Nowadays there is a high importance of working out and improving some aspects of natonal innovation policy connected with service innovation development. To date, however, innovation policy measures in most countries have not been attuned to the service sector. Only a few countries have integrated services-related concerns into their innovation policies, and participation of service-sector firms in sector-neutral programmes remains low. The few policies targeting service innovation aim primarily at ICT development and use. Clearly, greater effort is needed to raise awareness of innovation policies and programmes among service-sector firms, as well as to design or adapt support programmes to be more relevant and useful to the service sector.

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Eugen Fomenko*

FORMING PORTFOLIO OF INTERNATIONAL BANKING SERVICES UNDER CONDITIONS OF STRENGTHENING COMPETITION BETWEEN FINANCIAL INSTITUTIONS

Strategic approaches to portfolio construction of services of the commercial banks are opened, allowing to raise efficiency of its activity on international financial market, in the conditions of competition strengthening in spheres of functioning of polytypic credit and financial institutes.

Keywords: financial market, the market of financial services, financial service, banking activity, bank assets, bank liabilities, bank strategy, a portfolio of financial services.

Розкрито стратегічні підходи до формування портфеля послуг комерційних банків, що дозволить підвищити ефективність його діяльності на міжнародному фінансовому ринку в умовах посилення конкуренції у сферах діяльності різнотипних кредитно-фінансових інститутів.

Ключові слова: фінансовий ринок, ринок фінансових послуг, фінансова послуга, банківська діяльність, активи банку, пасиви банку, банківська стратегія, портфель банківських послуг.

For years of concurrence banking market became not just competition for resources but struggle of strategies which resulted that commercial banks pay special attention to the spheres which provides greatest competitive advantage. In this context, it is very important for commercial banks' to be in time to change its strategy, update structure and key business processes to challenge environmental changes.

All indicated challenges leads to structural changes in the banking sector of the financial market. New trends of improving efficiency of the banking sector leads to shifting strategy from mass-selling banking products and services to deployment and creation of individual portfolios aimed to satisfy specific consumer demands. Such restructuring brings creation of new products in portfolios of banking groups. Therefore, in modern condition the problem of forming and managing portfolio of commercial banks services is actual as never before.

Theoretical approaches on improvement management of commercial banks services most fully represented in works of foreign experts, such as Brue S.L., Van-Huza D.D., Velfelya Ch., Dolana Z., Kotler F., Murphy N.B., Miller R.L., Rose P., S. Sealy and other. Mostly in this works, the process of forming commercial bank services based on the classic segmentation approaches.

The works of Ukrainian scientists, such as A.Galchynsky, I.Burakovsky, Z.Lutsyshyn, A.Moroz, M.Savluk, V.Sutormina, V.Fyedosov focused on formalization of national priorities of banking business. The more vide view of strategic analysis are described in the works of A.Kredisov, D.Lukyanenko, Y.Panchenko, O.Plotnikov, A.Poruchnik, O. Rogach, A.Rumyantsev, A.Filippenko.

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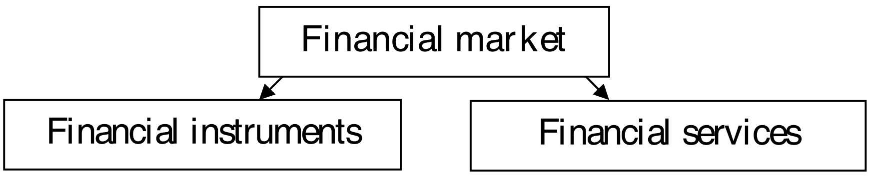
For a long time in the economic literature was expressed only the concept of financial markets, thus limiting understanding of the processes associated with money transferring. Complications of forms and methods of money allocation leading to emerging new specific professional activities aimed to serve owners of capital and the emergence of a new category - "financial service".

In connection with the above mentioned it is becoming increasingly important to study banking services and to identify factors that affect the bank's decision to include services to the portfolio.

The development of the financial market is characterized by the number of financial agents and variety of financial services that they provide. Financial services market is the market, where the object of sale is the various financial instruments and financial services [4]. Specificity and mechanism of financial services which are being provided are determined by the specificity and degree of financial market development and regulatory regulation of financial institutions. (Pic. 1).

Financial instrument it is a commitment that express from the one side contractual obligation to transfer funds or other financial asset and from another side contractual obligation to exchange financial instruments under potentially favorable condition. These include: securities, monetary obligations, futures, options, etc. In other words on the financial market is realized financial relationships through the provision of financial services by means of financial instruments, the number and types of which are set by the government.



Pic 1. The interconnection of the financial market and market of financial services.

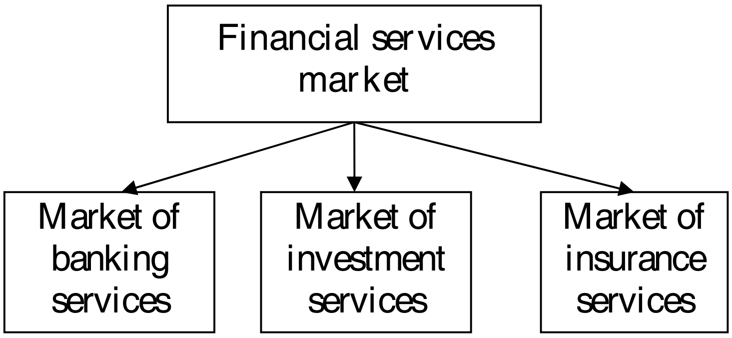
Financial service is a social-economic category associated with the transformation of money into the cash funds of legal entities or private individuals though the banking, insurance and investment markets and also other financial services.

The general services provided by financial agents on the primary market are allocation of funds in the form of deposits and loans granting though commercial banks in the loans market. Such service also can be consider underwriting or help to issuers in organizing and conducting emission of financial assets that resulted placement of issued assets in the market.

On the secondary market, financial agents provide stable functioning of the market and profit for legal entities and private individual during investing in financial assets. Different market institutions are not only meet the needs of investors on buying-selling financial assets on a regular basis and at market price, but also provide information, consulting and management services [6].

In general approach, the structure of financial services market can be regarded as the market of banking services that corresponds to credit market, foreign exchange and precious metals market, the market of investment services, including the stock market. On the financial services market can be separated insurance market, which is connected with all financial markets within the structure of financial markets (Pic. 2).

Banking services market is a specific sphere of market relations, which provides supply and demand for the banking services; sphere aimed to stimulation of banking operations that meets customer needs. The scope of banking market is not only central and commercial banks, but also commercial companies, investment funds, consulting companies, offshore areas etc [3]. In other words, the subjects of banking services is not only commercial banks but also non-banking financial institutions and non-financial enterprises, which formally are not banks, but their activity is directly related with provision of financial services similar to a bank (consulting firms, investment funds, factoring and forfeiting companies) [3]



Pic 2. Structure of the financial services market.

At the present stage of development, commercial banks are moving to a new level of service, transforming it into "firms which provides financial services, financial supermarkets" that propose wide range of banking products to the consumers.

Banking activity involves creating portfolio of services, organization of the market and sales of these services to the final consumer. Portfolio of banking services is a set of services that clearly connected with banking operations in a specific area of banking activity [9].

Increasing sales of goods, services, technologies and intellectual property in developed countries has caused a direct impact on the development of banking services. Currently, growing importance of services for foreign trade; enlarging volume of investment, consulting, information services; growing role of services in financial advisory, asset management; great role plays information technology banking services with usage of Internet. A typical portfolio of banking services includes correspondent banking relations, risk management, customers with foreign economic activity and also international investment services [2].

At the same time, managing of financial flows on the different countries under different conditions of external business environment without a clear decision-making principles regarding allocation of assets and resources is almost impossible. We can therefore conclude that the effectiveness of the bank is determined by one factor that is the quality of loan and deposit portfolios, because otherwise the poor quality of the portfolio directly leads to bank bankruptcy.

Factors that determine the principles and process of forming portfolios are conditions which are affecting the decision to include specific services in the portfolio, level of service sales, sales market and it cost [7]. The main factors are following:

1. The cost of service. Cost of service which is developing by a commercial bank, is one of the most important factors for consideration to include specific services in the portfolio for a particular consumers group. Depending on the needs and financial capacity of consumers and the availability of the resources to provide service, bank is determining service cost, which becomes part of the tariff policy. The service cost is the main factor among others. However, availability of resources, service lifetime, opportunity to conquer new market niches must be also considered. Service quality plays not the last role during portfolio forming.

2. Market share. Market share is usually achieved mainly through the duplication of portfolios and expanding the list of proposals to consumers and increasing flexibility of tariffs, and also allocating additional resources. The most popular services are being defined during portfolio formation.

3. Indicators of quantity and quality of services for evaluation the portfolio. Often exists situation when the same service is provided by various banks, which differs time on the market. Depending on this, the volume of information about service parameters in the bank may be dif-

ferent. The shorter period of service, the more different parameters may be offered to consumers in assessing service quality. Quantity and quality indicators are also depending on growing rate of specific service. Thus to determine the set of parameters for assessing the effectiveness of a particular portfolio may require additional data concerning not only the same service, but also market conditions.

4. Availability of resources to provide service. Significant impact on the process of forming portfolio of services affects availability of resources of the bank, which are detached to provide specific services. Amount of resources allows to range portfolio, create database of consumers and to ensure the regularity of result. Thus, the availability of resources proves universalization of the banking portfolio and increases efficiency of the bank on the market. This approach allows to develop more clearly portfolio strategy of the bank.

5. The attractiveness of service for a specific group of consumers. It is important for consumer to get a quality service for short period of time. To improve efficiency of the portfolio, services can be divided between various portfolios and responsible departments, whose duty is to provide various services to specific customers. Thus, the attractiveness of the services depends on available of resources, terms and quality.

6. Specialization. It is supposed that specialization in a particular service brings main income of the bank which is formed by providing a small but quality list of services. Thus, some banks may form single portfolio that includes all services with a high degree of specialization.

7. The cost of entry for the bank to the market of specific services. During forming portfolio of services periodically arise necessity to change the list of services according to change of consumer requirements. In these conditions, one of the factors for inclusion service in the portfolio is the cost of entry to a particular market. The higher cost of entry is the more complex decision to include services to the portfolio.

8. The relative effectiveness of service comparing to other bank services. To determine priority of service portfolios often use its comparative effectiveness. It is needed to evaluate quantity of services and its relative effectiveness before decision include or not specific services to the portfolio. Effective portfolio must be formed in the way that average performance of the portfolio corresponds to the requirements of the bank's strategy and meet the liquidity requirements.

9. Life-cycle of the service. Significant impact to the process of forming portfolio of services makes a life-cycle of the service. If the service is on the stage of initiation, it is necessary to use one structure of the portfolio and the result of the formation may be the answer to the question of economic utility or market potential of the portfolio composed from different services with different stages of the life cycle. If the service is under development, forming of the service portfolio is the subject to analyses about adequacy of tariffs and consumer demand, as well as the opportunities for closer interaction with the market. At the stage of stagnation main purpose of the portfolio is to prolong stable sales of the services in the market as long as possible. Recession stage requires answer to question about the painless exit of the market. Thus forming the portfolio, determination of the life cycle stage gives more precise expectations of the portfolio that can clearly justify the choice of specific services.

10. Bank's position on the market. The more stable position of the bank on the market, the more full information about the market it has. Volume and existing information allow to spend fund on services rather than the formation of new portfolios. This situation can improve the quality and quantity of services under creating and to take more informed decisions about forming portfolio. Depending on the bank's position on the market volume of efficient solutions concerning portfolio creation are increasing [10].

Based on consideration of factors that makes significant influence for the formation of the portfolio of services, we can conclude that the critical factors during forming list of services for inclusion in the portfolio are financial factors, because most of these factors influence performance of the bank.

The main objective of any commercial bank is allocation of funds in various active operations, without reducing profitability and liquidity. Besides, commercial banks may guide such methods of allocation as a method of general fund, which is based on the idea of unification of all resources. Total capital is distributed between the types of assets that are considered effective. In the model of the general fund capital detached to a particular active transaction, no matter from what source received funds, while their detachment contributes to the goals set by the bank. [5]:

1. The allocated funds are placed in active operations, which are allowing to fulfill liquidity and profitability parameters. According to that it is being determined which share of each dollar (or UAH), allocated in the bank, should be sent to the reserves of the first or second stage and which share should be used for other earning profit operations.

Provision of the first stage includes two groups: reserves required to serve collateral for liabilities on deposits and cash balances, the amount which is sufficient to serve everyday payments. In practice, the amount of funds of primary reserves is being determined based on the average share of total assets and deposits. This share almost the same for all banks.

The main purpose of second stage reserves is to serve the primary source of supplement of first stage reserves. In second stage reserves are included assets as usual portfolio of securities and in some cases loan fund on accounts.

Once the bank has determined the size of primary and secondary reserves, it can start to determine composition of the portfolio of banking services. For example funds remained after repayment of the loans and may be invested into relatively long-term first-rate securities. Purpose of investment portfolio is to generate income and serve as a reserve of second stage [10].

Using the “general fund” method bank can choose from great selection of categories of active operations. This method sets the priorities, although not always solves the dilemma of "Liquidity - profitability".

2. The method of distribution of assets, also known as a conversion method, allows to remove the limitations of general fund method. This method attempts to classify funds source in accordance with required reserves and according to speed of funds turnover.

For example, deposits on demand requires high rate of mandatory reserves comparing with savings and time deposits and the turnover rate is usually higher than in other types of deposits. Therefore, large proportion of each dollar of deposit on demand should be contained in primary and secondary reserves and a smaller part - in other investments. This model assumes creation multiple "profit centers" (or "liquidity centers") inside the bank used for allocation of funds mobilized by banks from different sources.

Having distributed funds to different centers basing on its liquidity and profitability, the Bank's management determines order of allocation fund by each center.

The main advantage of the considered method is reduction share of liquid assets and investments of additional funds into loans and investments that is increasing profit margins. Although the basis of different "profit centers" is deviation in fund turnover but there can not be a close link between the turnover of fund of some group and fluctuations in the total contributions of this group.

Another drawback of this method is that it assumes independence of the sources of funds from the ways of it usage. For example, practicing bankers trying to allocate more funds from business firms because these firms, as usual, borrow money in the same bank where they have opened accounts. So, allocation of new funds, simultaneous means obligation of the bank to provide loans for new depositors. This means that part of the new fund should be directed to credit the owners of these funds.

These two methods should be appraised not as a set of standards that provides the basis for decision making but as general framework within which the bank's management can determine the approach to asset management solution. Usage each of these methods involves the ability of the competent managers to explore the whole range of relationships to take decisions that meets specific condition of the bank.

The purpose of the bank as a commercial organization is maximizing net interest income, i.e. the spread between interest income and interest expense taking into account acceptable levels of risk. Bank expands range of services to attract new customers on deposit and credit market. However, cash flows in different markets may change over time under the influence of sudden changes in profitability or risk. Therefore, the distribution of investment terms ambiguous and should be taken into account during forming strategy of creation portfolio, such as ladder or spaced maturity policy, short-term or long-term focus, "bar", interest expectations [8].

3. The ladder, spaced maturity policy. One of the simple and popular approaches how to solve problems of dynamics, especially among smaller financial institutions. The most appropriate term is being selected, for example year as planning horizon. Within the chosen horizon executing distribution of investment capital among all appropriate financial instruments in equal proportions depending of terms of funds allocation. This strategy does not maximize income from investment, but has the advantage of minimizing the deviation of income in one or another side.

The policy of short-term focus (Front-end load maturity policy), according to which all capital is invested in short-term securities, thus only a short investment horizon is being selected. This strategy strengthens the position of the bank in liquidity, but short-term financial instruments usually have a poor yield [2].

Long-term policy focus (Back-end load maturity policy). This is the opposite to the previous strategy according to which all capital is being invested in long-term securities with maturity from 5 to 10 years. Thus this strategy worsens the liquidity balance, however, increases the profitability of assets. Problems of liquidity arising according to this strategy can be covered by short-term borrowing.

Strategy "bar". Investment portfolio consists of short-term and long-term financial instruments in equal proportions, medium-term investments is absent or takes a small part of the portfolio. It should be noted that this strategy does not require significant management decisions and is often used by investment funds. The choice of strategy in this case depends on the propensity to take risks and choice of investors.

Immunization strategy. For the bank profitability and risk of the portfolio is not less important characteristics as liquidity, payments flow and security of portfolio from interest rate risk. To control abovementioned factors the key information for the investment bankers is the level of assets income (sum and term) and the level of expenditures to serve liabilities [1].

Desire to get more profitable portfolio is always in contradiction with the desire to provide safe portfolio (with lowest limited risk). The risk is managing through diversification. Obviously, the optimal portfolio risk increases with increasing the required expecting effectiveness. If the capital borrowed, it is possible to form portfolio with variable expected efficiency, but the risk will grow indefinitely. Risky assets may be more reliable in diversified portfolio.

So, the main question for banking managers to choose the optimal portfolio, i.e. forming set of assets with the highest yield at the lowest or indicated level of investment risk, taking into account mutual correlations between assets income, that allows to conduct effective diversification of banking services portfolio.

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Alla Kobylianska*

EMERGING ECONOMIES IN CRISIS AFTERMATH

Annotation: *the paper is devoted to the analysis of the role of emerging economies in after crisis World. The rebalance of economic powers is considered. The changes in international investments are stressed.*

Key words: emerging economy, emerging market, world financial crisis, international investment.

Анотація: *стаття присвячена аналізу ролі країн з ринком, що формується, в посткризовий період. В статті розглядається зміни в балансі економічних сил Світу. Особлива увага приділена зміні в тенденціях іноземного інвестування.*

Ключові слова: країна з ринком, що формується, світова фінансова криза, міжнародні інвестицій

World economic crisis of 2008 revealed the main weaknesses of the world economy in whole and each region and country in particular. While major problems were quite common for the most of economies (e.g. financial sector troubles provoking plunge in private consumption, current account imbalances etc.), they were aggravated by local specifics. World financial crisis spillovers affected different economies in different manner. Consequently the solutions made were adapted to the countries' needs.

The actuality and the goal of the paper

Emerging market economies (EME) did not stay aside the world turmoil. Accounting for near 46% of world GDP, 30% of world FDI and 16% of world trade turnover in 2007 [1], thus being important international players, the countries showed themselves being rather sensitive to the external shocks. Although countries of EME group are quite different in the conditions they are characterized by, it is possible to figure out some common traces. Therefore, the paper is devoted to the comparative analysis of EME role in world economy in pre-crisis and after-crisis world. A particular attention is paid to the world investment flows, as a driver of economic growth, and change in their volumes and patterns. The goal of the paper is to figure out the importance of EME economies in post-crisis world development and rebalance of world economic powers. Some questions of possible economic over-heating related to financial injections in emerging economies are also discovered.

The economic development of EME countries in pre-crisis and post-crisis world was analyzed in depth by a variety of international institutions, governmental bodies of various countries, NGOs etc. due to their specific importance in world economic development. Current research will significantly enrich the literature on the issue addressing the questions of the role of particular countries entering the group of EME countries.

The object of the research is the development of world economy and its regionalization.

The subject of the research is EME countries and their role in international capital flows.

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The methods of the research

The goal of the paper which will be sequentially discovered in the process of its object and subject investigation and will be reached with the tool of comparative statistic analysis of EME key economic indicators of 2007 and thereafter, enriched by cross-country analysis. The dynamics of world and EME renewal will be also highlighted. At the same time the essential attention will be paid to the anti-crisis policies and the capital flows' reversals. Despite considerable efforts made by the authors of preceding research in the area, there is a lack in a comprehensive overview and analysis of world development in crisis aftermath with respect to the role of EME countries in the process. Thus, the paper is aimed to fill in the gap. The descriptive analysis will complement the general methodology of the paper.

The body of the paper

Crisis dynamics and projections and anti-crisis measures

World crisis showed an unprecedented drop in world industrial production and international capital flows after years of economic growth and rising financial globalization. It should be mentioned that there is evidence that that the variability of economic indices of emerging market economies (EME) depended on the vulnerabilities associated with respective economies in pre-crisis period. The impact of the crisis could be measured in several dimensions, the most exhausting of them are: real sector dimension and financial sector dimension. The former could be represented be deviations of observed during the crisis GDP growth rates from their potential average. The latter could be judged from variations in credit conduction, increase in sovereign debt spreads and changes in capital market indices. In most of the cases countries that experienced high real sector distresses simultaneously experienced financial sector instabilities. In sum, while advanced economies experienced around 4,5% drop in GDP growth rates, the respective contraction for emerging economies reached 4,9%. [2, 15] While there was a significant variability in economic performance changes between emerging economy countries with the most affected region Europe. At the same time emerging economies experienced a shorter-lived retrenchment than developed economies and showed faster recovery (Table 1).

Table 1.
World Economic Outlook Projections (% year on year)

	Projections				**Difference from April WEO projections**	
	2009	**2010**	**2011**	**2012**	**2011**	**2012**
World Output	**–0,5**	**5,1**	**4,3**	**4,5**	**–0,1**	**0**
Advanced Economies	**–3,4**	**3**	**2,2**	**2,6**	**–0,2**	**0**
United States	–2,6	2,9	2,5	2,7	–0,3	–0,2
Euro Area	–4,1	1,8	2	1,7	0,4	–0,1
Germany	–4,7	3,5	3,2	2	0,7	–0,1
France	–2,6	1,4	2,1	1,9	0,5	0,1
Italy	–5,2	1,3	1	1,3	–0,1	0
Spain	–3,7	–0,1	0,8	1,6	0	0
Japan	–6,3	4	–0,7	2,9	–2,1	0,8
United Kingdom	–4,9	1,3	1,5	2,3	–0,2	0
Canada	–2,8	3,2	2,9	2,6	0,1	0
Other Advanced Economies	–1,1	5,8	4	3,8	0,1	0
Newly Industrialized Asian Economies	–0,7	8,4	5,1	4,5	0,2	0

	Projections				Difference from April WEO projections	
	2009	2010	2011	2012	2011	2012
Emerging and Developing Economies	**2,8**	**7,4**	**6,6**	**6,4**	**0,1**	**–0,1**
Central and Eastern Europe	–3,6	4,5	5,3	3,2	1,6	–0,8
Commonwealth of Independent States	–6,4	4,6	5,1	4,7	0,1	0
Russia	–7,8	4	4,8	4,5	0	0
Excluding Russia	–3,0	6	5,6	5,1	0,1	0
Developing Asia	7,2	9,6	8,4	8,4	0	0
China	9,2	10,3	9,6	9,5	0	0
India	6,8	10,4	8,2	7,8	0	0
ASEAN-54	1,7	6,9	5,4	5,7	0	0
Latin America and the Caribbean	–1,7	6,1	4,6	4,1	–0,1	–0,1
Brazil	–0,6	7,5	4,1	3,6	–0,4	–0,5
Mexico	–6,1	5,5	4,7	4	0,1	0
Middle East and North Africa	2,5	4,4	4,2	4,4	0,1	0,2
Sub-Saharan Africa	2,8	5,1	5,5	5,9	0	0
Memorandum						
European Union	–4,1	1,8	2	2,1	0,2	0
World Growth based on market exchange rates	–2,1	4	3,4	3,7	–0,1	0
World Trade Volume (goods and services)	**–10,8**	**12,4**	**8,2**	**6,7**	**0,8**	**–0,2**
Imports						
Advanced Economies	–12,5	11,6	6	5,1	0,2	–0,4
Emerging and Developing Economies	–7,9	13,7	12,1	9	1,9	–0,4
Exports						
Advanced Economies	–12,0	12,3	6,8	6,1	0	0,2
Emerging and Developing Economies	–7,9	12,8	11,2	8,3	2,4	–0,4

While the crisis originated in advanced economy of USA, its effects quickly spread around the world and touched EME. The major transmission mechanism consisted of several channels. First of all major financial institutions hit by crisis withdrew their funds from subsidiaries located in EME. This led to significant weakening of balance shit positions and need to regain capital adequacy, consequently imposing some restrictions on lending to other institutions. The lack of funding was partly filled in by governmental support injected into the banking system.

Secondly, the global financial crisis led to significant drying up of global capital markets. Credit flows were hit the most. EME countries experienced high distress especially CEE ones experiencing high current account deficits. The contraction in capital flows was observed on all other investments positions as well, accounting for around 50-60% of decline between 2007 and 2008. Besides decrease in financial inflows, the withdrawal of investments in particular portfolios contributed to the worsening of financial account balance. This put significant pressure on EME being indebted and having needed to finance both current account deficits and refinance maturing debt. Emerging countries showed significant capital outflows with subsequent depreciation of local currencies and decline in international reserves.

Folding up of economic activity was the third transmission mechanism of world financial crisis. Decline in incomes of households and real sector led to decrease in respective demand and therefore in exports from emerging economies being the largest exporters to the advanced economies and those EME that entered the World supply chain. In addition to an obvious result of such a contraction of world trade, this provoked worsening of internal demand and deterioration of domestic credit and further weakening of financial sectors.

The plunge in economic activity throughout the world led to increase in unemployment and, thus, the decrease in demand for labour including foreign one. This resulted in the plunge in emigrant workers remittances. The estimate for total remittances being improved tends to lag behind the decline in economic activity and therefore the recovery. In any case remittances constitute a significant portion of EME population incomes and represent one of the sources of foreign currency injections entering to the current account. Remigration of labour migrants might put an addition pressure on local labor markets and, thus, local unemployment funds during the period of economic recovery. [4, 5-8]

While all EME were affected by the same crisis factors, the response to the economic slowdown varied across countries which predetermined further growth prospects. As the availability of external capital reduced extremely, some of EME (Brazil, Mexico, Singapore and South Korea specifically) entered into swap arrangement in order to strengthen reserves. Some emerging economies addressed to IMF to get the support from the institution seeking for some ways of export reduction combating and assuring debt repayments (Table 2).

Table 2.
IMF loans in the framework of stand-by-agreements to selected EME (as on 31 of August, 2011)

Country	Approved amount of support (m SDR)
Colombia	3870
Poland	13700, 19166
Latvia	1522
Hungary	10538
Mexico	31500, 47292

Source: IMF [1]

The financial sector of emerging economies countries also needed significant support and modification. The first steps in the area included deposit insurance schemes' revision. Thus, the coverage was broadened or introduced in case it was absent at all (e.g. in Asia). The measures were considered as those that should increase the credibility of banking system.

Besides, governmental support in the form of capital injections was provided in order to address capital adequacy problems and to support crediting, especially trade credit. Despite rather significant amounts of capital injected to the banking systems the mechanism lacked coordination with another measures.

Mimicking an experienced of advanced economies, some EME countries introduced substantial fiscal stimulus packages most of them aimed to stimulate internal activity (Tables 3-4). The most ambitious ones were introduced by China, India, and Turkey. On average stimulus packages amounted to around 1,5% of GDP of most EME. Besides direct governmental support of some infrastructure programs, these packages foresaw lowering of tax burden.

Table 3.
Fiscal stimulus packages in 2008-2010, % of GDP 2008

Country	Net effect	Tax measures					Expenditures increase					
		total	Physical persons	Legal entities	Consumption	Social insurance	total	Final consumption	Investment	Household transfers	Transfers to business	Transfers to local authorities
Czech Republic	-3	-2,5	0	-0,4	-0,4	-2	0,5	-0,1	0,2	0	0,4	0
Hungary	4,4	0	-0,1	-1,5	1,6	0	-4,4	-1,9	0	-1	-1,5	0
Poland	-1	-0,4	0	-0,1	-0,2	0	0,6	0	1,3	0,1	0	0
Mexico	-2,8	-1,9	-1,5	-0,2	0	-0,2	0,9	0,7	0,3	0,1	0	0

Source: OECD Economic Outlook. Interim report, March 2010, p.11

Table 4.
Fiscal Expansion (% of GDP with respect to 2007)

	2009			2010			Fiscal expansion Change from April WEO	
	Overall Balance	Crisis-related discretionally measures	Other factors	Overall Balance	Crisis-related discretionally measures	Other factors	2009	2010
Argentina	-1,1	-1,5	0,4	0,7	0	0,7	0,2	1,5
Brazil	-0,7	-0,6	0	1,2	-0,6	1,8	-1	-0,2
China	-5,2	-3,1	-2,1	-5,2	-2,7	-2,5	-0,7	-0,7
India	-4,7	-0,6	-4,1	-3,3	-0,6	-2,7	0,3	0,3
Indonesia	-1,4	-1,4	-0,1	-0,9	-0,6	-0,2	-0,1	0,1
Korea	-6,7	-3,6	-3	-7,8	-4,7	-3,1	0	0,4
Mexico	-2,5	-1,5	-1	-2,6	-1	-1,6	-0,3	-0,3
Russia	-12,2	-4,1	-8,2	-11,7	-1,3	-10,4	0,7	0
Saudi Arabia	-11,6	-3,3	-8,3	-7	-3,5	-3,5	8,1	10,2
South Africa	-4	-3	-1	-4,2	-2,1	-2,1	0,2	0,1
Turkey	-3,7	-0,8	-2,9	-3,3	-0,3	-3	0,1	-0,3

Source: IMF. [5, 125]

General composition of stimulus package was done in the next way: 1/3 accounts for revenue measures fostering private consumption and 2/3 were assigned to expenditure measures. The respective proportions varied from country EME was possible thanks to the years of international reserves building up and fiscal surpluses. At the same time CEE EME and India were rather restricted in their ability to inject some capital into the market. It should be noted that the practice of fiscal support alongside with worsening balance of payment may lead to weakening of fiscal position and debt repayment in future especially in case of further deterioration of world economy.

The third way to tackle economic challenges was taking of some protectionists measures. While leaders of G20 at summit in November 15, 2008 agreed to avoid protectionism, in early 2009 already 17 members of G20 introduced trade or trade related restrictive measures. In contrast to developed countries introduced subsidies and some other supports, developing countries made use of variety of instruments such as subsidies, import duties and banks, non-tariff measures. The most protected sectors were automotive industry and financial sector. As for the last, subsidies were introduced for domestically owned banks. While the support was relatively minor, its significance for some exports was of crucial importance.

Some countries specifics made their contribution to the after-crisis recovery of emerging economies. Thus, Emerging Latin America recovered rather quickly from the crisis owing to introduction of countercyclical macroeconomic policies before the crisis, high commodity prices and domestic demand stimulus alongside with external financing. In 2010 the group of countries experienced growth followed by South Africa. At the same time the crisis may end up with economy overheating and subsequent rising inflation current account deficit.

It is expected that Latin America emerging economies will demonstrate moderate economic renewal at 4-5% p.a. approaching the potential GDP growth. The main triggers of such increase will be sustained domestic demand while accompanied with current account deficit. It is highly possible that fiscal support will fold which will result in lower private demand affecting exporters. The countries of the region that were more integrated to world economy also showed some improvement. It could be more pronounce in case of higher remittances, more favorable terms of trade and lower public debt. There still exists the threat that loosening of fiscal policy may result in higher inflation and current account position leading to economy disequilibrium. On the other side there is a risk of slower renewal of global capital markets which could negatively affect financial side of balance of payments position.

Capital markets

As EME capital markets played crucial role in pre-crisis world economy and taking into account financial component of the crisis, it is important to investigate the effect of world economic turmoil on capital flows associated with emerging economies. In whole, the period of financial crisis regarding the changes in capital flows could be symbolically divided into three main stages. The first stage of the crisis was characterized by a slowdown in capital flows primarily banking ones among developed economies. In contrast, capital flows to and from emerging markets were generally not affected. The second stage of the crisis was marked by a broad reversal of capital flows, with investors across the globe liquidating holdings abroad. At that moment emerging markets were hit by a sharp reversal in flows. The third stage of the crisis saw a recovery of non-bank capital flows, particularly in Asian and Latin American emerging markets. While flows among developed economies remained well below pre-crisis level, with bank flows still contracting.

Looking more closely the composition of flows, it should be noted again that the reversals in flows to and from advanced economies was driven by banks. Besides, banks have continued reducing their cross-border exposure in advanced economies even in the final recovery stage. Although banking flows also played a major role during the collapse stage in emerging markets, their magnitude remained relatively small compared to other types of flows. Capital inflows to emerging markets took mainly the form of FDI and portfolio investment, which quickly resumed after the collapse. On the outflows side, the accumulation of foreign reserves plays a dominant role. In the collapse stage, emerging countries used the reserves to cover capital flows reversals instead of having the economy go through a costly shift in the net external balance. [6, 17]

Despite general tendencies were quite common for the most of EME, flows to and from emerging markets were marked by regional differences. Flows have quickly resumed for Latin America and emerging Asia, nearly reaching pre-crisis levels. By contrast, flows to and from emerging Europe remained at a very low level in the recovery stage of the crisis due to the fact that the region suffered the most from the crisis.

While discussing general capital flows' behavior during the crisis, the main causes of investments retrenchment could shed the light on regional differences. Actually the causes could be split into two broad groups. The first one is concerned with financial excesses (e.g. asset price bubbles, weak financial regulation) and associated macroeconomic imbalances and vulnerabilities; and the second one is international financial linkages explaining the transmission of the crisis. As emerging economies showed themselves experiencing less financial excesses and relatively weaker linkages with countries suffered the most from world crisis, they followed another pattern of development during the crisis and after it as it was shown.

Some examples could be provided. By dealing with weaknesses in their financial systems in the aftermath of pervious crisis, some emerging economies, such as Brazil and Indonesia, have been able to withstand the recent financial shocks. In other cases, such as India and China, very cautious financial opening and tight regulation (including direct state controls) prevented risky behavior before the crisis and enabled a rapid restarting of growth through credit expansion. For example, Asian equity markets rose by 30% since late 2008, while Latin America's ones showed 40% of improvement. These figures far exceed those of advanced economies and result in higher GDP growth. Thus, China, Indonesia, South Korea, and Singapore experienced GDP growth on average at 10 percent.

Further development of emerging capital markets could be considered from the prospective of different assets. The biggest share of capital in emerging markets is represented by bank deposits followed by equities. The share of the latter could increase in case of privatization of state enterprises or rise in value of private companies. The former also has significant potential for growth as a lot of population even does not have bank account. Increase in population incomes as well as increase in population itself will also contribute to deposits volumes increase.

There exist the prospective of growth in share of corporate bonds (15% of GDP comparing with 119% in Europe) and other private debt securities. While the increase will be possible only in case of legal and financial reforms especially that is concerned with regulation of bond markets which constitute the alternative for bank financing. [7,6]

At the same time further financial market development is not guaranteed- the main obstacle is an absence of financial market reforms. The crisis revealed the dangers of imperfect financial system deepening. At the same time the development of financial system has the main benefits in the form of more efficient capital allocation and better risk diversification. If proper reforms are introduced, emerging capital markets may project to 50% of world GDP in 25 years. [8, 12]

The recovery has long-term prerequisites which do not lose power. Among them there are traditionally high internal savings rates supporting investments. The latter are mostly directed to infrastructure projects resulting in increase in industrial production. In addition emerging capital markets are relatively smaller than those of advanced economies, thus, having higher convergence growth rates. At the moment the size of capital markets equals 165% of EMEs' GDP or 145% if excluding China which is far lower than in mature economies.

Boom-boost cycles

Up to the moment, the capital influx has taken the form of debt placement. These inflows are generally considered to be highly volatile but they strengthen domestic liquidity positions. If the situation continues, there exists the risk of too fast re-leveraging. There is a pattern of strong inflows into mutual funds of EME- the figure for the first quarter of 2011 was the highest in three years. EME bonds in comparison to US corporate high-yield bonds are more attractive for investors thanking to lower leverage and higher returns taking other things being equal. These preconditions are easing access of previously constrained companies to credit, while there is a serious worry that there could be over-inflows of capital into EME. In its turn in case of adverse movements in capital, this may lead massive outflows and incorrect pricing of credit.

The mentioned risk of economies overheating in crisis aftermath is in the center of last economic debate, capital influxes into emerging economies led to the spectacular credit increase aligned with high inflation. As weaker firms are entering capital markets due to rising corporate leverage this may lead to higher vulnerability of corporate balance sheets. Main economic measures in emerging economies should be simultaneously directed on three goals: avoidance of economy overheating, decrease of the possibility of financial risks and increase of policy credibility. Some macro prudential tools, e.g. capital controls, can support main ones. In other words main efforts should be directed on strengthening of financial system.

As most of the countries succeed to achieve their potential economic growth macroeconomic policy should be seriously reviewed. That is concerned with fiscal expenses, as in the context of sizable capital inflows and respective currency appreciation this may pose significant burden on monetary policy. As there is observed improvement in lending conditions causing asset price growth, some capital controls should be introduced in aim to strengthen financial systems of countries. Thus, Central America should replenish its international reserves eaten up during recession; Caribbean region should paid specific attention to fiscal policy issues in order to ensure sustainable economic growth.

Emerging market economies that achieved pre-crisis economic growth rates give the priority to tightening of macroeconomic policies supported by introduction or use of flexible exchange rates and high macro-controls in order to prevent boom-bust cycles. At the time when these countries increase policy rates, real rates remain law. Therefore further tightening of fiscal policies is needed supported by transparent monetary policies aimed to restrain inflation and manage inflation expectations. Those emerging economies that experience high fiscal deficits or substantial debts should strengthen their position especially those that have problems with current account or are subject to adverse capital movements. However, all these restrictions should be concerned with areas others than social sector spending or infrastructure projects financing. Countries with high current account surpluses may become the triggers of economic development of the regions for the medium term.

In sum, policymakers must act now to make the financial system more robust. Downside risks have again risen, including that the global economic recovery may be more fragile than had been thought, so time to address existing vulnerabilities may be running out. At the same time, the room for maneuver to counter shocks has been reduced, especially via traditional fiscal and monetary policy levers. Thus, it will be critical to make the financial system strong enough to withstand potential major shocks, thereby enabling it to support ongoing recovery. The key priorities are, first, to make the current financial system more robust, especially to clean up from the legacy of the crisis in advanced countries. Second, the financial reform agenda must be completed as expeditiously as possible.

Re-balancing of world economic powers

Still general outperformance of emerging economies lead to the revision of the role they play in world economy. The Summit of G-20 agreed that the role of the emerging economies (at least the largest ones) within the IMF and the World Bank would be expanded through agreement to increase their quota shares.[4] Although the large emerging market economies were hardly immune from the global crisis, their deeper integration into the international economy over the past two decades also gave them a strong interest in international collaboration designed to restore the global economy on a sustainable growth path.[9, 31]

The discussions on the new economic order became widespread. Despite an existence of controversial points of view, it seems to be that the trend to financial and economic globalization will persist. However, its nature is likely to change. This is because international bank flows are unlikely to regain their pre-crisis magnitude for a variety of reasons, so that the relative importance of some donors of capital would change. In contrast, financial globalization in emerging markets, which had proceeded at a less dramatic drop, could well prove more robust. So the revision of world financial and economic architecture is just the matter of time.

Although the world economic arena was divided among four main economic powers such as US, China, Japan, and India, there is a number of EME that gain more and more attractiveness in eyes of foreign investors and world manufactures. Any of them being integrated in world supply chains could seriously affect the composition of world economic powers in future and the direction of capital flows.

In Asia there are three possible locomotives for further economic renewal of the region: Malaysia, Indonesia and India. Thus, Malaysia succeeds to attract some automotive giants to build assembly lines in the country. The FDI will be also directed into hi-tech and resource intensive industries. In sum, this gives significant push to the market of logistic services. Indonesia will benefit from previously introduced softening of capital controls and may incur significant inflow of FDI Into telecommunication and logistics especially in the light of decrease in investment attractiveness of China. India may experience growth in investment flows into retail sector being an attractive investment destination due to relatively cheap and highly educated labor force and absence of language barrier.

The situation in Middle East differs a little bit. During the crisis Saudi Arabia indeed suffered from the world economic slowdown, but seemed to be able to develop its transportation system. The latter may become the source of future economic prosperity due to strategic geographical position of the country. Egypt, on the other side, lost its relative logistic advantage due to recent political turmoil. The situation in UAE varies across administrative districts. Dubai, Abu Dhabi and Sharjah are expected to be the main triggers of further economic development of the country. The last country of the region, Turkey, will benefit from its geographical position and the process of alignment of EU, thus as far as EU and Middle East will develop, Turkey may become the strategic player in economic and political dialogue between counterparties.

Russia is the main CEE emerging country to consider in the context of global production chains. Still it has significant resource based potential and possibly will set its rules in the region.

While considering Latin America specific attention should be paid to Mexico and Brazil. Mexico seems to benefit further to its tight connections with US companies which redirected their attention from China to Mexico. Despite economic growth, internal problems distract possible foreign investors. Brazil is indeed the leader of the region, possessing vast natural resources, being the large exporter of food and finished industrial production and representing big consumer market. In addition, the government introduces macroeconomic reforms aimed to stimulate economic activity that only gives an additional incentive for foreign investors. [10, 25]

Another most discussed result of the crisis is possible further decoupling of emerging economies from advanced world. Before the crisis the relative independence of emerging economies was the predominated point of view. At the same the examining of financial transmission mechanism of the crisis allow to figure out three phases: decoupling, re-coupling and re-decoupling. The last phase started in early 2009 and was marked by stabilization on emerging economies capital markets in parallel with striking gap opened between high vulnerability countries and others. These also affected capital flows. While low and medium vulnerable countries started experiencing inflows of capital already in the first quarter of 2009, highly vulnerable countries still experienced gross outflows.

In any case EME are supposed driving world recovery for a number of reasons. The countries experienced smaller economic slowdown (in particular Sub-Sahara Africa and Middle East) or even showed economic growth in 2008-2009 (China), and nowadays have higher recovery speeds. The reasons for the latter are improved trade and financial linkages, rising incomes and wider middle class, and therefore growing domestic markets. Taking into account that BRIC countries enter EME group, their indeed significant role in global economic governance seem to strengthen even further.

Conclusions

At the moment the prospects of EME development are better than of advanced economies. Besides, the group of the countries showed positive economic results during the crisis, the projections of future economic growth are also more prominent. [1] Asian EME industrial growth in crisis aftermath is higher than its potential industrial growth. Growth in EM Asia still may decelerate only slightly due to earthquake in Japan and disruption in production networks. Latin America is also on the path to the improvement and would be bolstered by commodity exports and internal demand. European emerging economies and some of CIS countries are lagging behind, while showing considerable and fast improvement. The countries will indeed growth faster than advanced economies of the region owing to sharp domestic demand cycle in Turkey. Higher oil demand and increase in prices support the development of Nearest East. Situation in Africa is a little bit different. An economic renewal in middle income countries and oil-exporters is supported by revival in world trade and increase in prices for traded goods. Low income countries just restored their output at the trend level. [11, 14] In future Sub-Sahara African activity will strengthen, with domestic demand remaining robust, and world price increase will support commodity exporters. The only region where fast and sustainable economic recovery seems to be questionable is Middle East due to political and social unrest.

For the sake of truth, it should be noted that in whole the speed of World economic recovery was underestimated, as real and financial sector restored their confidence more quickly than it was expected. Developed countries experienced positive changes due to favorable changes in inventories, less pronounce weakening of labor markets and more quickly revival in capital flows. However, EME are commonly accepted being locomotives of world economic development.

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THE STATE OF THE UKRAINIAN ECONOMY IN THE CRISIS PERIOD AND FORECASTING DIRECT FOREIGN INVESTMENTS

Annotation *The paper deals with the state and openness Ukraine's economy in crisis, the reasons of the low investment activity in the country and the growth of import dependence on foreign producers, as well as the needs of the country in attracting foreign investments are investigated. A comparative analysis of the indicators of foreign economic activity in the dynamics from 2000 till 2010 has been made. The main factors of the projected influx of investment in fixed assets for 2011-2015 are given. Under the conditions of the crisis termination in Ukraine gradual diversification of foreign trade and rapid development of industrial products with the release of final consumption are required.*

Key words: economic activity, direct foreign investment (DFI), economic reforms, economy openness, import dependence, investments, innovations, economic crisis.

Economic, social, political and cultural development of countries in the last quarter of the twentieth and the beginning of XXI century takes place under the influence of globalization. The issue of economic globalization was studied by both Ukrainian and foreign scientists: Galchinsky A.S., Lukyanovich N.V., Makagon Y., Filippenko A.S., Rumantsev A.P., Yakovets J., Bransky V.P., Anilionis G.P., Byelorussian O.G., Nikitina M.G., Golikov A.P., Seleznev A.Z., Blank N.V., Varnaly Z.V., Burns B., Brom M., Keynes J., Markvin R., Allais M. et al., but their views are ambiguous and require further investigation and solution.

Manufacturing industries and service sectors, where the flow of capital and skilled labor is primarily brought into effect, dominate in the world economic space. The criteria of economic globalization are the growing interdependence of economies of different countries, the openness of national markets, the deepening of international division of labor. The main economic components are:

- Foreign trade increase;
- The growth of the role of knowledge, new technologies, management, marketing used in the economic systems of developed countries;
- Labour migration;
- International direct and portfolio investment [6, 12, 13].

Considering the world economic development of Ukraine, regional integration processes are the most essential factors in the development of national economy. The main task of the Ukrainian economy is the reorientation of international specialization from primary export-oriented industries to science-intensive ones. Taking into account the development priorities of the leaders of the world economy - EU, U.S., Japan, China and new industrialized economies (NIEs), a promising direction for Ukraine is the development of integration processes within the single economic space. Prerequisites of improving the competitiveness of domestic goods and increa-

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sing the volume of Ukrainian exports not only to CIS countries, but also to other countries are created and thereby the conditions for Ukraine's transition to the innovation model of economic development are provided [2].

There is a risk of displacement of domestic producers by foreign competitors in Ukraine, both in the internal and the external markets. Under the concept of national competitiveness proposed by M. Porter, the competitiveness development of the region, as well as countries in general is carried out via four stages:

- Competition on the basis of production factors;
- Competition on the basis of investments;
- Competition on the basis of innovations;
- Competition on the basis of wealth.

The first three stages provide economic growth, the last one - the stagnation and decline [7].

Modern researchers have proposed to evaluate the level of regional economic development per capita income indicators: the size of the gross regional product (GRP), the value of productive resources (fixed assets, etc.), the value of the natural resources and human resources (education level).

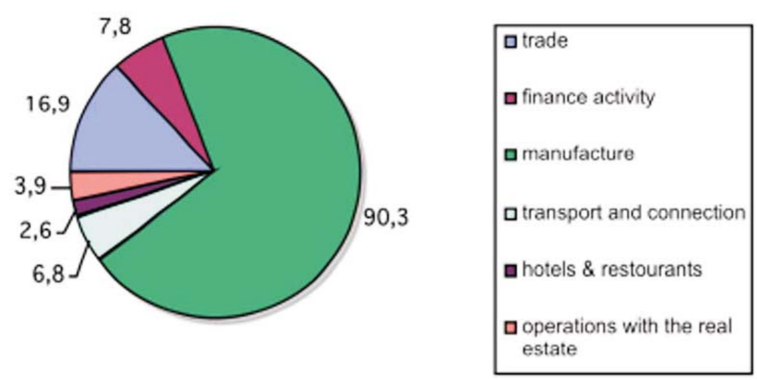
Taking into consideration the significant deterioration (physical and moral) of assets it is necessary to add a level of direct foreign investments (DFI) in the region's economy to the indicators mentioned above, including science intensive manufacture. Competitiveness is estimated by the level of essential services based on international standards and other indicators.

The role of foreign investment and the problems of attracting them to Ukraine. In the modern era of market relations the basis for successful development of the country's economy is the availability of investment potential. Attracting DFI into Ukraine's economy is an effective way of overcoming the economic crisis at the state level. The effectiveness of the process of attracting foreign investment depends on many factors. Namely,

- Political;
- Legislative;
- Economic;
- Demographic;
- Resort;
- Environmental and others. Interactions of all these factors create a country's investment climate [1, 3].

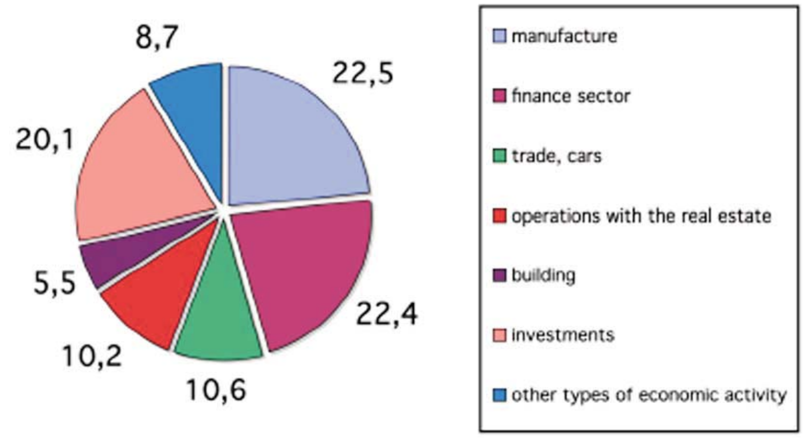
A consequence of the investments attraction into the economy of Ukraine is:

- Domestic savings increase;
- The role of DFI in providing know-how;
- The role of DFI in the access to foreign markets.



Picture 1. The structure of direct foreign investments in Ukraine according to the economic activities in 2002 [14].

The Ukrainian economy has a relatively high investment potential and it has caused considerable interest of foreign investors in the market with 47 million consumers. In 2010 according to the State Statistics Committee of Ukraine the investments increased by 6.2%, despite low business ratings. In the economy of Ukraine received 5.986 mln.dol.US, that is



Picture 2. The structure of direct foreign investments in Ukraine according to the economic activities in 2010 [14].].

6.2% more than in 2009 (5.634 mln.dol.US). The total volume of DFI in Ukraine on January, 1, 2011 amounted to 44.7 mln.dol.US, that is 11.6% more than in 2010 per 1 person (978.5 dol.US) [4, 10].

According to State Statistics Service of Ukraine the main investors in Ukraine were in 2002: the USA - 17.1%, Cyprus - 10.8%, the UK - 9.1%, the Netherlands - 8.2%, Russia - 6.9 % and other countries - 47.9% and in 2010 these countries were: Cyprus - 21.5%, Germany - 16.5%, the Netherlands - 10%, Russia - 6.7%, Austria - 6.5%, which provided almost 90% in foreign capital increase [5, 17].

Table 1.
The structure of foreign direct investments from Ukraine to the economies of the world in 2010 [14].

Country	Index, %
Cyprus	92,9
Russia	2,7
Poland	0,8
Georgia	0,5
Latvia	0,5
Other countries	2,6

Constraints of DFI inflow into Ukraine:

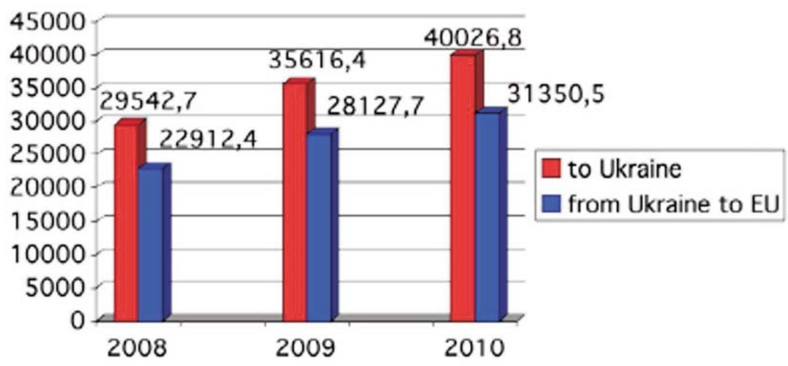
- o Low international rating of Ukraine;
- o Underdeveloped domestic financial market;
- o Weak political responsibility of the state;
- o Low level of political and legal stability (weak legal framework);
- o Lack of government guarantees for foreign investments;
- o Weak innovative component of the economy and outdated technologies;
- o Corruption;
- o Lack of competitiveness of products;

Total direct foreign investment in Ukraine in 2009 was 35723.4 mln. dol.US, which is 20.9% more than in 2008, per person - 775.3 dol.US, investments came from 124 countries of the world. The ten major investor countries were: Cyprus - 7682.9 mln.dol.US, Germany - 6393.8 mln.dol.US, the Netherlands - 3180.8 mln.dol.US, Austria - 2445.6 mln.dol.US, Russia - 1851.6 mln.dol.US, the USA - 1471.5 mln.dol.US, Virgin Islands - 1316.1 mln.dol.US, Sweden - 1263.0 mln.dol.US, France - 1226 mln.dol.US [7,14].

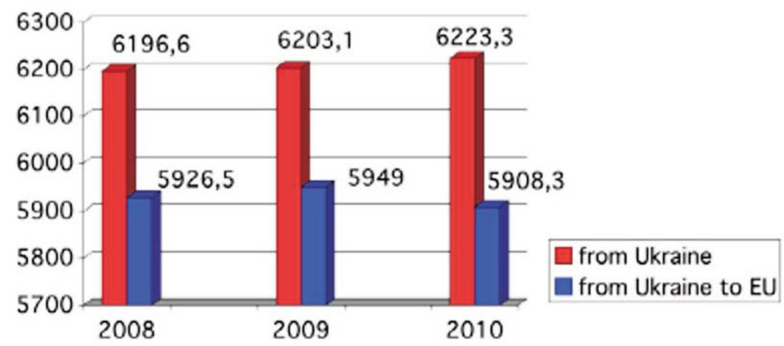
At the industrial enterprises: processing - 6928.0 mln.dol.US and mining - 1001.8 mln.dol.US, production of metal products - 1353.7 mln.dol.US, engineering - 1090.4 mln.dol.US, chemical and petrochemical industry - 952.8 mln.dol.US and others.

In 2009 direct foreign investments amounted to 6198.6 mln.dol.US from Ukraine to other economies, including the EU countries - 5949.0 mln.dol.US (96% of the total), the CIS countries - 195.7 mln.dol.US (3.1%) in other countries - 53.9 mln.dol.US (0.9%). Direct investments from Ukraine came to 51 countries, most of them - to Cyprus. Total direct investments in the economies of other countries, given the borrowing, amounted to 6321.9 mln.dol.US [8, 17].

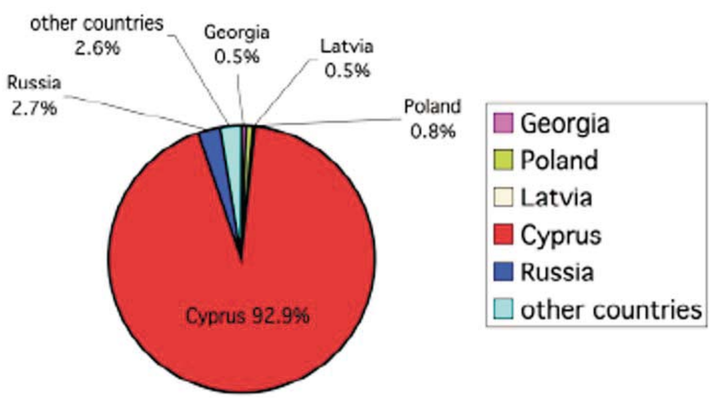
In general, we can conclude that foreign countries, like Ukraine, in crisis need to attract foreign investments that contribute to the formation of national investment markets, macroeconomic stability and makes it possible to solve the socio-economic problems of the country and its regions.



Picture 3. Direct foreign investments to Ukraine, mln.dol.US [9,14].



Picture 4. Direct foreign investments from Ukraine, mln.dol.US [14]



Picture 5. The structure of foreign direct investments from Ukraine to the economies of the world in 2010 [14]..

It is rather difficult to work as foreign investors in Ukraine under the circumstances. European Association measured the index of investment attractiveness of Ukraine in the first quarter of 2011 and noted the decline. Thus, 37% of the EBA experts interviewed noted the implementation of Tax Code, which entered into force on January, 1, 2011. The rating conducted by Transparancy International organization in 2010. Ukraine was ranked 134th on the corruption level among 178 countries [10, 14].

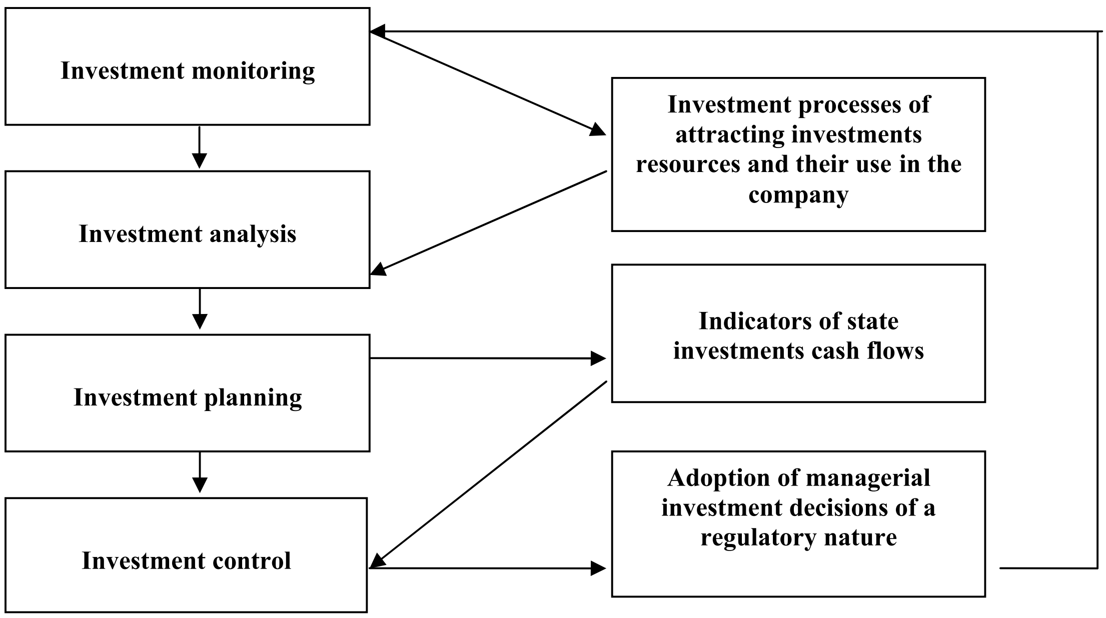
Despite significant investment potential for foreign investors, there are a number of problems constraining DFI inflows:

- Political and economic instability;
- Inadequate legal and regulatory framework;
- High level of taxation and foreign trade duties;
- Weak privatization;
- Inflation;
- Hryvnia exchange rate volatility;
- Acute crisis of the population purchasing power;
- Low wages;
- Semi-criminal nature of many enterprises, etc.

In order to improve policies to attract foreign investment in Ukraine a system of benefits for foreign investors in certain sectors and regions should be created, foreign trade and economic legislation should be improved, the tax burden should be reduced and the structure of taxes should be simplified. Thus, the abolition of quotas should be provided, land reform should be carried out and the government must guarantee the implementation of major investment projects and reduce the cost of loans for investors.

DFI into Ukraine's economy in 2011 is expected to reach 7 bln.dol.US, 16.7% or 1 bln.dol.US exceeds the rate of 2010. The main income is expected in the financial sector and capital injections into banks submitted at the Ukrainian market are expected as well [11, 14].

Due to the huge investment potential and public policy, Ukraine has all chances to attract DFI and to succeed in economic development. At the present stage of market processes an essential effective condition of management companies' investments the mechanisms of planning, coordination and investment controlling are applied. Controlling is widely used at the enterprises of the West and brings good results, though in the management of domestic enterprises, it does not find any proper application.



Picture 6. Block diagram of the investment controlling organization system at the enterprise [14]..

The figure shows that the controlling as the system of decision-making on investment management at the enterprise is an integral part of modern investment management, which provides a complex approach in dealing with crisis management issues.

The investment controlling functions:

- Monitoring;
- Analysis;
- Planning;
- Control and coordination
- The investment controlling should be an integral part of crisis management of the enterprise [4, 9].

The problems of innovation activity development in Ukraine. Under modern conditions the advanced economies are innovative, i.e. they are based on the application of new knowledge and modern information technology. Ukraine's entry into the World Trade Organization (WTO) and the prospect of joining the EU requires the modernization of enterprises, a complex approach to the effective use of high technology.

The assessment of the level of innovations in the country is produced at a rate of innovation, which is the average 5% for Ukraine, which indicates the low competitiveness of the country. To assess the level of innovation the term "Global Innovation Index" is used, the technique developed by Boston Consulting Group, the National Association of Manufacturers and the Institute of production [15].

Currently, Ukraine is the 64th in the rating of countries on the global innovation index, despite the fact that the country has a fairly developed infrastructure, the enterprises and research institutes working in the field of innovation, and it also has rich natural resources. Most enterprises use a production base and they are not engaged in new developments and manufacture low-tech products, they are engaged in the assembly of finished products from imported components or produce low-tech "half-finished products" for further manufacturing in more developed countries.

Much of the research on improving the innovation process has no practical application, e.g. due to the lack of equipment at the nano-level. Scientific developments are funded only by public funds; local businesses are not interested in the development of innovative technologies it is cheaper to buy foreign developments. There are no moral encourage meant of young professionals working in the area of innovation field. Many foreign discoveries have "Ukrainian roots", so it is more sensible to solve the existing problems.

It is possible to create a park of high technologies, benefits and tax simplifications for domestic and foreign companies operating in the innovation field. The introduction of innovative technologies in traditional sectors of the Ukrainian economy should increase their competitiveness at domestic and foreign markets [4, 16].

Country's competitiveness is largely determined by the production of innovative technologies. An analysis of statistical data shows that the number of employees in the innovation field has achieved 3.3-fold decrease since 1990, while in the EU and the U.S. it has increased by 2 times and in the Southeast Asia 4-fold; 3.5 – fold decreased the number of scientists in the field of technical sciences has fallen, the development of new technology has gone down – 14,3. The proportion of innovation active enterprises in Ukraine amounted to 12.8%, which is 5 times less than in 1990. The density of sales of innovative products - 4.8%, the share of exports is negligible.

According to analysts of the OECD the annual growth rate of industrial production in the world is 75% at the expense of scientific and technological progress (STP), whose share will grow up to 90% in the future in Ukraine is less than 1%, and the basis for the growth is resource- and energy-intensive production based on outdated technologies, using obsolete equipment.

In the world innovation rating Ukraine was the 88th in 2010; and in 2011 it went down lower than 90th; in the rating of competitiveness it was 89th. The low level of innovation activity in Ukraine is due to the following factors:

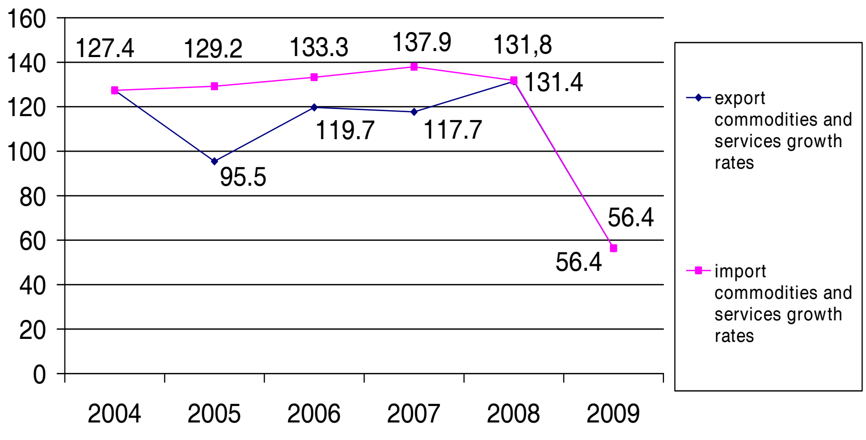
- Unstable economic situation;
- Costs of financing research and education are less than 1% of GDP and make 9.2 billion UAH. embodied in the state budget for 2011, while in the world, the figure is 2-3%;
- Imperfect legal framework;
- Lack of expertise and certification assessment and patent protection;
- Absence of management and marketing knowledge of most managers and researchers;
- Low level of interaction between enterprises and science;
- Organization own funds deficiency .

Overcoming the existing problems is possible under implementing the national innovative development policy. B. Geyets and B. Semynozhenko consider innovative component of the investment processes as the essential prerequisite for economic strategy development, which would give opportunity for Ukraine to take its worthy place in the global economy [2, 17].

Given the current state of development of Ukrainian economy and its desire to exit out of a deep crisis, as well as Ukraine's integration into the EU, we can conclude that innovations can be a driving force for improving competitiveness at domestic and international markets. The experience of industrialized countries can be an example of an innovation strategy increasing production volume and sales, improving productivity, increasing the circulation of capital invested, supplying high quality innovative products to the market. The range of products and technology of its production is being constantly updated and scientific and engineering developments for production-oriented innovations are being implemented. Thus, the fusion of science, technology and production takes place, creating parks, techno, business incubators, etc. For any country, there is a parameter - the coefficient of innovation implementation. This is the percentage of company profits, which is allocated for the modernization and new technology introduction. If it is below 15%, the enterprise is doomed to failure, although machinery and plant shops can be used for many years. The products of such companies are forced out from the market by foreign competitors. For Ukraine, the average implementation indicators does not exceed 5%, many enterprises are closed for this reason. Each State must pay great attention to innovative activity. Innovation is the weapon of competition in the XXI century.

Table 2.
Distribution of total innovation expenditure, % [5, 14]

Index	2008	2009
Internal research and development	8	8
External research	2,4	2,7
Purchasing of machinery, equipment and software	63,9	62,6
Acquisition of foreign knowledge	3,5	1,4
Other costs	22,2	25,3



Picture 7. The dynamics of foreign trade with EU [3, 14].

Export activities of Ukraine. Export potential is an integral part of the national economy. Its strategic role is to activate the existing and potential competitive advantages of economy of Ukraine in the international division of labor. It is a means of stable economic growth in Ukraine in comparison with developed countries.

Ukraine has a well developed industrial base and rich agricultural complex, and a lot of mineral resources for local use and export. The main exports from Ukraine are ferrous and non-ferrous metals, chemicals, machinery, fuel, petroleum products, transport equipment and food products. Currently, the country's GDP is estimated at 136.6 billion dollars. United States, major export partners are Russia, Germany, Italy, Turkey, the United States. Consider the basic indicators of the export potential of Ukraine for 2006-2010 years in the dynamics.

Table 3.
The dynamics of the Ukrainian export potential [14].

Index	2006	2007	2008	2009	2010
Foreign trade turnover (bln.dol.US.)	843,3	109,9	152,5	85,1	170,7
Exports of goods (bln.dol.US.)	38,3	49,2	67	39,7	116,3
Imports of goods (bln.dol.US.)	45	60,7	85,5	45,4	54,4
Balance (bln.dol.US.)	-6,7	-11,5	-16,9	-5,7	61,9
The coverage ratio of export over import	0,85	0,81	0,78	0,87	2,14

In 2009 the exports fell by 40% and the imports decreased by 47%, and the foreign trade turnover went down by 44% respectively. This decline is associated with the global financial and economic crisis. The coverage ratio of up to 2006 and after 2010 was more than 1 (positive trend), and from 2006 till 2009 less than 1 (negative trend), which means the country's dependence on imported goods and reduces the export potential of the region. Promising groups of Ukraine's exports are goods of vegetable origin, mineral products, chemicals and related industries, nonprecious metals and articles thereof, mechanical equipment.

Based on the analysis of export activity in Ukraine it has been determined the moral and technical wear of material and technical basis, which accounts for more than 50% materials consumption of production and the irrational pattern of export flows; debt of Ukrainian companies to foreign investors at the end of 2009 made up 6615.2 mln.dol.US (according to the State Statistics Service of Ukraine).

High risk of financial losses, unprofitable terms in export credit, export duties increase the cost of exports and thus lead to its decline, in comparison to the sale of goods at the domestic market.

On the Day of Unification of Ukraine (News RBC-Ukraine, 2011) V.Yanukovych stressed in his speech that Ukraine was threatened with gaining the status of "poor quality products and cheap raw materials market".

At the Ukrainian-Japanese Business Forum (18.01.2011) Viktor Yanukovych noted that the Government of Ukraine was "to solve hard but realistic problems" to reduce the tax burden on business, to reduce the licensing system. According to the approved program of economic reforms (2014) macroeconomic stability, growth of social standards, improving the business climate, structure of modernizing of basic sectors of the economy must be provided. Ukraine is working currently at the implementation of the economic reform program for 2010-2014. «A Prosperous society, a competitive economy, an effective government and the National Action Plan for 2011» will implement economic reform programs in the relevant directions [15].

The Ukrainian foreign trade turnover in 2008 was 170.7 bln.dol.US, that is 5 times more than in 2000. Due to the crisis in 2009 foreign trade turnover decreased by almost 2 times up to the level of 98.8 bln.dol.US. The foreign trade balance from 2000 till 2005 was positive and since 2006 it was negative, which indicate that import prevails over export.

Table 4.
Indices of the Ukrainian foreign trade [13].

Foreign economic indexes	2000	2004	2005	2006	2007	2008	2009
Export of goods and services, mln.dol.US	18059.3	37980.2	40363.1	45873.2	58237.2	78695.7	49223.6
Import of goods and services, mln.dol.US	15106.9	31054.6	39071.3	48846.9	61478.2	92003.3	50604.4
Economic openness, %	57.8	58.5	46.9	42.6	40.8	43.6	53.1
Import dependence, %	48.3	47.9	45.4	45.3	43.1	51.0	54.6
Balance of foreign trade, mln.dol.US	2952.4	6925.6	1291.8	-2973.7	-3241.0	-13307.6	-1380.0

Analyzing the indices of foreign trade of Ukraine for 2000-2009, a conclusion can be made that the economy of the country is characterized by high openness (53,1%) and the increase of import dependence on foreign producers (53,6%). This demonstrates the shortcomings of the state regulation of foreign trade conditions [2].

Developed countries export high-tech products, as for Ukraine, it exports about 40% of steel products and imports mineral products 32,8% (89% belong to the CIS countries) and about 14% of machinery and equipment.

For the national economies it is the international investment activity that defines the basic mechanisms of long-term economic growth. The Ukrainian need attracting foreign investments is due to 3 important reasons:

1)low investment activity of domestic producers;

2)technical and technological modernization of production and market and social systems; 3)the introduction of new management techniques, management and marketing.

The forecast of the inflow of investments in fixed capital in 2011-2015. Ukraine remains attractive for investment for foreign investors in the medium term (2011-2015). This is facilitated by the implementation of programs of public investment policy: 1)The adoption of the regulatory framework for public and private partnership in Ukraine; legislation on the use of natural resources, the concession activity, industrial parks; the clustering of Ukrainian economy in order to introduce new and to improve the existing instruments to attract investments in the economy; 2)Government support for innovation and investment projects implemented at the enterprises of aviation, space industry, defence industry, mechanical engineering, agriculture, energy, coal mining and construction industries through the cheaper system of loans; 3)The concentration of budget funds for the investment and infrastructure development aimed at contributing the weakening of inflationary indicators and supporting the demand of the domestic goods in manufacturing industry, the retention of the employment rate [3, 18].

Table 5.
Projected DFI volumes distributed from 2010 till 2015
(millions of dollars USA) [2, 13].

Index	2008	2009	2010	2011	2012	2013	2014	2015
	Forecast							
DFI (capital gains) according to the inertial (pessimistic) script	6073,7	4410,4	4500	5000	5500	6000	6500	7000
Dynamics of the change over the previous period, %			-	11,1	10	9,1	8,3	7,7
DFI (capital gains) according to the investment activity (optimistic script)	6073,7	4410,4	5000	5500	6000	6500	7000	7500
Dynamics of the change over the previous period, %			-	10	9,1	8,3	7,7	7,1

The main factors of the projected investment inflows:

- Improving Ukraine's place in the system of international popularity rating;
- Stable hryvnia exchange rate over the forecast period;
- Stabilization of the banking system;
- Overcoming the raise of inflation;
- Development of the insurance and capital markets;
- DFI inflow for the implementation of projects under the State program for the European Football Championship 2012 preparation and holding the finals [4].

According to the investment projects implemented in Ukraine on the 1d of January, 2011 (191 projects) the investments of 2044,0 mln.dol.US. were received (82,4% from the specified volumes). Ukrainian investors placed 1426,0 mln.dol.US. investments are (69,8% of total), foreign investors put – 618,0 mln.dol.US. (30,2%) [5, 14].

The biggest investment levels since the beginning of the projects realization are: - Germany -237,0 mln.dol.US. (38,3% of total DFI); - Cyprus - 62,2 mln.dol.US. (10,1%); - Japan – 44,9 mln.dol.US. (7,3%); - Poland - 43,6 mln.dol.US. (7,1%); - France - 29,6 mln.dol.US. (4,8%); - USA – 23,8 mln.dol.US. (3,9%); - Italy - 22,7 mln.dol.US. (3,7%); - New Zealand - 19,9 mln.dol.US. (3,2%) [17, 19].

Ukraine joining the WTO has increased the role of external economic factors. Under the conditions of Ukraine's exit from the crisis the gradual diversification of foreign economic activity, and the accelerated development of the industries producing final consumption goods are required.

Science and technology programs and projects related to the development, introduction and adaptation of complex technological systems in production can be accepted as a basis to contribute to the competitive product output.

Thus, in the context of the global crisis, under the pessimistic assessments of the economic situation in Ukraine, the only strong point is the high investment attractiveness of Ukraine for foreign investors.

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Iryna Lebid*

MANAGEMENT OF FOREIGN ECONOMIC ACTIVITY IN UKRAINE IN THE POST-CRISIS PERIOD: THE SEARCH FOR OPTIMAL STRATEGY

Although today it is believed that the main components of the crisis have already been overcome, but the question of post-crisis development is just put, while debate of sources of recovery, effective policy measures provoke new controversial questions, rather than provide appropriate responses. According to the prominent foreign and domestic researchers, the global crisis of 2007 – 2009 has strengthened the globalization processes, has accelerated the systematic changes in the global economy – the major developed countries and developing countries approach, new integration organizations form and strengthen, transnational corporations configuration and impact change. However, unexpectedness and depth of the crisis led to the dramatic view of factors and components of the global economy.

Yes, today it is no doubt that over the next two or three years a new configuration of world division of labor will be forming and this requires adequate domestic economic policy of the participating countries of the global economic environment formation.

Consequently, it can be said that global economic metamorphosis taking place in the modern world under crisis, causing extreme necessity in the diagnosis of foreign economic sector of Ukraine to form a strategy for its future development. Such necessity is dictated by the fact that the current economic processes dynamics in external markets and national transformation processes under crisis, determine the need to find the priorities of national foreign economic activity sector in the post-crisis context.

Among the economic priorities the raising of competitiveness of Ukrainian economy is often called. However, we can state that despite some positive developments, competitiveness remains low:

- the characteristic of Ukraine's economy is domination in the production structure of goods with low value-added, which are resource-intensive, with high power input;
- almost complete absence of competition in the domestic market, its small capacity, monopolization and overregulation do not allow to create appropriate conditions for the growth of competitiveness in general (if there is low competition in the domestic market, we can not expect to be competitive in the international markets);
- the share of Ukraine in most dynamic and high-tech markets is low (the high-tech goods export makes up less than 5% of total export of Ukraine);
- Ukraine export of insurance, financial and computer services is only 7-8% of total services export value;
- Forced (because of noncompetitiveness) reorientation of trade flows to the markets of Russia and CIS, which means new additional risks due to economic instability and low productivity of the eastern markets[1].

[1] Забезпечення фінансової стабільності в Україні в умовах посткризової економіки/За редакцією Я. В. Белінської. - К.: НІСД, 2011. - с.11. [Ensuring financial stability in Ukraine in the conditions of post-crisis economy / Edited by Ya.V. Belinska. – K.: NISD, 2011. – p. 11]

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Despite the fact that, according to international experts, the crisis may provide countries with transition economies with additional incentives to accelerate the transformations, improving economic structure, increasing its competitiveness and entry into new "niches" of global flows of goods and capital, today is extremely difficult to point for notable structural changes in Ukraine. Foreign economic sector analysis confirms the economic weakness of the country – laying-up of poor economic environment in which determining the structure of exports (which in fact can be a criterion of competitiveness) are industries and spheres with low value-added. Thus, in crisis 2009 year the metal industry has suffered most noticeable losses, but in 2010 with total goods exports ($ 36.4 billion) and its structure Ukraine, in fact, returned to the levels of 2007 – as previously, the foreign economic "niche" of Ukraine remains technologically low. At the same time maintaining low incomes did not allow to improve the structure of production by expanding consumer markets. That is, as for Ukraine, it can be said that the main factor of economic problems was and remains unreformed noncompetitive economy and its orientation to export raw materials and low-efficient markets. As a result, economic recovery in the world countries, and consequently the increase of foreign economic activity (for niches in the international division of labor recovery) led to significant deterioration of the new foreign economic indicators for Ukraine. Thus, in the first half-year of 2010 the foreign trade deficit amounted to 2 billion USD, and the current account balance was positive (+ 0.6 billion USD), then according to final results of the year past the trade deficit has already exceeded 5.4 billion USD (worsened by almost 3.5 billion USD), and the current account balance became deficit (- 0.7 billion USD (deterioration for 1.3 billion USD)[2].

This actualizes the issue of a new strategy of management of foreign economic activity, in which megatrends of world economic development in the post-crisis period as well as domestic realities of foreign economic sector functioning would have been treated. This strategy should aim not only eliminate the negative trends in the organization of Ukrainian businesses in global markets, but also be a kind of comprehensive restructuring of department of foreign economic sector.

So, today we can state that despite the presence of sufficiently significant basis for the active participation of domestic companies in the international economic relations, currently foreign economic activity of Ukraine in general may be characterized as ineffective.

Such facts as the lack of goods diversification of Ukrainian exports, focus mainly on commodities and products with low degree of processing (that makes Ukrainian exports strongly dependent on price fluctuations in global market) and a weak regional diversification of Ukrainian exports, orientation mainly on markets from countries with low development level, low level of technological development of Ukrainian exports and lack of competitiveness of Ukrainian products on international markets, inefficient strategies of Ukrainian companies entering global markets, ineffective tools of international marketing, etc. are in favor of this statement.

Therefore, to improve the efficiency of foreign economic activity in Ukraine and strengthen the competitive positions of domestic producers in the international markets, it was important to develop the multi-vector strategy of management of foreign economic activity with separation of individual levels and functional directions of its formation, and we have done it. In particular, three-level strategy of management of foreign economic activity in Ukraine was developed and proposed to implement. It is presented in Figure 1.

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[2] Юрчишин В. Пост-кризове економічне відновлення і перспективи для України//Василь Юрчишин [Електронний ресурс]. – Режим доступу : http://www.uceps.org/upload/yurchyshyn_post-crisis_agrg_2011.pdf [Yurchushun V. Post-crisis economic recovery and prospects for Ukraine // Vasyl Yurchyshyn [electronic resource]. – Mode to access: http://www.uceps.org/upload/yurchyshyn_post-crisis_agrg_2011.pdf]

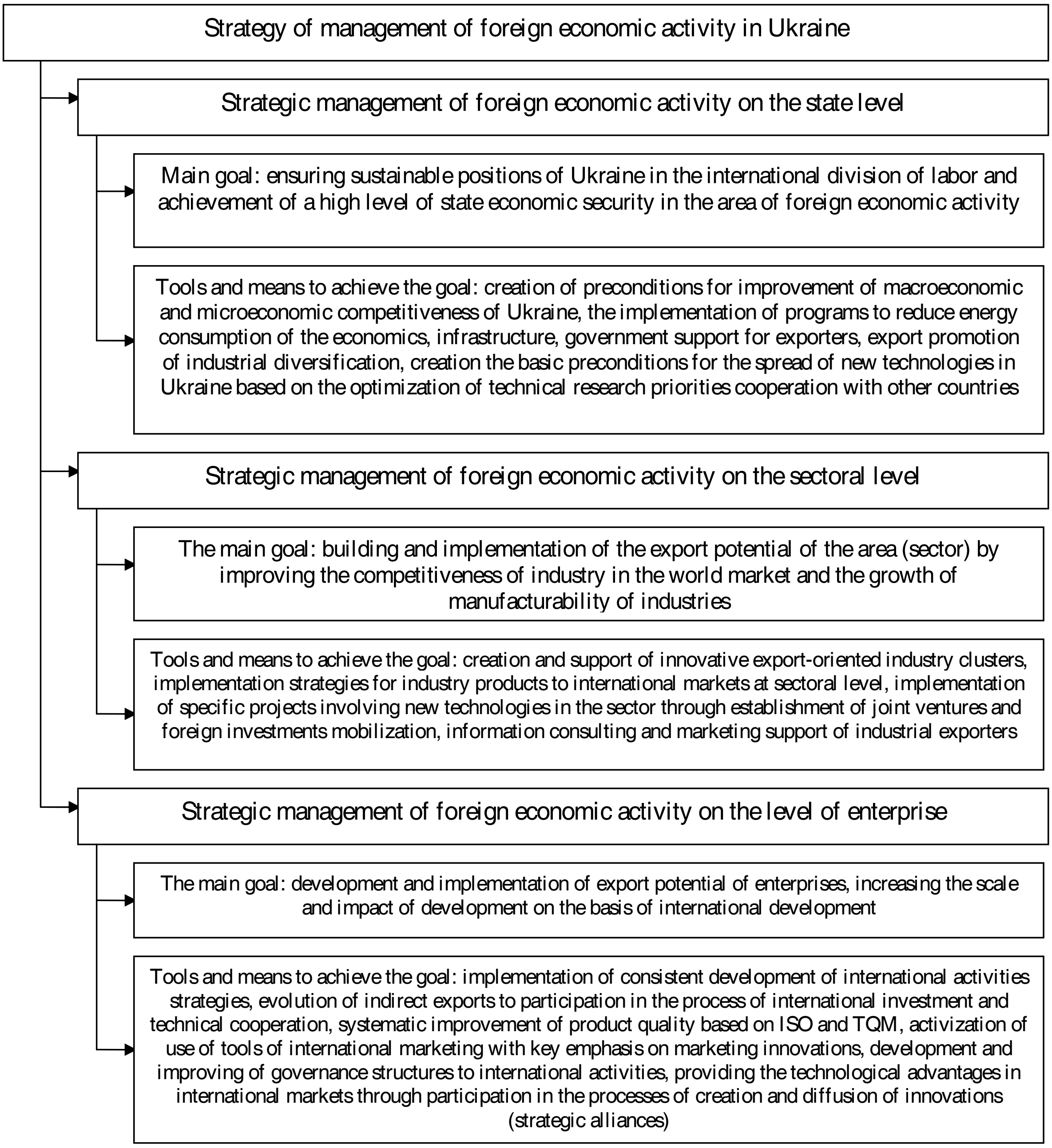

Figure 1. Three-level diagram of the strategy of management of foreign economic activity in Ukraine (developed by the author)

According to the presented diagram, the strategy of management of foreign economic activity in Ukraine shall be provided at 3 levels:

- state,
- sectoral,
- level of individual enterprises – participants of international economic activity.

The highest level of strategic management of foreign economic activity in Ukraine is the state level, where we identified as a strategic goal the need for stable position of Ukraine in the international division of labor and on this basis achievement of a high level of state economic security in the area of foreign economic activity. The means and tools to achieve the strategic goal at the state level are as follows:

- creation of infrastructure and macroeconomic conditions to increase the competitiveness of the economy of Ukraine (in particular, through continuous monitoring of Ukraine's position in the ranking of international competitiveness, which enables to identify key strengths and weaknesses of Ukraine in modern international competition);

- implementation of programs to reduce energy consumption of the national economy (especially in basic export industries – metallurgy, machine building and chemical industries) based on energy efficiency technologies;

- further development of export infrastructure and active government support of exporters (considerable emphasis should be done on supporting export-oriented enterprises of small and medium business);

- encouraging further diversification of the domestic export industries based on the definition of sectoral priorities in support of exporters (particularly through continuous monitoring of indices of competitiveness in the international market area (RCA), the dynamics of demand for the industry in global markets and strategic importance of the export sector to the national economy, which is counted in the proportion of industry in GDP);

- creation of the basic preconditions for the spread of new technologies in Ukraine based on the optimization of the priorities in the scientific and technical cooperation with other countries.

The main goal of strategic management of foreign economic activity in Ukraine at the state level is to create conditions for achieving a high level of external economic state security. Researches show that in the process of further integration of domestic economy in the world economic system, the problems to ensure sufficient level of external economic state security are becoming more relevant. We should note that external economic state security is to minimize the state's losses of the negative impact of foreign economic factors, creation of favorable conditions for economic development through its active participation in global division of labor, correspondence of foreign economic activity to national economic interests[3]. It should be noted that insufficient attention at the state level to the problems of external economic state security in the post-crisis period may have several adverse consequences for the domestic economy, including especially worthy to mention is fixing for Ukraine the global market niche of raw materials and semi-processed goods supplier, and vice versa – imported goods with high added value consumer, which in turn leads to significant deformation of foreign trade balance structure. It should also be mentioned that in the absence of a clear strategy of management of foreign economic activity of Ukraine at the state level, the processes of the loss of key markets for Ukrainian products (mainly talking about production engineering and aircraft industries) will continue to occur, which will be followed by further degradation of Ukrainian industry and decrease of its manufacturability.

Another problem of external economic security of Ukraine is the lack of product diversification and regional trade ties. In particular, foreign economic activity in Ukraine the geographical factor is critical, namely – excessive dependence on Russian supplies to Ukraine in certain strategically important goods (goods of critical imports) and energy resources, which in fact is a significant threat to the external economic security of Ukraine. The same applies to the factor of product diversification of exports and imports: excessive concentration of trade in specific commodities, increase Ukraine's dependence on external markets and promotes the transfer of risks to the international environment of the internal market of Ukraine. Thus, we can once again

[3] Економіка України на на шляху від депресії до зростання: джерела, важелі, інструменти / Я. А. Жаліло, Д. С. Покришка, Я. В. Белінська [та ін.]. – К.: НІСД, 2010. – с.41. [Economy of Ukraine on the path from depression to growth: sources, instruments, tools / Ya.A. Zhalilo, D. S. Pokryshka, Ya.V. Belinska [and others]. – K.: NISD, 2010. – p. 41]

highlight the critical importance of ensuring the security of Ukraine in the export sector, which in general causes tasks of its achievement as a priority strategy for managing foreign economic activities at the state level. At the same time studies show that despite the high level of liberalization of foreign economic activity in Ukraine achievement of the strategic objectives of public management is not currently provided, which, in accordance, creates significant external threat to Ukraine's security. Thus, domestic research scientists prove insufficient security of Ukraine in the foreign economic sphere, in particular proving such facts as: the negative balance of foreign trade of Ukraine, lack of coverage of imports and exports of high level of openness of the national economy (especially the negative impact of openness of economy of Ukraine was felt in the period 2008 – early 2009, during which the import to Ukraine volumes were the largest compared to 10 previous years) that in conditions of orientation of Ukrainian exports substantially increases the negative impact of situational risks of the world market on the Ukrainian economy and creates additional external threats to its security[4].

The next important factor of threats to the external economic security of Ukraine is Ukrainian unfavorable structure of foreign trade. Studies, represented in the national scientific literature, show that imbalanced structure of Ukrainian export and the substantial gap between Ukraine and the leading countries in supplying to the international market of high-tech exports production 4th, 5th and 6th classes of technology is nowadays one of the most significant development problems of foreign economic activity in Ukraine. We can note that one of the most effective mechanisms for implementing a comprehensive strategy of product diversification of foreign economic activity in Ukraine, focusing on the increase in the structure of supply the parts of high technology products to world markets, should be selective state support for exporters, formed on the basis of sectoral priorities for export development. It should be said that the special importance of diversification of export potential of Ukrainian enterprises, which involves optimization of its structure and improve manufacturability, came under the global economic crisis, which turned out that basic export industries – metallurgy and chemical industry – are extremely vulnerable. This experience of foreign trade activities with developing countries (especially such as China, India, Brazil, Singapore, South Korea, Mexico, etc.) indicates that this application of strategy and regional commodity export diversification has provided the foundation of their economic growth and strengthen of competitive positions of their national producers in international markets[5].

In our opinion, in determining the strategic priorities of export support to specific sectors it can be appropriate to use the revealed comparative advantage index (RCA), which is used by a sector of market analysis of the International Trade Centre UNCTAD. Thus, in the Table 1 the calculated value of revealed comparative advantage RCA for the major export sectors in Ukraine in 2010 is presented.

The estimation made allow us to select 3 groups of sectors (industries) depending on the index of revealed comparative advantage RCA:

- the first group includes sectors with the highest revealed comparative advantage RCA – the so-called basic export sectors – the ferrous and nonferrous metallurgy (RCA index value is 40.2) and the production of agriculture sector (RCA is 13.5);

[4] Економіка України на шляху від депресії до зростання: джерела, важелі, інструменти / Я. А. Жаліло, Д. С. Покришка, Я. В. Белінська [та ін.]. – К.: НІСД, 2010. – с.43-44. [Economy of Ukraine on the path from depression to growth: sources, instruments, tools / Ya.A. Zhalilo, D. S. Pokryshka, Ya.V. Belinska [and others]. – K.: NISD, 2010. – p. 43-44]

[5] Белінська Я.В. Державна підтримка експорту: зарубіжний досвід та уроки для України // Стратегічні пріоритети. – 2008. – № 3(8). – С. 128. [Belinska Ya.V. State support of export: international experience and lessons for Ukraine // Strategic Priorities. – 2008. – #3 (8). - p. 128].

- the second group includes sectors with high levels of revealed comparative advantage RCA, primarily concerned light industry – namely, commodity group 62 "production of garments and textiles", the index of RCA for which is 10.4. Also significant level of comparative competitive advantages can be seen for the technological machinery industries, in particular – the sphere of mechanical equipment, machinery is set at 5.8 RCA. Among subgroups of products of the industry product group 86 "railway locomotives and rolling stock, trams" has index RCA 6.37, product group 89 "ships, boats and other crafts" has index RCA 3.19, product group 88 "aircraft, space apparatus and their parts" with the index of RCA at 2.40;
- the third group includes sectors with low revealed comparative advantage RCA. Estimates show that the lowest level of international competitiveness of domestic products are marked as products of fuel and energy complex, high-tech products industries with high added value, pharmaceutical products, pharmaceuticals, electrical machinery.

Table 1

The value of indexes of revealed comparative advantage RCA for major export sectors in Ukraine in 2010[6]

#	Categories of goods	Revealed comparative advantage RCA
1	Production of agricultural sector	13-Тра
2	Mineral raw materials	4-Сер
3	Metallurgical products	40.2
4	Chemical products	9-Лип
5	Pharmaceutical products	2-Січ
6	Mechanical equipment, machinery	5-Сер
7	Telecommunication equipment	0.7
8	Electronic devices	6-Сер
9	Computer technologies	1-Тра
10	Integrated circuits and electronic components	3-Кві
11	Textiles and clothing	10-Кві

Note that one of the measures aimed at ensuring sustainable Ukraine's position in the international division of labor and to achieve a high level of economic security in the external field should be measures to create macroeconomic conditions and infrastructure to improve the competitiveness of Ukraine's economy. Thus, according to Global Competitiveness Report in 2010, Ukraine won the 70th position as compared with 72nd position in 2009 (with 136 possible). According to the rating results, Ukraine has a worse position in comparison with such countries as Lithuania (40th position), Latvia (43rd place), Hungary (46th position), Poland (49th position), Croatia (56th position), Russia (57th position). According to interim results of the international competitiveness ranking of the countries, relative macroeconomic and infrastructure strengths in Ukraine should be included quality of railway infrastructure (30th position in the world), state debt (26th position in the world), the quality of primary education (50th and position in the world), access to higher education (18th position in the world), the quality of mathematics and science education (46th position in the world), the quality of the education system (49th position in the world), the practice of hiring and firing (16th position in the world), the cost of dismissal of staff (19th position in the world), the ratio of productivity to wages (28th position in the world), control over international distribution (46th position in the world) ability to innovate (40th position in the world)[7].

[6] Забезпечення фінансової стабільності в Україні в умовах посткризової економіки/За редакцією Я. В. Белінської. - К.: НІСД, 2011. - с.15. [Ensuring financial stability in Ukraine in the conditions of post-crisis economy / Edited by Ya.V. Belinska. – K.: NISD, 2011. – p. 15].

[7] Забезпечення фінансової стабільності в Україні в умовах посткризової економіки/За редакцією Я. В. Белінської. - К.: НІСД, 2011. - с.19-20. [Ensuring financial stability in Ukraine in the conditions of post-crisis economy / Edited by Ya.V. Belinska. – K.: NISD, 2011. – p. 19-20]

Thus, based on the study of Ukraine's advantages in international competition, it is possible to say that the competitive position of domestic producers in the international markets in the strategic plan can be based on 2 main factors:

- firstly – first and foremost the basis of competitive advantages of domestic producers in the international markets will create a factor of lower personnel costs at a relatively high level of its performance;
- secondly – Ukrainian producers a competitive advantage in international markets may be formed due to such factors as high intellectual potential and ability of organizations to change. Formation of competitive advantage contributes to overall high level and quality of special education in Ukraine, highly creative and intellectual potential of Ukrainian workers and high capacity for innovation.

However, despite the presence of a number of competitive advantages in Ukraine, Ukraine by the most competitive factors is behind of not only developed countries but also the developing countries as a whole and causes the outsider position of Ukraine in the international division of labor. Thus, among the major deficiencies in the formation of macro-economic competitiveness of Ukraine, it is necessary to include high trade barriers, a significant tax burden on business, restrictions on movement of capital, low efficiency of anti-monopoly policy, poor quality of road and air infrastructure and low professionalism of senior managers, combined with further "brain drain". Thus we can say that the poor quality of infrastructure and institutions is a key factor of low competitiveness of Ukraine. World experience shows that practically all the leaders have such highly developed elements of foreign infrastructure as: an open market economy, free pricing, low customs barriers, competitive market environment, prevalence of private property and its defense, effective tax administration, tax system, controlled taxpayers through representative of democratic institutions, effective government organizations with low levels of corruption, transparent public financial institutions and democratic political system with a high level of political competition, reliable mechanisms of control over the state and bureaucracy, strict observance of laws by citizens, independent judicial system that is trusted by citizens, strong system of law enforcement and enforcement of judgments, minimum gap between formal and informal norms of social behavior.

We should note that very important step in implementing the strategy at the state level of international competitiveness recovery is the strategy of strengthening the competitive position of Ukrainian enterprises through reduction of energy consumption of their production processes. Significant impact on production costs makes energy consumption rate of GDP as a whole, and individual sectors. During the past 30 years, the industry of the developed countries is characterized by a gradual decrease in energy consumption, the global energy crisis in 1973 gave the impetus to this. As a result of developing and implementing strategies for reducing energy consumption in key industries, the energy intensity unit of GDP in developed countries fell from 57% to 35%. However, by the opposite trend is typical for Ukraine and for the past 20 years energy intensity of Ukraine's GDP increased by 31% and industrial production – by 39%[8]. Currently, an important area of improvement of energy intensity level of industrial production in Ukraine according to this basis and strengthening of the competitive position of Ukrainian producers in the international markets is the "Energy Efficiency Economy Program through Innovation for 2010 – 2014", designed by the State Agency of Ukraine for Investments and Innovations in 2009. The program aims to:

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[8] Економіка України на шляху від депресії до зростання: джерела, важелі, інструменти / Я. А. Жаліло, Д. С. Покришка, Я. В. Белінська [та ін.]. – К.: НІСД, 2010. – с.57. [Economy of Ukraine on the path from depression to growth: sources, instruments, tools / Ya.A. Zhalilo, D. S. Pokryshka, Ya.V. Belinska [and others]. – K.: NISD, 2010. – p. 57]

- create the favorable conditions for sustainable reduction of energy intensity of GDP, efficiency and natural energy resources of national economic competitiveness by supporting investment and innovation projects on energy efficiency and energy conservation;
- create of institutional framework for the development of appropriate infrastructure innovation and creation of favorable investment and innovative environment (support of production of new (scientific) knowledge and its commercial use);
- introduce and implement energy saving and energy efficient technologies in accordance with the priorities for innovation, support for innovative business activity in energy conservation and energy efficiency.

Implementation of this Program will allow to introduce new efficient technologies and equipment, primarily in the basic and priority sectors, will reduce the amount of energy resources, natural resources, water and increase the use of alternative and renewable energy in the production of goods and services; enhance energy security of Ukraine by reducing the rate of GDP energy intensity approaching to the level of developed countries of the world. Ultimately the achievement of intermediate objectives of the power efficient economy of Ukraine program is oriented on providing the basic goal – to increase the level of international competitiveness of national economy on this basis[9].

The second level of foreign economic activity in Ukraine is the level of basic industries (which have the greatest export potential), the main goal of strategic management at the sectoral level of foreign economic activity is increasing and further realization of export potential of the area, the foundation for which is the systematic improvement of the competitiveness of industry in the world market and increase its level of technological development. We have determined the means and tools to achieve strategic goals in the management of international management at branch level, they are as follows:

- initiating and activation of programs of legal, financial and informational support of the innovative export-oriented industry clusters. These measures, in our view, will create a foundation for successful implementation in key export sectors of Ukrainian industry cluster development concept, which is now recognized as key to achieve competitive advantages of domestic producers in world markets;
- implementation the strategies of industry products promotion to international markets, which includes the development and implementation of effective mechanisms to support industrial exporters in their quest to enter to world markets on branch level;
- implementation of specific projects involving new technologies in the industry through joint ventures and foreign investments. Successful application of these measures first requires a clear recognition as a priority in attracting foreign direct investment to areas of the 4th (mechanical engineering, first of all), 5th (electrical and electronics industry, aviation and pharmaceutical industries) and 6th (micro and nano) technological lifestyles. We can determine that the main priority in attracting FDI – investment in the form of new technologies and equipment, technology, product and management know-how;
- comprehensive information and advice, and marketing support to industrial exporters.

Our point of view is that the key focus in the formation of effective strategies for managing foreign economic activity in Ukraine at the branch level should focus on creating internationally competitive industry clusters, as how shows the international experience, the cluster model

[9] Галузева програма енергоефективності економіки шляхом впровадження інновацій на 2010-2014 роки./ [Електронний ресурс]. – Режим доступу: www.in.gov.ua/index.php?get=497 [Branch program of the economy energy efficiency through innovation for 2010 – 2014. / [electronic resource]. – Mode of access: www.in.gov.ua/index.php?get=497]

of branch systems, with emphasis on new technologies and innovations becomes effective mechanism for increasing the international competitiveness of national producers. Studies have shown that very important task for national economies in the global economic system is to mobilize all resources to increase competitive advantages in the world markets. To achieve this, most of the world uses the cluster model of production, for which, in turn, developed and implemented strategies and programs for economy clustering[10].

The most important feature of industrial clusters is their high competitiveness in the global market, which in turn is achieved by 3 major factors – namely, improving productivity of enterprises and industries cluster, creating the preconditions for innovative development of enterprise clusters and promotion the formation of new business, which supports diffusion of innovation processes and provides the further technological development of a cluster (Figure 2).

Analysis of existing national research on cluster development convincingly shows that Ukraine has considerable potential for clustering, i.e. the stable functioning of the system of interconnected clusters across industries, including important export industries such as machine building, instrument engineering, chemical and light industries, bio- and nanotechnologies to create new materials, information technologies, development of agricultural sector development and food industry. Thus we can state that in point of view, the cluster development of export industries must become the dominant way to build a modern innovation and competitive domestic economy.

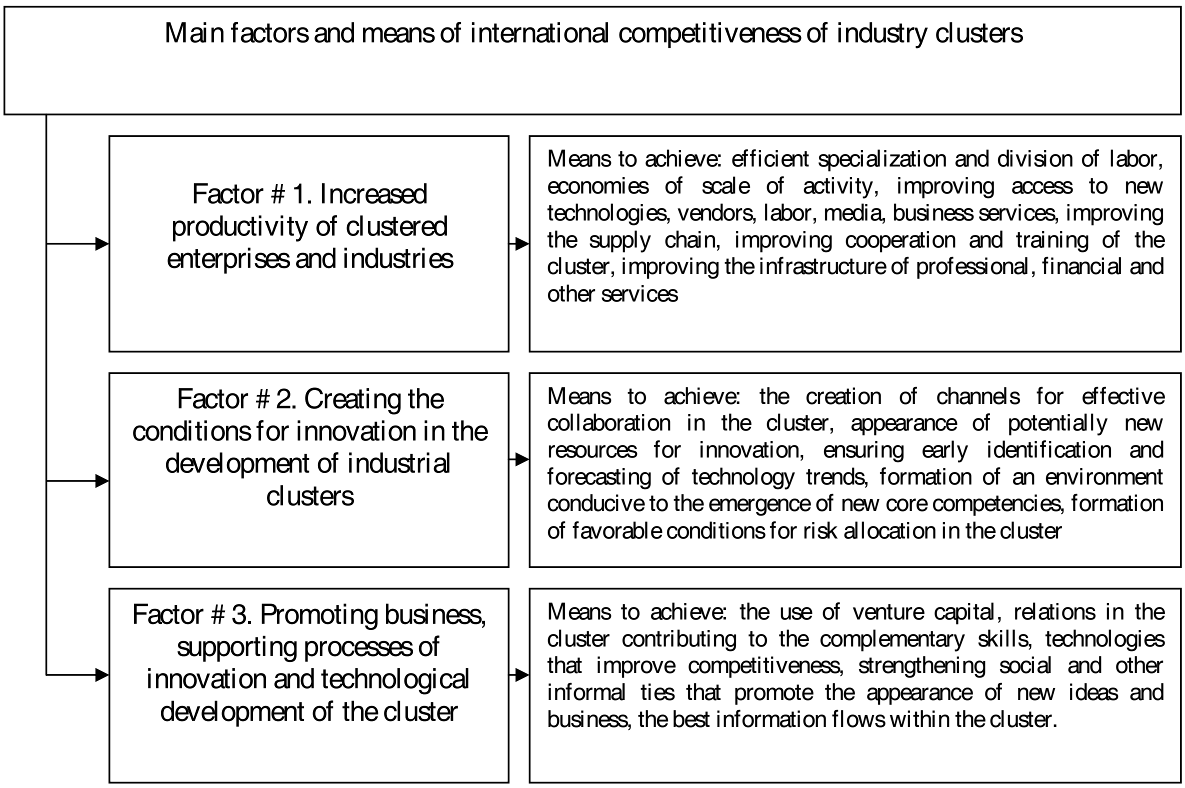

Figure 2. Main factors creating competitive advantages of industry clusters in the world market (developed by the author)

The second level of priority element of the strategic management of foreign economic activity in Ukraine at the sectoral level is the comprehensive strategy for promoting industry products to international markets and providing information and advice, and marketing support for

[10] Глазьев С.Ю. Выход из кризиса. Возможные сценарии развития/ [Електронний ресурс]. – Режим доступу : http://www.netda.ru/slovo/krizis1.htm. [Glaziev S.Yu. Way out of the crisis. Possible ways of development / [electronic resource]. – Mode of access: http://www.netda.ru/slovo/krizis1.htm]

key industry exporters. The flowchart of the product strategy for promoting the industry product to the international markets, that we recommend to introduce, is as follows (Figure 3).

According to our recommendations, the strategy to promote Ukrainian goods on the international markets at the branch level is implemented in 4 basic steps:

- the first stage in the process of forming a strategy to promote the industry product of Ukraine to the world market provides for a comprehensive study of the conditions, factors and trends in the development of the field operation environment at the global level, which in turn will set the key factors that makes positive or negative impact on the prospects of Ukrainian sectoral products and companies of the sector in the international markets;
- the second stage of the formation of the strategy promoting the Ukrainian sectoral product to the world market process, according to the structural logical diagram, developed by the author, is the determination of the product groups and industry sector companies, which have the greatest potential of competitiveness and most likely can take a strong position in the global market. The main goal of this stage in the sectoral strategy of promotion to international markets is the optimization of product and corporate structure of the international development of the global market;
- the third step in the strategy of promoting the Ukrainian sectoral product to the world market is the development of sectoral strategies to promote key product groups and companies to the international markets. This stage in the implementation of the sector strategy involves identifying the major competitors of national industrial producers of Ukraine in key foreign markets, evaluation of their strengths and weaknesses in competition and development on this basis of the optimal positioning strategy and product promotion of the sector to the world market;
- the final stage in the development strategy of promoting the Ukrainian sectoral product to the world market is to implement a marketing program to promote industry products to the international markets, the main emphasis should be made on activities such as promotion of industry products to the international market by opening the sectoral foreign missions on the key markets, information and promotional support for sectoral product promotion in global markets through participation in organizing the international exhibitions, formation of common marketing channels of Ukrainian industrial exporters in the key foreign markets and advertising information activities to create a positive image of the sectoral production of Ukraine in the world market.

The third level of the strategic management of foreign economic activity is the level of specific domestic companies which act as subjects of international economic activity. The main objective of strategic management of international management at the level of individual economic enterprises is active development and realization of export potential of enterprises, promotion of the growth of the scale and impact of their activities on foreign markets. The means and tools to achieve strategic goals in the management of foreign economic activity at the level of individual enterprises are as follows:

- implementation of a coherent strategy of international activity that involves the evolution of forms of Ukrainian companies penetration – from simple models of indirect exports (which, as researched have demonstrated, is currently still the main variant of the strategies of domestic companies to penetrate overseas markets) to complex models of the international network companies that have diversified manufacturing assets abroad and broad participation in the programs of international technological cooperation (international cooperation and strategic alliances);
- systematic improvement of quality and competitiveness of Ukrainian companies that provide programmatic certification standards of the ISO family and implementing effective quality management systems based on TQM;

- intensification of the use of instruments of international marketing in Ukrainian companies in the world markets, which involves the application of effective procedures to filter the international markets and reasonable selection of the most appropriate target segments based on set of criteria. An important emphasis in complex international marketing of Ukrainian companies in the international markets should be made on the construction of marketing commodity policy based on innovation, which in turn requires the development of mechanisms for planning and management of new products to the needs of international the markets;
- dynamic development of organizational structures of international activities of the Ukrainian companies, which includes continuous improvement of management systems of foreign economic activity of the enterprises, gradual shift from functional management structure of foreign economic activities (with the application of the models of direct and indirect exports) to divisional structures with construction on the product or regional principle (at transferring to models of joint enterprise or foreign direct investment) with the continued evolution and complication of foreign economic activity of Ukrainian companies provided the transition from divisional management structures to the project and matrix organizational structures;
- providing with the technological advantages in the international markets through participation in the processes of creation and diffusion of innovation through participation in projects of international technical cooperation (particularly in the technology of international strategic alliances).

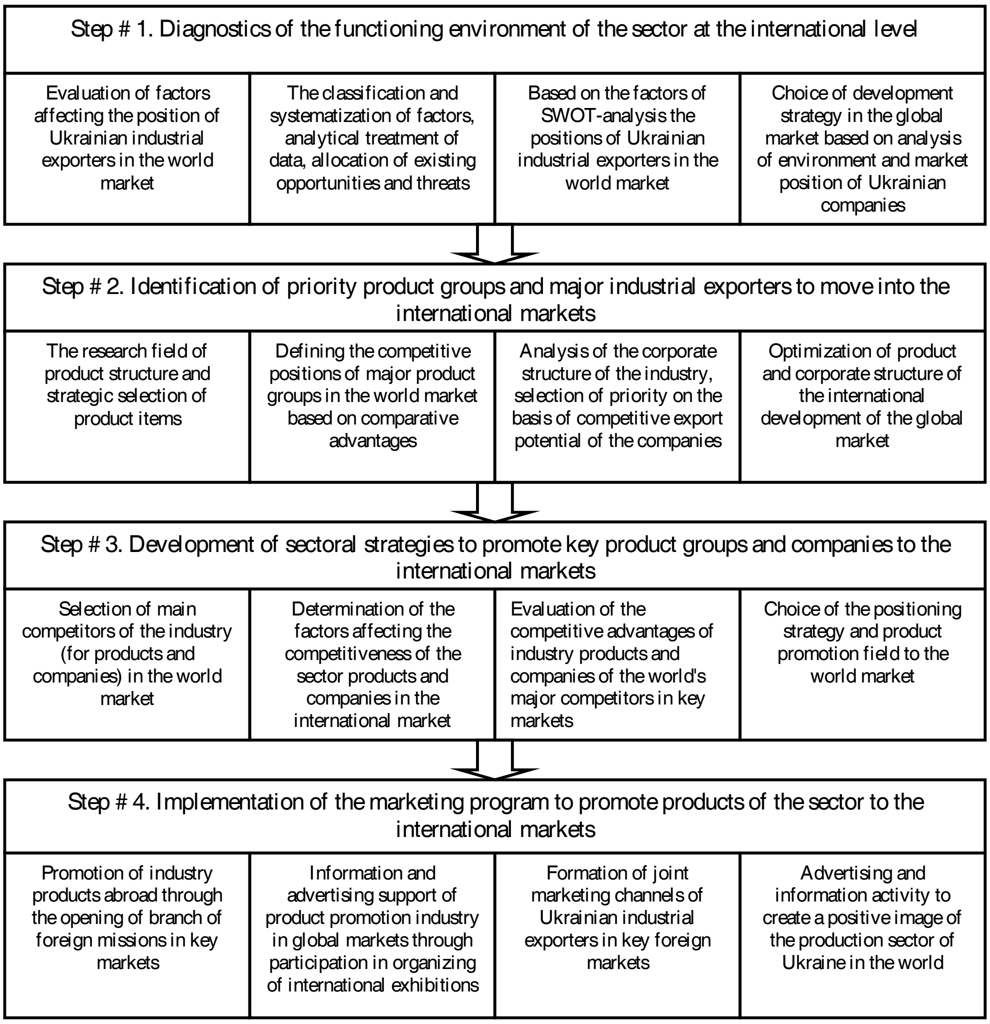

Figure 3. The flowchart of the strategy to promote Ukrainian products and companies in the international markets at the sectoral level (developed by the author)

As a result of our research we can draw certain conclusions. Today Ukraine is still trying to cope with global economic crisis that has which covered almost all areas of the state life. The improvement of macroeconomic indicators in 2010 still does not give us the reasons to talk about the way out of crisis and new phase of economic growth. Restoring of the economic growth is provided mainly to improve conditions for Ukraine's traditional export markets. Thus, certain macroeconomic stabilization under long preservation of the structural imbalances of the domestic economy does not give us the reasons to make conclusions of securing it from potential financial and economic shocks in the near future, the complex of problems that pose risks of crisis recovery remains unsettled.

Considerable depth of lesion of the economy of Ukraine by the global financial and economic crisis demonstrated the need for modification of Ukraine's participation in the international division of labor in order to strengthen resistance to fluctuations of world markets and greater use of national resources potential. Analysis showed that the structure of Ukrainian exports is characterized by a large share of raw material orientation and low value added, which exhausts the domestic resource base and makes the economy extremely vulnerable to external shocks. Taking into account changes in the international division of labor, because of the global financial crisis, there is a need for concentration of activities within the strategy of foreign economic activity, determining the strategic guidelines for the functioning of domestic enterprises in the world markets. The goals of the strategy should be the strengthening the role of Ukraine in the international division of labor and promotion of competitiveness of national exports in the world markets. We should also mention that the post-transformational changes which are occurring in the global economy and are accompanied by replacement of the dominant class of technology, open possibilities for economic growth. It requires that countries try to enter the postindustrial trajectory, the concentration of resources and government support for increasing the competitiveness of industries with high added value and to formation of the key industries of new technologies.

In this study we developed and offered to implement 3-level system of strategic management of foreign economic activity that involves developing the strategy at state, sectoral and microeconomic levels. It is necessary mention that the implementation of the strategy of foreign economic activities at state and sectoral levels forms the basic preconditions for international competitiveness and external capacity of domestic producers. In turn, the practical realization of foreign economic potential of Ukraine is carried out at the level of foreign economic entities, thereby actualizing this field of research as the formation of effective strategic management of international activities of the Ukrainian companies at the microeconomic level. When implementing this strategy Ukraine has a chance not only to minimize the negative impact of economic recession but also provide resistance to new management challenges of the global economy and join the cohort of the most dynamically developing countries that have energetic processes of post-crisis recovery.

Maryna Petrenko*

CRISIS ON THE WORLD DERIVATIVES MARKET

The main aim of this research is to analyse the global derivatives market, its current trends, volumes and prospects. We study the influence of derivatives on the world financial market, as one of its main and fast-developing parts, and mainly the correlation with the modern global financial crisis. We investigate the influence of trends of financial globalization on the international securities market.

Основною метою даного дослідження є аналіз світового ринку похідних, його поточних тенденцій, обсягів торгівлі та перспектив. У статті вивчається вплив похідних цінних паперів на світовий фінансовий ринок, в якості однієї з основних і динамічно розвиваючихся частин, і в основному кореляція із сучасною світовою фінансовою кризою. Ми досліджуємо вплив тенденцій фінансової глобалізації на міжнародний ринок цінних паперів.

Keywords: derivatives, world financial crisis, investors, trading, futures, options.

Over the last ten years, the development of derivative trading was very impressive. Volumes increased 7.8 times and grew even more rapidly than volumes on cash markets, especially between 2003 and 2007, when equity markets were bullish. The highest growth rate was observed for equity derivatives: volumes increased 13.5 times between 1998 and 2008 and in 2008 they accounted for 69% of the derivative trading volumes against 40% in 1998. The growth of equity derivatives has been stronger than the one of cash equity markets. The other products, namely interest rate, currency and commodity derivatives, also experienced rapid growth during this period: they grew respectively 5.7, 4.9 and 7.8 times. In the last ten years, the industry of stock exchanges saw many changes. So in this article we will turn our attention to crisis tendencies connected with derivatives [8].

General growth

All groups of products (defined by their underlyings) showed an increase in their trading volumes between 1998 and 2008. The smallest increase observed was for interest rate products with volumes increasing 3.6 times, while stock index options and futures showed the largest rise with volumes increasing 17 times. Part of the growth recorded for index derivatives is due to the tremendous success of KOSPI 200 options. 3.9 billion options on the KOSPI 200 index were traded in 2008, representing two thirds of the global volumes recorded by all derivative exchanges. Even though the notional value of individual KOSPI 200 options is lower than the average notional value of index options traded on other exchanges, the Korea Exchange also dominates in terms of the overall notional value traded. The case of KOSPI 200 options is so specific that it raises statistical difficulties. Therefore, we decided to present both figures, includ-

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ing and excluding the Korea Exchange when necessary [10]. When KOSPI 200 options are excluded, the growth of equity index derivatives appeared to be parallel to that of individual equity derivatives: both segments of the market show volumes traded increased eleven times, a growth that is lower than KOSPI 200 options, although it remains considerable.

Contribution of new exchanges

The following table shows the respective contributions to the overall growth of exchanges already offering in 1998 a given group of products on the one hand, and of exchanges newly offering these products on the other.

Table 1:
Contribution of existing and new exchanges to the growth of derivative trading
(millions of contracts traded)

Contribution of existing and new exchanges to the growth of derivative trading *(millions of contracts traded)*						
	Equity options	Equity futures	Index options	Index futures	LTIR options	LTIR futures
(1) Vol. in 1998	623	-	196	172	75	421
(2) Add. trading 2008/1998: (3) + (4) - (5)	3 745	1 059	3 881	2 114	96	900
(3) Of which ex. already present in 98	*2 541*	-	*3 613*	*1 819*	*108*	*884*
(4) Of which new exchanges	*1 204*	*1 059*	*268*	*295*	*0*	*20*
(5) Of which ex. that exit the market	-	-	-	-	*12*	*4*
(6) Vol. in 2008: (1) + (2)	4 368	1 059	4 077	2 286	171	1 322
Number of exchanges active in that market						
Number of exchanges in 1998	26	0	47	44	18	29
Number of exchanges in 2008	27	19	30	30	7	16

Equity options was the group of products with the largest volume of trading in 1998 and they were still in top position ten years later, in 2008. It is also for that group of products that new exchanges, which either did not exist in 1998 or included equity options in their offer between 1998 and 2008, contributed the most to the growth: of the 3.8 billion additional contracts recorded in 2008 as compared to 1998, one third were traded on new exchanges when compared to 1998. The largest is the International Securities Exchange founded in 2000 and where almost one billion equity options were traded in 2008. 27 exchanges offered equity options in 2008, close to the 26 exchanges already present in 1998. However, behind the stability of the number of exchanges, only 18 of them existed in 1998: the eight new exchanges were offset by the nine exchanges that exited the market or were integrated within groups of exchanges (such as NYSE Euronext). Equity futures show a very different picture, as they did not exist in 1998. This group of products is new for all 19 exchanges present in this segment.

Index options are the products that showed the most growth, with a contract volume increasing 21 times between 1998 and 2008. Here, new entrants contributed no more than 7% to the overall growth. However, a single player, the Korea Exchange is the main contributor responsible for the increase in the number of contracts to 3.9 billion (2.7 billion more options traded on the KOSPI 200 index in 2008 than in 1998). The Korea Exchange accounted for 16% of global volumes in 1998, and more than two thirds in 2008. Excluding Korea, the contribution of new entrants would represent 23% of the growth. Index options are the most frequently listed products in the world with 30 exchanges including them in their offer. Nine new exchanges appeared in this segment, the largest in 2008 being the National Stock Exchange of India. However, the consolidation of the industry reduced from 47 to 30 the number of exchanges recording trading volumes in 2008.

Volumes of index futures increased 13 times between 1998 and 2008. The contribution of new exchanges is of the same order of magnitude as for index options. But the contribution of exchanges already present in 1998 was lower for index futures (2.1 billion contracts) than for index options (3.9 billion contracts). The average size of index futures contracts is higher than that of index options, and the overall notional value of traded index futures was 10% higher than that of index options. Finally, there were as many exchanges offering index futures (30) as index options in 2008. However, both lists of exchanges are not completely identical: reflecting the split of jurisdictions between options and futures, four US exchanges list index options without listing index futures. Symmetrically, four relatively small exchanges are present in the index futures segment, and not on the index options, the largest being the Turkish Derivatives Exchange (40 million contracts in 2008).

Finally, the long term interest rate segment could be considered as a more mature segment, although the number of options traded doubled while the number of futures traded tripled, reflecting an industry that was still growing, at least until 2007. All exchanges active on LTIR options in 2008 already existed in 1998 and the recorded volumes are the smallest among all groups of products. The number of exchanges offering LTIR options decreased from 18 in 1998 to 7 in 2008. The withdrawal of exchanges from this market had little impact (negative 12 million) contracts on the global activity in this group of products. In other words, those exchanges already recorded low volumes in 1998. The number of exchanges offering LTIR futures also decreased, from 29 to 16 in the last ten years. Six new exchanges introduced LTIR futures contracts in their offer (the largest volumes being recorded by the Korea Exchange in 2008), but nine other exchanges with relatively low levels in 1998 withdrew. However, it should be noted that the size of LTIR contracts is much higher than that of equity-linked derivatives. As a result, LTIR options record the highest notional value of trading among all groups of products (280 000 billion US dollars in 2008).

Regional developments

The main region that contributed to the growth of equity options over the last ten years was the Americas, and more specifically the United States. The Americas increased their dominance at the expense of the Europe, Africa, Middle East region. Part of this trend can be explained by the growth of ETF options in the United States, products that, in many instances, are substitutes for index options: if ETF options were not taken into account, the relative weight of the Americas in global equity option trading would be 80% instead of 83%. The Asia Pacific region grew at a pace similar to that of the Americas but starting from a much lower level (see in Table 2). The main contributors to growth in that region were Hong Kong Exchanges. In Europe, the Compound Annual Growth Rate (CAGR) was not as strong as in the other two regions, but it was still high (14%). The main contributor to growth was Eurex.

Table 2:
Stock options volumes (millions of traded contracts)

Stock options volumes *(millions of traded contracts)*					
	Volumes traded in 1998	Volumes traded in 2008	Compound Annual Growth Rate (CAGR)	Regional breakdown in 1998	Regional breakdown in 2008
Americas	439	3646	24%	70%	83%
Asia Pacific	10	84	23%	2%	2%
Europe, Africa, Middle East	174	638	14%	28%	15%
Total	**623**	**4 368**	**21%**	**100%**	**100%**

[9]

The most striking phenomenon when we look at the development of index options is the sharp increase of Asia through KOSPI 200 options in Korea, which allowed the Asia pacific region to represent three-quarter of global volumes (refer to Table 3).

Table 3:
Index options volumes (millions of traded contracts)

Index options volumes *(millions of traded contracts)*					
	Volumes traded in 1998	Volumes traded in 2008	Compound Annual Growth Rate (CAGR)	Regional breakdown in 1998	Regional breakdown in 2008
Americas	75	310	15%	38%	8%
Asia Pacific	40	3057	54%	20%	75%
Europe, Africa, Middle East	81	710	24%	41%	17%
Total	**196**	**4 077**	**35%**	**100%**	**100%**

If the Korean figures are removed then the Asia Pacific region is still the one with the highest growth rate by far (look at Table 4). Asia has almost caught up with Americas thanks to the tremendous growth of the National Stock Exchange of India and of TAIFEX in Taiwan. However, as mentioned above, part of the decrease in the United States market share in index options is offset by the growth of ETF options in that country. In Europe, the CAGR has also been very strong over the last ten years. The growth in Europe was mainly driven by the Dow Jones STOXX 50 options traded on Eurex, where 84% of the European index options were traded in 2008.

Table 4:
Index options volumes, excluding Korea (millions of traded contracts)

Index options volumes, excluding Korea *(millions of traded contracts)*					
	Volumes traded in 1998	Volumes traded in 2008	Compound Annual Growth Rate (CAGR)	Regional breakdown in 1998	Regional breakdown in 2008
Americas	75	310	15%	46%	24%
Asia Pacific	8	290	44%	5%	22%
Europe, Africa, Middle East	81	710	24%	50%	54%
Total	**164**	**1 311**	**23%**	**100%**	**100%**

Index options trading also increased rapidly in Europe.

Index futures trading developed in all the geographical zones. The most rapid growth was recorded in the Americas, where the CME Group maintains an overwhelming domination following the merger with CBOT. The two other regions grew at a similar and rapid pace. The main contribution to growth came from Eurex in Europe and from the National Stock Exchange of India and Osaka Stock Exchange in Asia (see in Table 5).

Table 5:
Index futures volumes (millions of traded contracts)

Index futures volumes *(millions of traded contracts)*					
	Volumes traded in 1998	Volumes traded in 2008	Compound Annual Growth Rate (CAGR)	Regional breakdown in 1998	Regional breakdown in 2008
Americas	53	941	33%	31%	41%
Asia Pacific	49	583	28%	29%	26%
Europe, Africa, Middle East	70	761	27%	41%	33%
Total	**172**	**2 286**	**29%**	**100%**	**100%**

LTIR derivative trading grew slower than equity-linked products in the last ten years. It remains marginal in Asia, where only two exchanges, the Tokyo Stock Exchange and the Australian Securities Exchange, still include LTIR options in their offer.

In Europe the concentration process has been dramatic: 16 exchanges active in LTIR options trading in 1998 were replaced by only one in 2008 (Eurex). This trend has been accompanied, or was the result of a concentration of trading on derivatives with German underlyings, the other government debts being highly correlated to the German one. The Johannesburg Stock Exchange is the only other remaining player in the region. But this region is the only one where LTIR option trading grew in the same order of magnitude as other derivatives [2].

In the Americas, the growth of LTIR futures has been more than twice as strong as options. That region gained market share for the latter products, while it lost its overwhelming dominance for the latter. The CME group emerged as the largest player in the Americas, followed by the Montreal Stock Exchange and Mexder (refer to Table 6).

Table 6:
Long term interest rate options volumes (millions of traded contracts)

Long term interest rate options volumes *(millions of traded contracts)*					
	Volumes traded in 1998	Volumes traded in 2008	Compound Annual Growth Rate (CAGR)	Regional breakdown in 1998	Regional breakdown in 2008
Americas	53	98	6%	83%	57%
Asia Pacific	3	4	4%	4%	2%
Europe, Africa, Middle East	8	69	24%	13%	40%
Total	**63**	**171**	**10%**	**100%**	**100%**

Over the last ten years, the development of derivative trading was very impressive. Volumes increased 7.8 times and grew even more rapidly than volumes on cash markets, especially between 2003 and 2007, when equity markets were bullish.

The highest growth rate was observed for equity derivatives: volumes increased 13.5 times between 1998 and 2008 and in 2008 they accounted for 69% of the derivative trading volumes against 40% in 1998. The growth of equity derivatives has been stronger than the one of cash equity markets. The other products, namely interest rate, currency and commodity derivatives, also experienced rapid growth during this period: they grew respectively 5.7, 4.9 and 7.8 times [5].

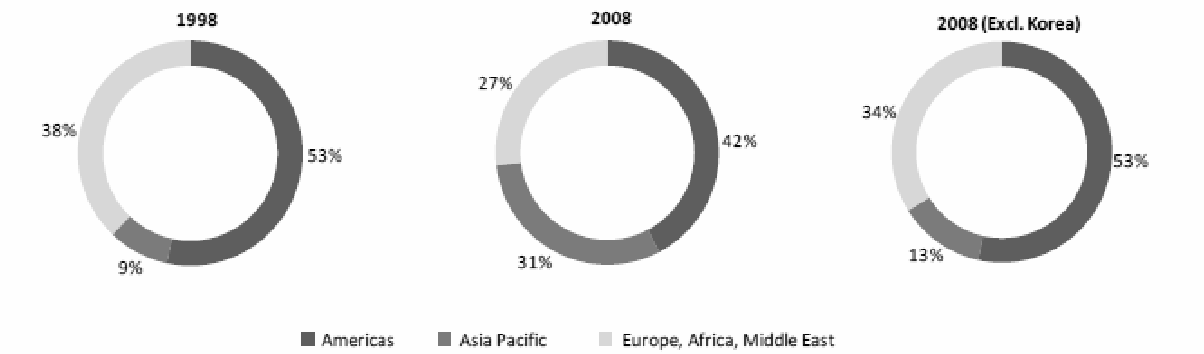

Figure 1: Breakdown of equity and LTIR derivatives volumes by geographical zone

Regarding regional development of derivative trading, the most striking phenomenon is the tremendous growth of Asia with the impressive development of KOSPI 200 Options. Apart from this particular product, Asia Pacific region also developed with the arrival of new stock exchanges. In Americas, equity options were very successful, particularly with options on ETFs and in Europe, index options experienced a strong growth mainly driven by Eurex.

In ten years, the industry of stock exchanges saw many changes. There have been a lot of mergers and acquisitions involving the biggest stock exchanges and new exchanges appeared.

In the recent years, electronic trading has gained an increasing share of the trading activity. Nevertheless, the analysis of the velocity of trading demonstrates that the increase of derivative trading was not mainly generated by the development of algorithmic trading. The growth of derivative markets is driven by an increasing use of its products by investors and other economic agents. Further developments are expected following the demand for safer markets by investors, market players and regulators, which should result in a transfer of a significant part of OTC trading to on-exchange trading [1].

17 billion derivative contracts were transacted in 2008 on exchanges worldwide (7.8 billion futures and 9.3 billion options). These figures are apparently positive as they represent a new historic record. However, we will show below that these figures hide wide disparities between products and between the first three quarters of the year and the last quarter, Lehman Brothers' collapse marking a profound break in the activity of the derivatives markets.

The pace of growth in 2008 (+13%) was significantly below the two previous years. Although futures declined the most, their growth is still superior (+14%) to that of options (+11%). Futures growth is the lowest for six years and that for options is similar to 2005 and 2006. Again, the break of September triggered a much stronger slowdown, especially for futures.

The global activity of derivatives exchanges is heavily influenced by the weight of the Korea Exchange in equity index options trading. When KOSPI 200 options traded on the Korean market are excluded from statistics, the growth rate of options trades is the weakest since 2003.

Exchange and products trends [13]:

- In 2008, the growth rate in the volume of equity derivatives was more than halved compared to 2007, even if KOSPI 200 options are taken into account or not.
- For the first time since 2003, negative growth rates were observed on all groups of interest rate products.
- The growth rate of currency derivatives was ten times lower compared to 2007.
- Commodity derivatives, driven by Chinese markets, seem to be the only segment that has not been affected by the financial crisis.

After several years of rapid growth, the pace of development of all derivative markets segments, except commodity futures, slowed down in 2008. It turned negative on interest rate products [3].

Although a sharp downturn has been observed since Lehman Brothers collapse, equity products are resisting, and their share in total derivatives trading increased from 65% to 69%.

Crisis tendencies on derivatives market (refer to table 7):

- For the first time trading in equity options has exceeded trading in equity index options. However, the financial crisis was still producing its negative effects at the beginning of 2009 and growth seems to be at least provisionally frozen on a majority of exchanges.
- Index options and futures were also hit by the financial crisis. However, a huge increase in KOSPI index options was observed in February 2009: more than 200 million contracts were traded during that month alone (against 140 million in February 2008).
- The fledgling market of equity futures again showed a very impressive rate of growth and there were again new exchanges that introduced equity futures trading in Asia.
- Growth of all segments of interest rate derivatives turned negative, short term like long term products, options like futures.

- Futures on short term interest rate products suffered the worst decline. The growth of this segment had already shown a slowdown in 2007. But half of the decrease in 2008 is due to a technical change on Mexder, where a short term contract has been replaced by a long term contract with a much lower velocity of trading.
- The growth of currency derivatives had been exceptional in 2007. It remained strong but slowed down in 2008. However, it should be noted that the pace of growth of currency options did not weaken in 2008.
- The growth of commodity derivative markets, driven by Chinese markets, seems to be the only one that has not been affected by the financial crisis.

Table 7:
2008/2007 derivatives trade volumes

2008		Single Stock	Stock Index	STIR	LTIR	Currency	Commodities
Millions of contracts traded	Options	4 368	4 077	439	171	50	154
	Futures	1 059	2 286	1 243	1 322	332	1 545
Growth rate of contracts traded	Options	17%	9%	-6%	-9%	17%	16%
	Futures	66%	34%	-18%	-14%	4%	38%
2007		**Single Stock**	**Stock Index**	**STIR**	**LTIR**	**Currency**	**Commodities**
Millions of contracts traded	Options	3 729	3 745	469	188	43	132
	Futures	638	1 706	1 522	1 530	320	1 121
Growth rate of contracts traded	Options	35%	18%	21%	6%	79%	22%
	Futures	122%	46%	13%	20%	52%	19%

We think that the year 2008 can hardly be discussed without distinguishing the trends before and after worsening of the crisis triggered by Lehman Brothers' collapse. The period that began in the fourth quarter of 2008 is characterized by a very marked decline in liquidity. Due to increased volatility and regulatory restrictions on short selling, spreads quoted by market makers increased while, in some cases, some market makers were unable to fulfill their obligations. For example, spreads on individual equity options increased 40% on average compared to the third quarter of 2008, and by about 100% compared to the fourth quarter of 2007 in the US. Simultaneously, the depth of order book diminished everywhere. Trading volumes fell to levels lower than the same period of 2008, while their growth had been continuous throughout all the previous years. First releases relating to March 2009 volumes indicate that derivatives volumes are still significantly lower than in March 2008 [7].

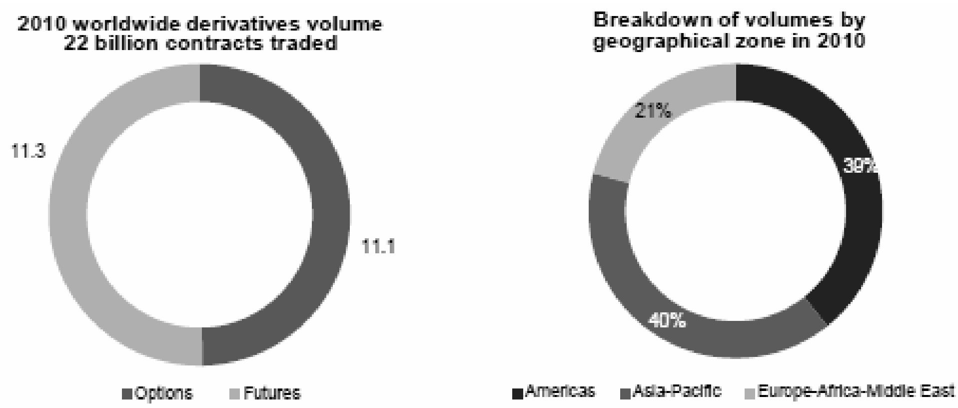

Figure 2: 2010 worldwide derivatives volume and Breakdown of volumes by geographical zone in 2010

Trading in derivatives contracts on regulated exchanges worldwide surged 25% in 2010 (look at Figure 2). 22.4 billion derivative contracts were traded on exchanges worldwide (11.3

billion futures and 11.1 billion options) against 17.9 billion in 2009. The share of futures in the total number of traded contracts nearly doubled between 2005 and 2010. In 2010, the number of futures traded surpassed for the first time the number of options (see in Figure 3).

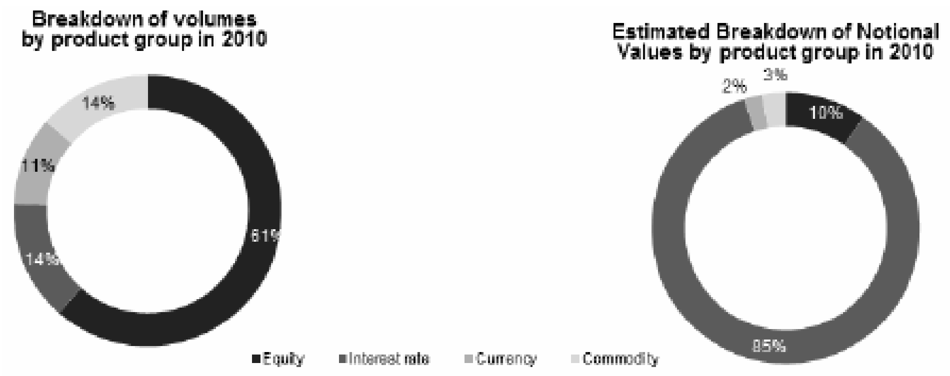

Figure 3: Breakdown of volumes by product group in 2010

The highest growth rate (+41%) was observed in the Asia-Pacific region and for the first time volumes traded in this geographical zone were higher than in the two other zones.

The growth rate (+25%) is one of the highest observed since 2005. The number of futures traded increased faster (+36%) than options (+16%).

Exchange and products trends (refer to Figure 4):

- Equity derivatives grew rapidly (+14%) in 2010. Asia Pacific region experienced the highest growth rate (+20%) followed by the Americas (+10%) and Europe Africa Middle East region (+8%).

- Interest rate segment that had been the most heavily hit by the financial crisis grew substantially (+29%), but did not reach again pre-crisis volumes.

- Currency derivatives, with 2.4 billion contracts traded in 2010, remain the smallest segment of organized markets. Nevertheless, driven by the Indian exchanges that accounted for 71% of the volumes traded in 2010, they have experienced triple-digit growth rates in 2010 (+142%). When the Indian exchanges are excluded from statistics, the growth rate of traded volumes in 2010 was still very strong (+ 36%).

- Commodity derivatives continued to grow rapidly in 2010 (+33%). Chinese exchanges accounted for 51% of the traded volumes [12].

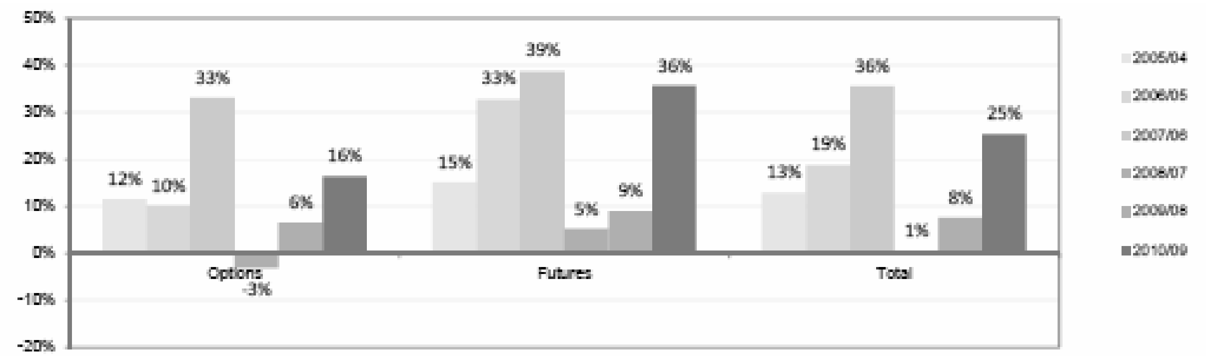

Figure 4: Derivatives volume growth rate

Conclusions: Finally, we think that the period that began in the fourth quarter of 2008 is characterized by a very marked decline in liquidity. Due to increased volatility and regulatory restrictions on short selling, spreads quoted by market makers increased while, in some cases, some market makers were unable to fulfill their obligations.

The financial crisis had triggered a marked slowdown of derivatives markets in 2008. The crisis continued and deepened for certain types of contracts in 2009. Index futures had only started to slow down at the fall of 2008, the year 2009 ended with a negative performance of 16%. LTIR derivatives have plunged in an even more acute crisis with trading volumes declining by one third and open positions being dramatically reduced. On the contrary, commodity futures continued to grow rapidly in 2009 as in 2008 [4].

2010 was a remarkable year for on-exchange derivatives. After a net decrease of volumes growth in 2008-2009, derivatives volumes are back to their pre-crisis growth rate + 25% in 2010.

This performance is due to the overall better market conditions that prevailed in 2010. It is also a sign of confidence in the on-exchange infrastructure. At a time where systematic risks still a major issue, the on-exchange environment providing price transparency and central counterparty offers a valuable framework to mitigate risk and improve efficiency.

Obviously, all OTC products will not be eligible to the on-exchange environment, but the vast majority of OCT derivatives exposures are sufficiently standardized to be applicable to both SEFs and CCPs (90% according to Tabb Group).

The major regulatory changes taking place in the US and in the EU may provide the relevant framework to mitigate systemic risk and encourage the migration to the the on-exchange multilateral paradigm and its associated benefits. Several successful initiatives from various exchanges and clearing houses in various products (interest swaps, CDS, flexible options…) have shown how some OTC products can benefit from an on-exchange environment which can address the some of the OTC needs.

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MOTIVES FOR FINANCIAL CONGLOMERATION AND THE RISKS INVOLVED

У статті досліджуються вимоги, яким має відповідати фінансова група, щоб кваліфікуватися як фінансовий конгломерат відповідно до Директиви ЄС про фінансові конгломерати. Наводиться динаміка фінансових показників найбільших світових фінансових груп за останні роки. Визначаються ключові характеристики основних сфер діяльності конгломерату та висвітлюються мотиви конгломерації та ризики, які з цим пов'язані.

Ключові слова: фінансовий конгломерат, регульована організація, міжсекторна інтеграція, Директива про фінансові конгломерати.

The paper examines the conditions required for a financial conglomerate to exist under the EU Financial Conglomerates Directive. The data on the financial results of the largest financial conglomerates are being reviewed. Finally, the research identifies the key characteristics of the conglomerate`s main business areas and sheds some light on the motives for conglomeration and the risks involved.

Key words: financial conglomerate, regulated entity, cross-sectoral integration, Financial Conglomerates Directive.

Financial services are often offered through group structures. Such groups, in particular those that combine banking and insurance, have become increasingly important in Europe and The USA over time. They often result from cross-sectoral mergers and acquisitions, which are typically domestic in nature. The majority of large banks and insurance companies in the European Union (EU) are now part of a wider banking and insurance (bancassurance) group.

Financial companies are increasingly moving into each other's traditional core business areas and one way of doing so is through financial services groups. Some of these groups, called "financial conglomerates",are active in several business areas such as banking and insurance. These groups pose certain risks which are not adequately addressed by the sectoral supervisory framework. In order to tackle this, the Financial Conglomerates Directive was adopted at the European Union (EU) level. This paper investigates in more detail the various issues related to the emergence of such conglomerates.

Because of demographic developments, deregulation, increasing competition and innovation, financial companies are increasingly moving into each other's areas. Banks are now acting as insurance agents or brokers by selling insurance policies through their branch networks, insurance companies are selling insurance policies that have all the characteristics of investment products, and many commercial banks have moved into the securities business. In Europe the combination of banking and insurance has become increasingly popular. Apart from banks developing insurance activities ("bancassurance" or "bankinsurance" in the narrow sense), insurance companies also develop banking activities ("assurfinance") or holdings combine both

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("allfinanz"). These cross-sectoral strategies can take different forms: distribution agreements, joint ventures, the establishment of own subsidiaries or mergers and acquisitions (M&A) involving already existing companies. This paper concentrates in particular on bancassurance groups as they are a common form of financial conglomerates in the EU [11].

In the most general sense, a financial conglomerate is a group of entities whose primary business is financial and whose regulated entities engage to a significant extent in at least two of the activities of banking, insurance and securities.6 According to this definition, bancassurance groups would qualify as financial conglomerate, but so would groups combining insurance and securities or banking and securities. The definition used in the different countries for their supervision of financial conglomerates is sometimes more restrictive than the aforementioned general definition. For example, the regulations on financial holding companies in the United States require the presence of a bank, which is not a prerequisite under the Financial Conglomerates Directive. Also, bank-investment firm groups do not fall under the Directive since they are treated as "homogeneous" groups while in the United States, the financial holding regulations apply.

Definition under the Financial conglomerate directive.

Although the Directive does not refer to the concept of systemic groups, it is this type of group that the EU legislator had in mind when establishing the supervisory framework. The following formal requirements have to be met for a group to qualify as a financial conglomerate under the Directive:

(i) the presence in the group of at least one regulated entity in the EU;

(ii) if the group is headed by a regulated entity, it must be the parent of, hold a participation in or be linked through a horizontal group with an entity in the financial sector;

(iii) if the group is not headed by a regulated entity, its activities should occur mainly in the financial sector;

(iv) the group should have at least one insurance or reinsurance undertaking and at least one entity from a different financial sector; and

(v) the group must have significant crosssectoral activities.

A "group" is a set of undertakings, consisting foremost of a parent undertaking and its subsidiaries as defined under the Consolidated Accounts Directive. However, according to the prudential objective of the Financial Conglomerates Directive, the group concept is at the same time wider than the one used for pure accounting consolidation. First, the supervisory authorities can include in the group entities between which in their opinion a dominant influence exists, even if they do not formally meet the accountancy definition of parent-subsidiary. Second, the group also includes the participating interests8 held by the parent and subsidiaries. And third, horizontal groups are equally covered.9 Because of the wider definition, a group that qualifies as a financial conglomerate does not necessarily coincide with a group that is required to publish consolidated accounts under the Consolidated Accounts Directive. In addition, the entities that have been used to check whether the group meets the definition of a financial conglomerate, are not necessarily the same that will be subject to the supplementary supervision provided for in the Financial Conglomerates Directive.

The group should include at least one regulated entity in an EU Member State. A "regulated entity" is a credit institution, insurance undertaking or investment firm as defined under the respective EU directives for those sectors. The reason for this requirement is that the aim of the Financial Conglomerates Directive is to create a supplementary supervision of EUregulated entities. If there are no such entities, there is no need for an additional layer of supervision. It is not required that the regulated entity is a credit institution. If the group is not headed by a regulated entity, which is the case when it is headed by a nonregulated entity or does not have a parent company (a "horizontal group"), the group's activities should mainly occur in the financial sector. When a non-regulated entity heads a financial conglomerate, its parent is called a mixed financial holding company. A quantitative threshold, based in principle on balance sheet data,10 is used to define what "mainly occur in the financial sector" means. The ratio of the balance sheet total of the financial sector entities in the group to the balance sheet total of the whole group has to be greater than 40%.

The financial sector entities envisaged are:

(i) credit institutions, financial institutions and ancillary banking undertakings (= banking sector);

(ii) insurance undertakings, reinsurance undertakings and insurance holding companies (= insurance sector);

(iii) investment firms and financial institutions (= investment services sector);

(iv) mixed financial holding companies; and

(v) asset management companies.11

These various types of entity are defined under the respective sectoral Directives. Some of them are regulated entities according to these Directives, while others, such as financial institutions, reinsurance undertakings and the various holding companies, are not.

The group should have at least one entity in the insurance sector and at least one entity in

another financial sector, i.e. the banking or the investment services sector. It is not required that there is a regulated entity in each financial sector covered by the group. For example, a group consisting of a regulated investment firm and an unregulated reinsurance undertaking could, in principle, qualify as a financial conglomerate.

The last condition is that the group should have significant cross-sectoral activities. For this assessment, two sectors are considered: (i) the insurance sector and (ii) the banking/investment services sector taken together, and both have to be significant. Again, quantitative criteria are used to define what "significant" means. There is a relative criterion and an absolute criterion.

The relative criterion refers to the importance of the sector in the group's total assets and solvency requirements, which has to be on average more than 10%.12 The absolute criterion is that when the smallest sector, measured according to the above-mentioned relative criterion, has a balance sheet total of more than €6 billion, the cross-sectoral activities are also presumed to be significant. But if the group does not meet at the same time the minimum threshold of the relative criterion, the competent authorities may decide not to treat

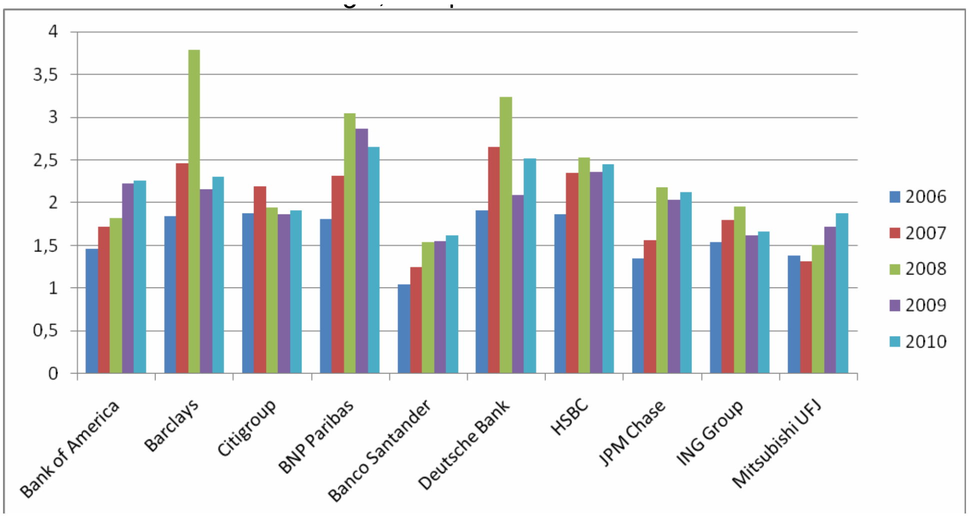

Chart 1. Total assets of ten financial conglomerates in 2006-2010 (trillions of dollars). SThece: Based on information from annual reports of the financial conglomerates.

the group as a financial conglomerate

Today, a large number of financial groups operates in the world, each of which is quite a powerful player on the international financial markets. Charts 1and 2 show the financial performance of 10 financial groups, which are from different countries and continents of origin, but operate worldwide.

As it is seen from the chart, the volumes and dynamics of financial groups assets have some common trends: from 2006 to 2008 almost all of these groups had growth of total assets in each year of the analyzed period. An exception is Citigroup, where assets were of less volume in 2008 than in 2007, and Mitsubishi UFJ, whose assets in 2007 decreased compared to 2006, but during the next years we can see a steady growth of this indicator. At the same time there is a noticeable reduction in the amount of total assets of the most of these groups in 2009 in comparison with the figures of 2008. This can be explained by the sale of inefficient groups of assets as one of the steps to cope with the crisis. Then in 2010, as for all financial groups except BNP Pariba there was an increase in total assets if to compare to 2009.

The chart 2 shows that in 2008 almost all of the financial groups had decline in net income,

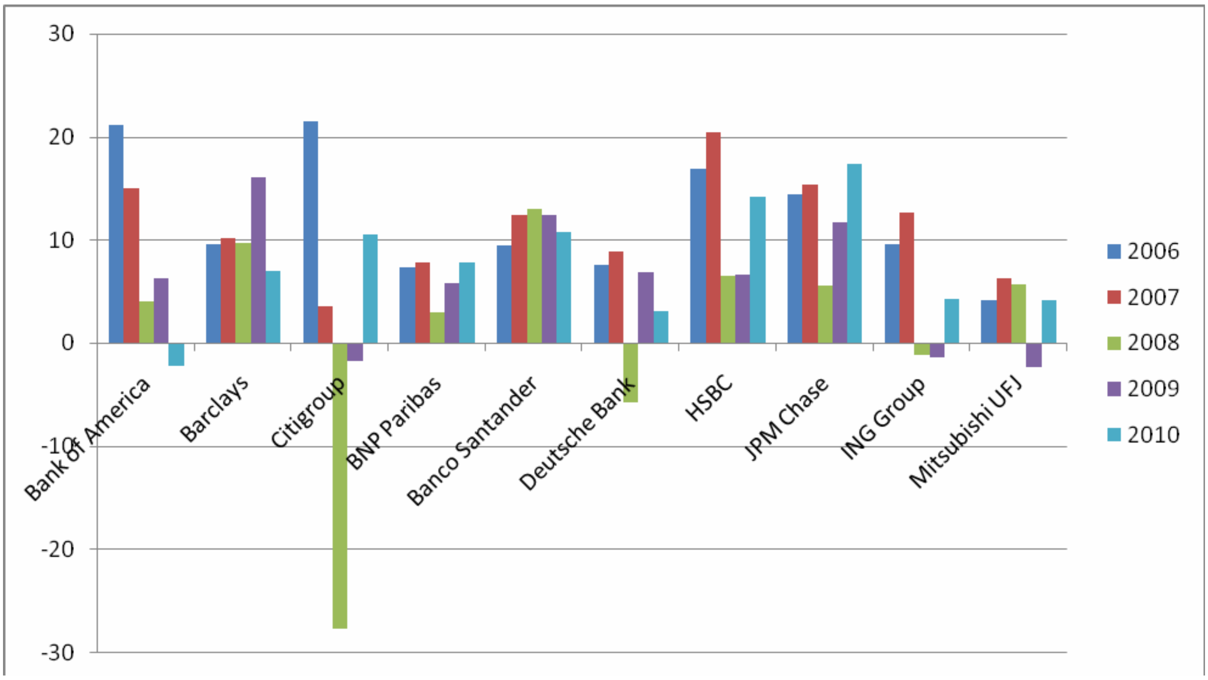

Chart 2. Net income of ten financial conglomerates in 2006-2010 (billions of dollars).
SThece: Based on information from annual reports of the financial conglomerates..

except only Banco Santander, which in 2008 had even some increase in income compared to the previous two years. However, in 2009 and 2010 it reduced, although it still remains at the highest level among these financial groups. Companies, which suffered from the crisis the most, are Citigroup, which had losses of 27.68, and $ 1.7 billion in 2008 and 2009 respectively, Deutsche Bank (5,74 billion dollars in 2008), Mitsubishi UFJ (2,29 billion dollars in 2009) and ING Group (1,07 and $ 1.3 billion U.S. dollars in 2008 and 2009).

And now let`s analyse the volumes of total revenues and net income of several financial groups in aspect of different areas of business in order to see how each of business segments was influenced with the financial crisis.

Chart 3 demonstrates the total net revenue of Bank of America.

Deposits include a comprehensive range of products provided to consumers and small bu-

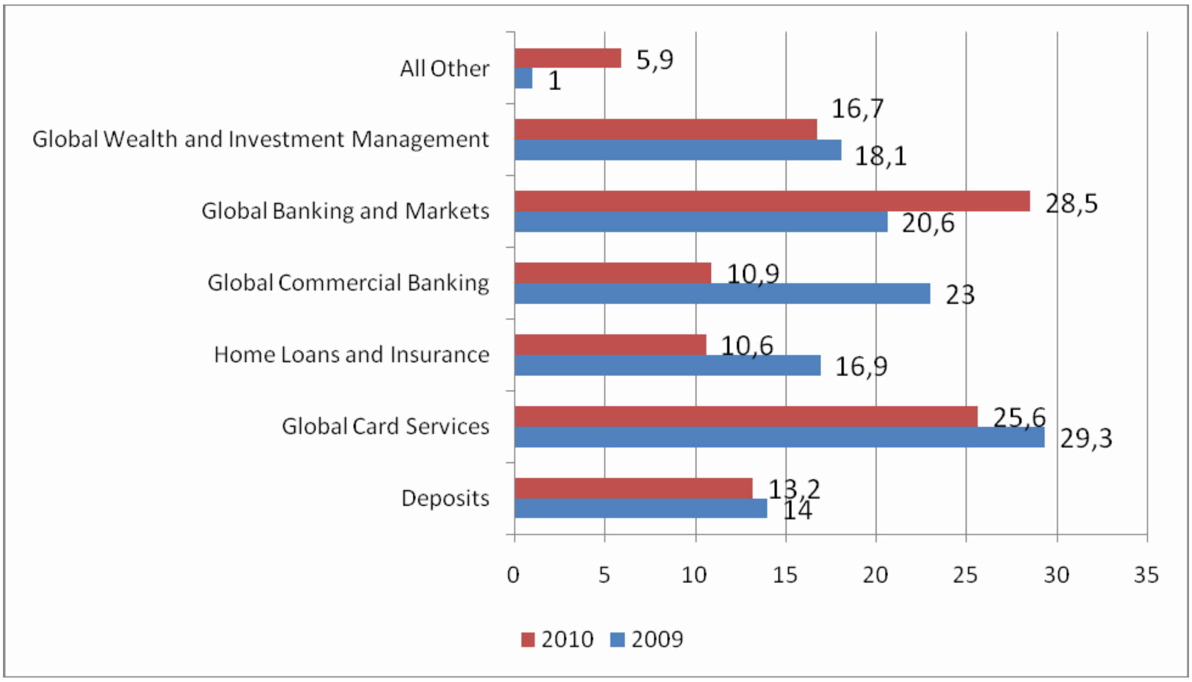

Chart 3. Total Net Revenue Per Line of Business of Bank of America (dollars in billions)
SThese: Based on data from Bank`s of America annual report

sinesses, including traditional savings accounts, money market savings accounts, CDs and IRAs, and noninterest- and interestbearing checking accounts. Deposit products provide a relatively stable sThece of funding and liquidity. In the U.S., we serve approximately 57 million consumer and small business relationships through a franchise that stretches coast to coast through 32 states and the District of Columbia utilizing The network of more than 5,800 banking centers, 18,000 ATMs, nationwide call centers and leading online and mobile banking platforms [1].

Global Card Services is one of the leading issuers of credit cards in the United States and Europe. We provide a broad offering of products including U.S. consumer and business cards, consumer lending, international cards and debit cards to consumers and small businesses. We provide credit card products to customers in the U.S., Canada, Ireland, Spain and the U.K. We offer a variety of co-branded and affinity credit and debit card products and are one of the leading issuers of credit cards through endorsed marketing in the U.S. and Europe.

Home Loans & Insurance provides an extensive line of consumer real estate products and services including fixed and adjustable rate first-lien mortgage loans for home purchase and refinancing needs, home equity lines of credit and home equity loans to customers nationwide.

Home Loans & Insurance products are available to The customers through The banking centers, mortgage loan officers in 750 locations and a sales force offering The customers direct telephone and online access to The products. These products are also offered through The correspondent loan acquisition channel.

Global Commercial Banking provides a wide range of lending-related products and services, integrated working capital management and treasury solutions to clients through The network of offices and client relationship teams along with various product partners. The clients include business banking and middle-market companies, commercial real estate firms and governments.

The lending products and services include commercial loans and commitment facilities,

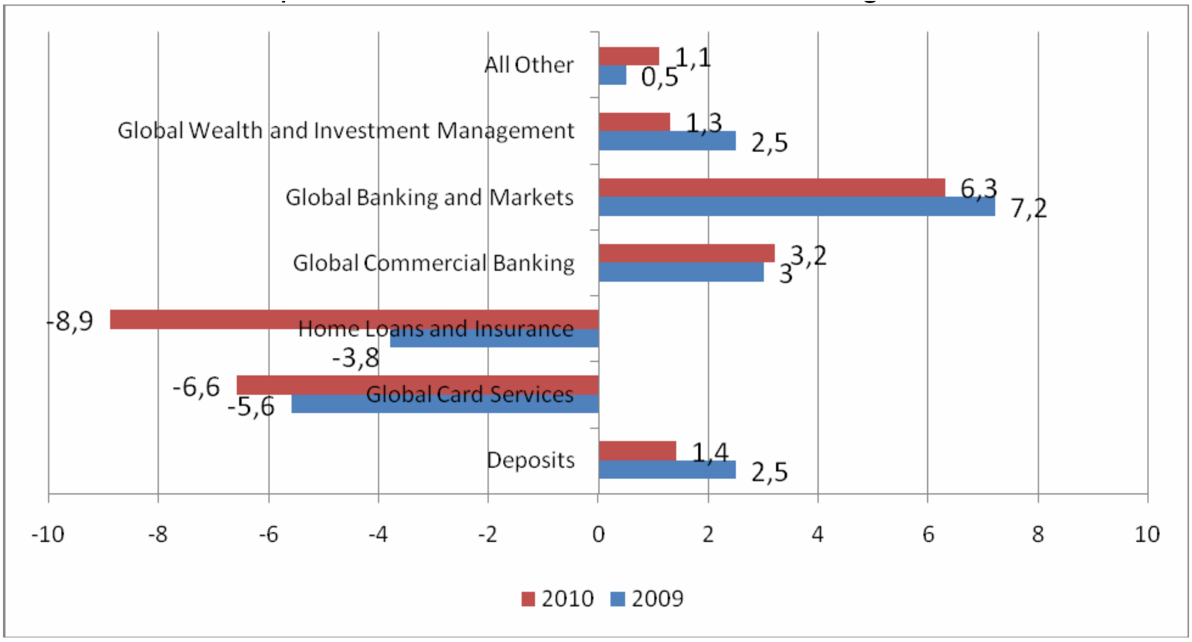

Chart 4. Net Income (Loss) Per Line of Business of Bank of America (dollars in billions)
Sourse: Based on data from Bank`s of America annual report

real estate lending, asset-based lending and indirect consumer loans. The capital management and treasury solutions include treasury management, foreign exchange and short-term investing options.

Global Banking & Markets (GBAM) provides financial products, advisory services, financing, securities clearing, settlement and custody services globally to The institutional investor clients in support of their investing and trading activities. We also work with commercial and corporate clients to provide debt and equity underwriting and distribution capabilities, merger-related and other advisory services, and risk management products using interest rate, equity, credit, currency and commodity derivatives, foreign exchange, fixed-income and mortgage-related products. GBAM is a leader in the global distribution of fixed income, currency and energy commodity products and derivatives, has one of the largest equity trading operations in the world and is a leader in the origination and distribution of equity and equity-related products. The corporate banking services provide a wide range of lending-related products and services, integrated working capital management and treasury solutions to clients [1].

Global Wealth & Investment Management (GWIM) provides comprehensive wealth management capabilities to a broad base of clients from the emerging affluent to the ultra high net worth. These services include investment and brokerage services, estate and financial planning, fiduciary portfolio management, cash and liability management and specialty asset management. GWIM also provides retirement and benefit plan services, philanthropic management, asset management and lending and banking to individuals and institutions. The primary wealth and investment management businesses are Merrill Lynch Global Wealth Management, U.S. Trust, Bank of America Private Wealth Management and Retirement Services.

Deposits include a full range of products for consumers and small businesses including traditional savings accounts, money market savings accounts, CDs, IRAs, and noninterest- and interest-bearing checking accounts. Deposits results also include student lending and the impact of The Asset and Liability Management activities. Global Card Services is one of the leading issuers of credit cards in the United States and Europe and provides a broad offering of products to consumers and small businesses, including U.S. consumer and business card, consumer lending, international card and debit card and a variety of cobranded and affi nity card products.

Home Loans & Insurance provides an extensive line of consumer real estate products and services including fi xed and adjustable rate fi rst-lien mortgage loans for home purchase and refi nancing, reverse mortgages, home equity lines of credit and home equity loans. HL&I also offers property, casualty, life, disability and credit insurance.

Global Banking provides a wide range of lending-related products and services, integrated working capital management, treasury solutions and investment banking services. The clients include multinationals, middle- market and business banking companies, correspondent banks, commercial real estate fi rms and governments. Global Markets provides fi nancial products, advisory services, fi nancing, securities clearing, and settlement and custody services globally to institutional clients. We also work with commercial and corporate clients to provide debt and equity underwriting and distribution and risk management products.

Global Wealth & Investment Management provides a wide offering of customized banking, investment and brokerage services to meet the wealth management needs of the individual and institutional customer base.

The primary wealth and investment management businesses are: Merrill Lynch Global Wealth Management; U.S. Trust, Bank of America Private Wealth Management; and Columbia Management.

On January 1, 2009, the Corporation acquired Merrill Lynch through its merger with a subsidiary of the Corporation in exchange for common and preferred stock with a value of $29.1 billion, creating a premier financial services franchise with significantly enhanced wealth management, investment banking and international capabilities. Under the terms of the merger agreement, Merrill Lynch common shareholders received 0.8595 of a share of Bank of America Corporation common stock in exchange for each share of Merrill Lynch common stock. In addition, Merrill Lynch non-convertible preferred shareholders received Bank of America Corporation preferred stock having substantially identical terms. Merrill Lynch convertible preferred stock remains outstanding and is convertible into Bank of America common stock at an equivalent exchange ratio. With the acquisition, the Corporation has one of the largest wealth management businesses in the world with more than 18,000 financial advisors and more than $1.8 trillion in client assets. Global investment management capabilities will include an economic ownership of approximately 50 percent (primarily preferred stock) in BlackRock, Inc., a publicly traded investment management company. In addition, the acquisition adds strengths in debt and equity underwriting, sales and trading, and merger and acquisition advice, creating significant opportunities to deepen relationships with corporate and institutional clients around the globe. Merrill Lynch's results of operations will be included in the Corporation's results beginning January 1, 2009 [1].

The Merrill Lynch merger is being accounted for under the acquisition method of accounting in accordance with SFAS 141R. Accordingly, the purchase price was preliminarily allocated to the acquired assets and liabilities based on their estimated fair values at the Merrill Lynch acquisition date as summarized in the following table. Preliminary goodwill of $5.4 billion is calculated as the purchase premium after adjusting for the fair value of net assets acquired and represents the value expected from the synergies created from combining the Merrill Lynch wealth management and corporate and investment banking businesses with the Corporation's capabilities in consumer and commercial banking as well as the economies of scale expected from combining the operations of the two companies. The allocation of the purchase price will be finalized upon completion of the analysis of the fair values of Merrill Lynch's assets and liabilities.

On July 1, 2008, the Corporation acquired Countrywide through its merger with a subsidiary of the Corporation. Under the terms of the agreement, Countrywide shareholders received 0.1822 of a share of Bank of America Corporation common stock in exchange for each share of Countrywide common stock. The acquisition of Countrywide significantly improved the Corporation's mortgage originating and servicing capabilities, while making us a leading mortgage originator and servicer.

As provided by the merger agreement, 583 million shares of Countrywide common stock were exchanged for 107 million shares of the Corporation's common stock. The $2.0 billion of Countrywide's Series B convertible preferred shares that were previously held by the Corporation were cancelled.

The merger is being accounted for as a purchase in accordance with SFAS 141. Accordingly, the purchase price was preliminarily allocated to the assets acquired and liabilities assumed based on their estimated fair values at the merger date as summarized below. The final allocation of the purchase price will be finalized upon completing the analysis of the fair values of Countrywide's assets and liabilities. Purchase price $ 4.2.

On October 1, 2007, the Corporation acquired all the outstanding shares of LaSalle, for $21.0 billion in cash. As part of the acquisition, ABN AMRO Bank N.V. (the seller) capitalized approximately $6.3 billion as equity of intercompany debt prior to the date of acquisition. With this acquisition, the Corporation significantly expanded its presence in metropolitan Chicago, Illinois and Michigan by adding LaSalle's commercial banking clients, retail customers and banking centers. LaSalle's results of operations were included in the Corporation's results beginning October 1, 2007.

On July 1, 2007, the Corporation acquired all the outstanding shares of U.S. Trust Corporation for $3.3 billion in cash. The Corporation allocated $1.7 billion to goodwill and $1.2 billion to intangible assets as part of the purchase price allocation. U.S. Trust Corporation's results of operations were included in the Corporation's results beginning July 1, 2007. The acquisition significantly increased the size and capabilities of the Corporation's wealth management business and positions it as one of the largest financial services companies managing private wealth in the U.S. MBNA

On January 1, 2006, the Corporation acquired all of the outstanding shares of MBNA Corporation (MBNA) and as a result, 1,260 million shares of MBNA common stock were exchanged for 631 million shares of the Corporation's common stock. MBNA shareholders also received cash of $5.2 billion. MBNA's results of operations were included in the Corporation's results beginning January 1, 2006.

2004 Bank of America purchases FleetBoston Financial Corporation, extending the franchise throughout the Northeast, forming the first truly nationwide bank.

2006 Acquier MBNA, making BoA the largest credit card issuer in the industry.

2007 Acquissition of US Trust, a prestigious 153-yearold firm, adds scale to BoA`s private banking business an significantly advances capabilities to serve ultra high net worth clients.

2009 Acquires Merill Lynch [1].

Secondly, we are going to examine the role of different business segments of Citigroup (Chart 5).

Citigroup currently operates, for management reporting purposes, via two primary business

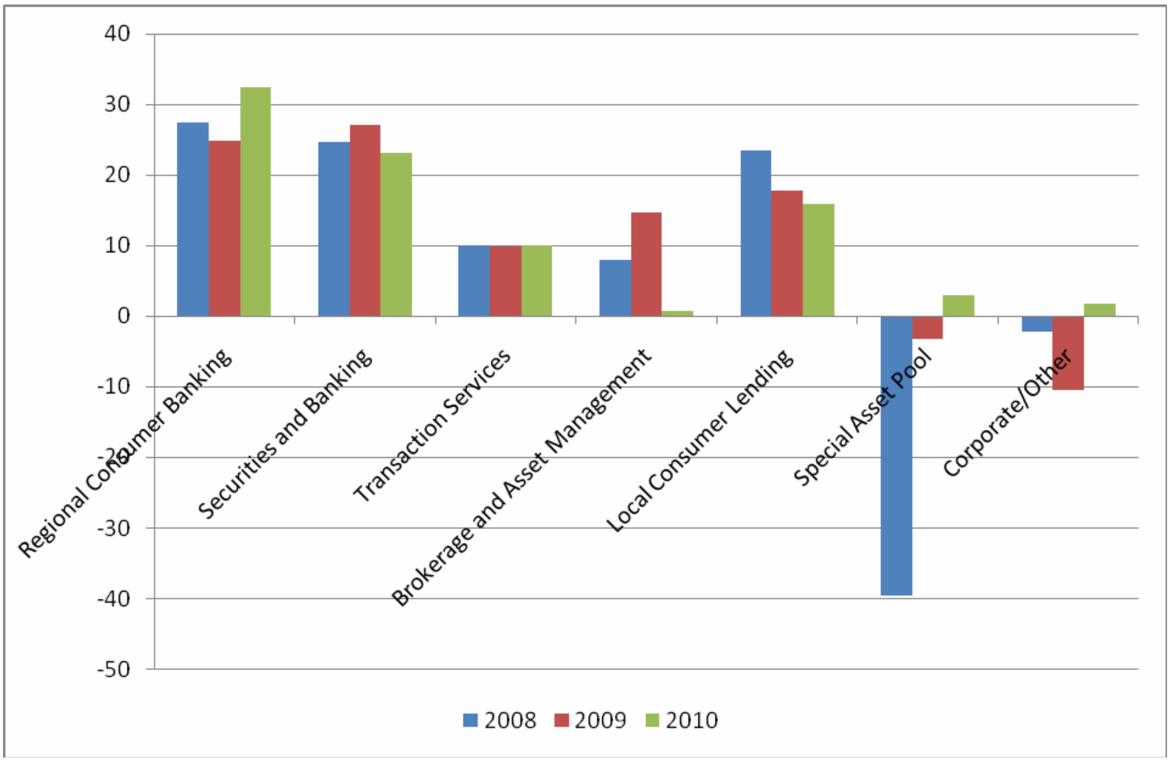

Chart 5. Total Net Revenue Per Line of Business of Citigroup (dollars in billions)
Sourse: Based on data from Citigroup annual report

segments: Citicorp, consisting of Citi's Regional Consumer Banking businesses and Institutional Clients Group; and Citi Holdings, consisting of Citi's Brokerage and Asset Management and Local Consumer Lending businesses, and a Special Asset Pool. There is also a third segment, Corporate/Other [3].

In 2011, management will continue its focus on growing and investing in the core Citicorp

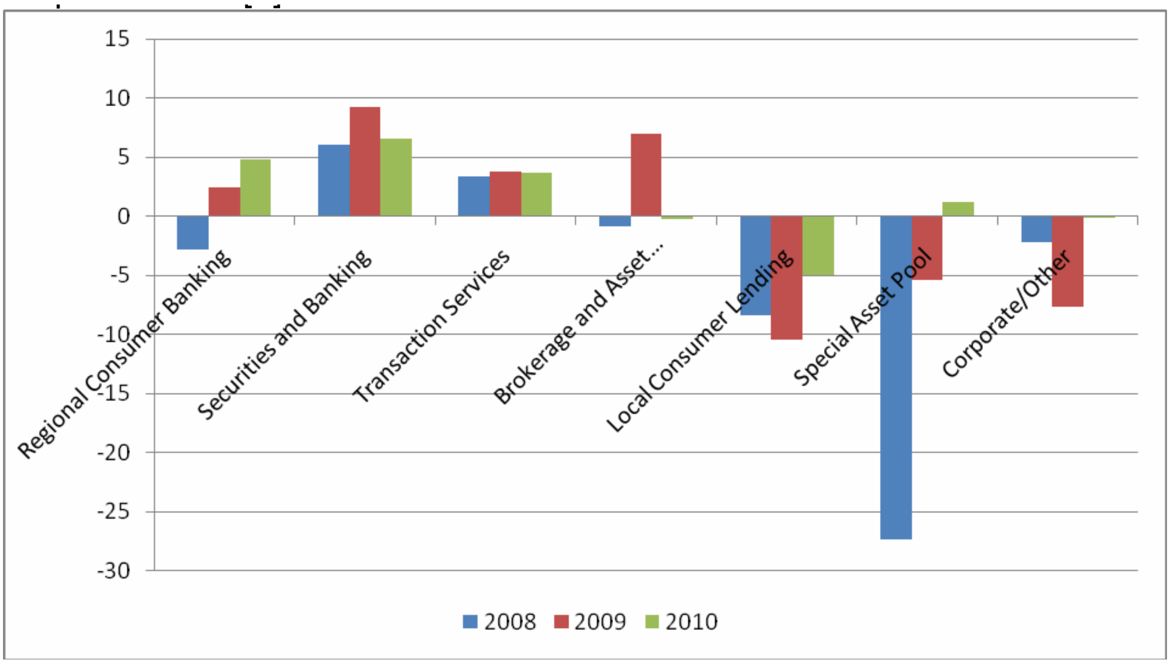

Chart 6. Net Income (Loss) Per Line of Business of Citigroup (dollars in billions)
Sourse: Based on data from Citigroup annual report

franchise, while economically rationalizing Citi Holdings. However, Citigroup's results will continue to be affected by factors outside of its control, such as the global economic and regulatory environment in the regions in which Citi operates. In particular, the macroeconomic environment in the U.S. remains challenging, with unemployment levels still elevated and continued pressure and uncertainty in the housing market, including home prices. Additionally, the continued implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Financial Reform Act), including the ongoing extensive rulemaking and interpretive issues, as well as the new capital standards for bank holding companies as adopted by the Basel Committee on Banking Supervision (Basel Committee) and U.S. regulators, will remain a significant sThece of uncertainty in 2011. Moreover, the implementation of the change in methodology for calculating FDIC insurance premiums, to be effective in the second quarter 2011, will have a negative impact on Citi's earnings. In Citicorp, Securities and Banking results for 2011 will depend on the level of client activity and on macroeconomic conditions, market valuations and volatility, interest rates and other market factors. Transaction Services business performance will also continue to be impacted by macroeconomic conditions as well as market factors, including interest rate levels, global economic and trade activity, volatility in capital markets, foreign exchange and market valuations. In Regional Consumer Banking, results during the year are likely to be driven by different trends in North America versus the international regions. In North America, if economic recovery is sustained, revenues could grow modestly, particularly in the second half of the year, assuming loan demand begins to recover. However, net credit margin in North America will likely continue to be driven primarily by improvement in net credit losses. Internationally, given continued economic expansion in these regions, net credit margin is likely to be driven by revenue growth, particularly in the second half of the year, as investment spending should continue to generate volume growth to outpace spread compression. International credit costs are likely to increase in 2011, reflecting a growing loan portfolio. In Citi Holdings, revenues for Local Consumer Lending should continue to decline reflecting a shrinking loan balance resulting from paydowns and asset sales. Based on current delinquency trends and ongoing loss-mitigation actions, credit costs are expected to continue to improve. Overall, however, Local Consumer Lending will likely continue to drive results in Citi Holdings. Operating expenses are expected to show some variability across quarters as the Company continues to invest in Citicorp while rationalizing Citi Holdings and maintaining expense discipline. Although Citi currently expects net interest margin (NIM) to remain under pressure during the first quarter of 2011, driven by continued low yields on investments and the run-off of higher yielding loan assets, NIM could begin to stabilize during the remainder of the year [3].

Regional Consumer Banking

Regional Consumer Banking (RCB) consists of Citigroup's the RCB businesses that provide traditional banking services to retail customers. RCB also contains Citigroup's branded cards business and Citi's local commercial banking business. RCB is a globally diversified business with over 4,200 branches in 39 countries around the world. During 2010, 54% of total RCB revenues were from outside North America. Additionally, the majority of international revenues and loans were from emerging economies in Asia, Latin America, Central and Eastern Europe and the Middle East. At December 31, 2010, RCB had $330 billion of assets and $309 billion of deposits.

Securities and Banking

Securities and Banking (S&B) offers a wide array of investment and commercial banking services and products for corporations, governments, institutional and retail investors, and high-net-worth individuals. S&B includes investment banking and advisory services, lending, debt and equity sales and trading, institutional brokerage, foreign exchange, structured products, cash instruments and related derivatives, and private banking. S&B revenue is generated primarily from fees for investment banking and advisory services, fees and interest on loans, fees and spread on foreign exchange, structured products, cash instruments and related derivatives, income earned on principal transactions, and fees and spreads on private banking services.

Transaction Services

Transaction Services is composed of Treasury and Trade Solutions (TTS) and Securities and Fund Services (SFS). TTS provides comprehensive cash management and trade finance and services for corporations, financial institutions and public sector entities worldwide. SFS provides securities services to investors, such as global asset managers, custody and clearing services to intermediaries such as broker-dealers, and depository and agency/trust services to multinational corporations and governments globally. Revenue is generated from net interest revenue on deposits in TTS and SFS, as well as from trade loans and fees for transaction processing and fees on assets under custody and administration in SFS.

Brokerage and Asset Management

Brokerage and Asset Management (BAM), which constituted approximately 8% of Citi Holdings by assets as of December 31, 2010, consists of Citi's global retail brokerage and asset management businesses. This segment was substantially reduced in size due to the sale in 2009 of Smith Barney to the Morgan Stanley Smith Barney joint venture (MSSB JV) and of Nikko Cordial Securities (reported as discontinued operations within Corporate/Other for all periods presented). At December 31, 2010, BAM had approximately $27 billion of assets, primarily consisting of Citi's investment in, and assets related to, the MSSB JV. Morgan Stanley has options to purchase Citi's remaining stake in the MSSB JV over three years starting in 2012.

Local Consumer Lending

Local Consumer Lending (LCL), which constituted approximately 70% of Citi Holdings by assets as of December 31, 2010, includes a portion of Citigroup's North American mortgage business, retail partner cards, Western European cards and retail banking, CitiFinancial North America and other local Consumer finance businesses globally. The Student Loan Corporation is reported as discontinued operations within the Corporate/Other segment for the second half of 2010 only. At December 31, 2010, LCL had $252 billion of assets ($226 billion in North America). Approximately $129 billion of assets in LCL as of December 31, 2010 consisted of U.S. mortgages in the Company's CitiMortgage and CitiFinancial operations. The North American assets consist of residential mortgage loans (first and second mortgages), retail partner card loans, personal loans, commercial real estate (CRE), and other consumer loans and assets.

Special Asset Pool

Special Asset Pool (SAP), which constituted approximately 22% of Citi Holdings by assets as of December 31, 2010, is a portfolio of securities, loans and other assets that Citigroup intends to actively reduce over time through asset sales and portfolio run-off. At December 31, 2010, SAP had $80 billion of assets. SAP assets have declined by $248 billion, or 76%, from peak levels in 2007 reflecting cumulative write-downs, asset sales and portfolio run-off.

Corporate/Other

Corporate/Other includes global staff functions (including finance, risk, human resTheces, legal and compliance) and other corporate expense, global operations and technology, residual Corporate Treasury and Corporate items. At December 31, 2010, this segment had approximately $272 billion of assets, consisting primarily of Citi's liquidity portfolio, including $87 billion of cash and deposits with banks [3].

Thirdly, let`s take a look at the financial data of Banco Santander (chart 7).

Secondary level (or business). This segments the activity of the operating units by the type

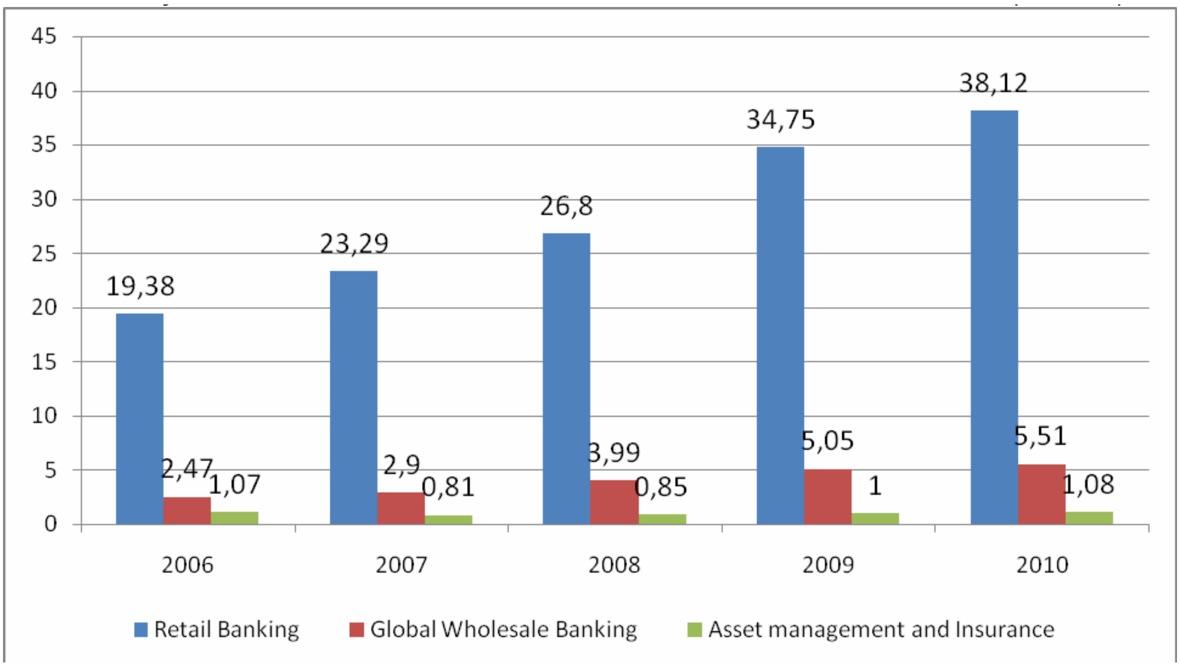

Chart 7. Total Net Revenue Per Line of Business of Banco Santander (euros in billions)
Sourse: Based on data from Banco Santander annual report

of business. The reported segments are:

• Retail Banking. This covers all customer banking businesses (except those of Corporate Banking, managed through the Global Customer Relationship Model). Because of their relative importance details are provided by the main geographic areas (Continental Europe, United Kingdom and Latin America) and Sovereign, as well as by the main countries. The results of the hedging positions in each country are also included, conducted within the sphere of each one's Assets and Liabilities Committee.

• Global Wholesale Banking (GBM). This business reflects the revenues from Global Corporate Banking, Investment Banking and Markets worldwide including all treasuries managed globally, both trading and distribution to customers (always after the appropriate distribution with Retail Banking customers), as well as equities business.

• Asset Management and Insurance. This includes the contribution of the various units to the Group in the design and management of mutual and pension funds and insurance. The Group uses, and remunerates through agreements, the retail networks that place these products. This means that the result recorded in this business is net (i.e. deducting the distribution cost from gross income). As well as these operating units, which cover everything by geographic area and by businesses (their totals are the same), the Group continues to maintain the area of Corporate Activities. This area incorporates the centralised activities relating to equity stakes in industrial and financial companies, financial management of the structural exchange rate position and of the parent bank's structural interest rate risk, as well as management of liquidity and of shareholders' equity through issues and securitizations [5].

As the Group's holding entity, this area manages all capital and reserves and allocations of capital and liquidity. It also incorporates amortisation of goodwill but not the costs related to the Group's central services except for corporate and institutional expenses related to the Group's functioning.

As for mergers and acquisitions of this bank, it can be demonstrated through the following

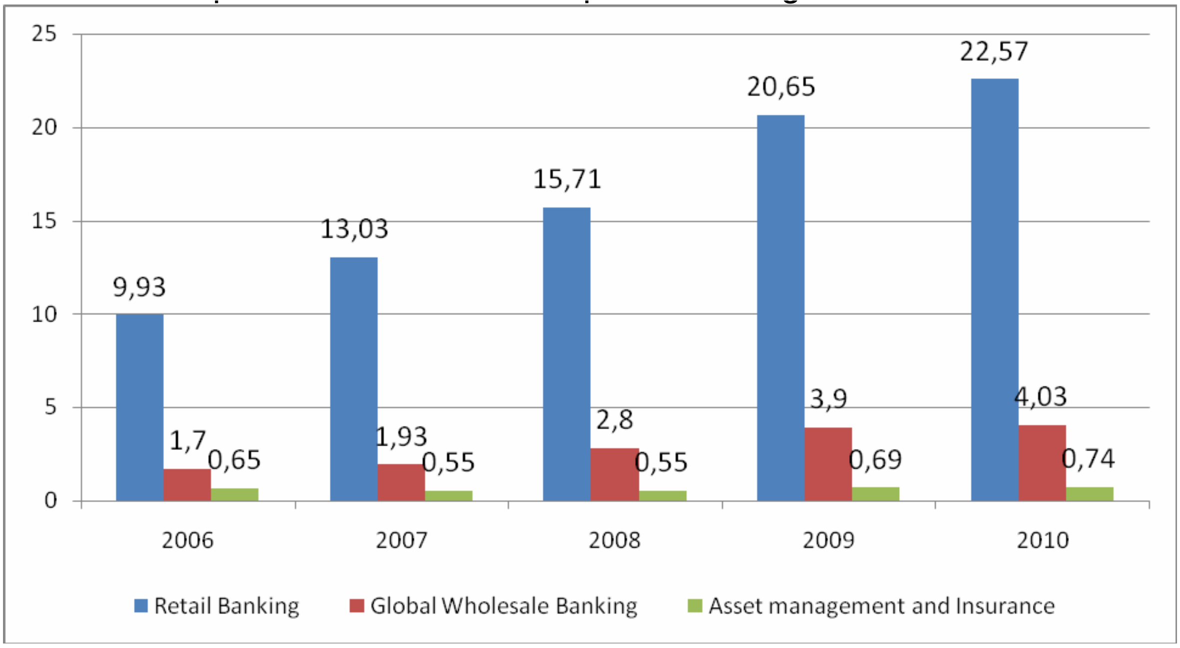

Chart 8. Net Income (Loss) Per Line of Business of Banco Santander (euros in billions)
Sourse: Based on data from Banco Santander annual report

facts:

• From the year 2000, the Group was joined by Banespa in Brazil, Grupo Serfín in Mexico and Banco Santiago in Chile. This consolidated the Group's position as the leading financial franchise in Latin America.

• In 2003, the Group set up Santander Consumer when it merged German company CC-Bank, the Italian Finconsumo, Hispamer in Spain and other Group companies. This new consumer banking franchise today has a presence in 12 European countries (Spain, the UK, Portugal, Italy, Germany, the Netherlands, Poland, the Czech Republic, Austria, Hungary, Norway and Sweden), in the USA, through Drive Finance, and it has recently struck an agreement to start up its first operation in Latin America, in Chile.

• In April 2004, it moved its Central Services in Madrid to the new headquarters, Santander City, where 6,800 people work today.

• That same year, in November, another major landmark was reached with the Group's takeover of Abbey, the sixth largest bank in the United Kingdom.

• In 2005, Santander reached agreement to take a 19.8% stake in Sovereign Bancorp, the 18th biggest bank in the USA.

• In 2006, Santander made record profits of € 7.596 billion, the biggest of any Spanish company, spurring heavy investment in retail banking and quality of service. "We want to be yThe bank" (Queremos ser tu banco) in Spain and other enterprising action in Portugal, at Abbey and in America are examples of this drive.

• In 2007, Santander celebrated its 150th anniversary as the twelfth largest bank in the world by stock market capitalisation, seventh by profits and the bank with the largest retail distribution network in the western world: 10,852 branches. Santander formed a consortium with the Royal Bank of Scotland and Fortis to launch a take-over bid for ABN Amro, through which the bank acquired Banco Real in Brazil, doubling its presence in the country.

• In 2008, Santander continued to grow, making important acquisitions in a strategic market for the bank, the UK. Through the incorporation of Alliance & Leicester and Bradford & Bingley, Santander expanded its high street network to 1,300 branches in the country and became the third largest bank in the UK by deposits. With profits of EUR 8,876 million, Santander became the third largest bank in the world by profits.

• In 2009, Santander entered the US retail banking market with the acquisition of Sovereign, which has 722 branches in the north east of America [5].

Finally, the Deutsche Bank`s financial data is regarded (chart 9).

The following business segments represent the Group's organizational structure as reflec-

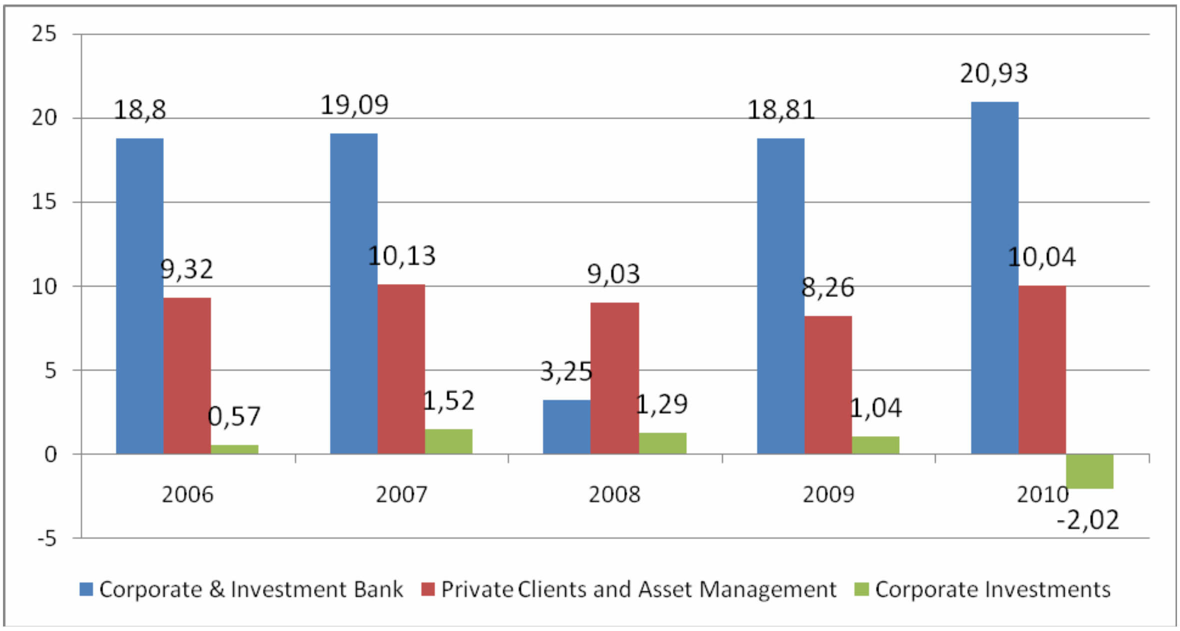

Chart 9. Total Net Revenue Per Line of Business of Deutsche Bank (euros in billions)
Sourse: Based on data from Deutsche Bank`s annual report

ted in its internal management reporting systems. The Group is organized into three group divisions, which are further subdivided into corporate divisions. As of December 31, 2010, the group divisions and corporate divisions were as follows:

The Corporate & Investment Bank (CIB), which combines the Group's corporate banking and securities activities (including sales and trading and corporate finance activities) with the Group's transaction banking activities. CIB serves corporate and institutional clients, ranging from medium-sized enterprises to multinational corporations, banks and sovereign organizations. Within CIB, the Group manages these activities in two global Corporate Divisions: Corporate Banking & Securities (CB&S) and Global Transaction Banking (GTB).

— CB&S is made up of the Markets and Corporate Finance business divisions. These businesses offer financial products worldwide, ranging from the underwriting of stocks and bonds to the tailoring of structured solutions for complex financial requirements.

— GTB is primarily engaged in the gathering, transferring, safeguarding and controlling of assets for its clients throughout the world. It provides processing, fiduciary and trust services to corporations, financial institutions and governments and their agencies.

Private Clients and Asset Management (PCAM), which combines the Group's asset management, private wealth management and private and business client activities. Within PCAM, the Group manages these activities in two global Corporate Divisions: Asset and Wealth Management (AWM) and Private & Business Clients (PBC).

— AWM is composed of the business divisions Asset Management (AM), which focuses on managing assets on behalf of institutional clients and providing mutual funds and other retail investment vehicles, and Private Wealth Management (PWM), which focuses on the specific needs of high net worth clients, their families and selected institutions.

— PBC serves retail and affluent clients as well as small corporate customers with a full range of retail banking products.

Corporate Investments (CI), which manages certain alternative assets of the Group and other debt and equity positions [6].

In this environment, we generated a net income of € 2.3 billion in 2010, compared to € 5.0

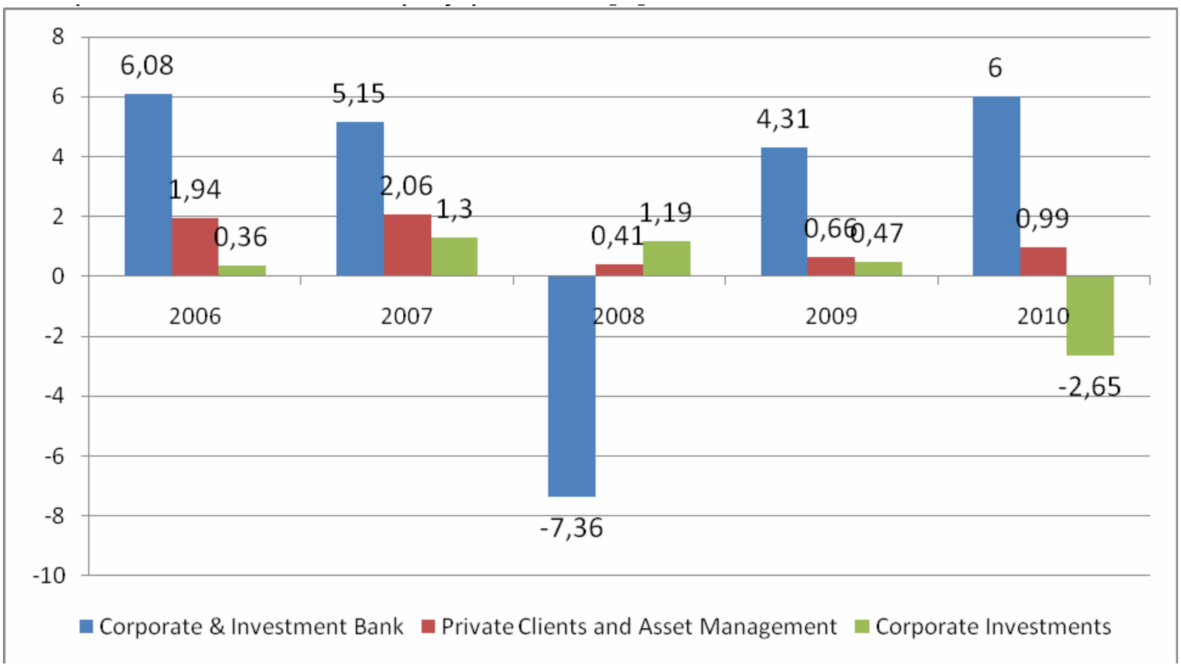

Chart 10. Net Income (Loss) Per Line of Business of Deutsche Bank (euros in billions)
Sourse: Based on data from Deutsche Bank`s annual report

billion in 2009, a solid result considering the impact of several significant factors. These factors include, firstly, certain valuation- and integration-related charges from the acquisitions of the commercial banking activities from ABN AMRO in the Netherlands, of Sal. Oppenheim/BHF-BANK and of Postbank, the latter including a charge of € 2.3 billion in the third quarter 2010. Secondly, during the year we invested in the integration of The CIB businesses, in The IT platform and in other business growth initiatives. Thirdly, deferred compensation expenses were significantly higher in 2010 reflecting changes in compensation structures implemented in 2009. Additionally, the aforementioned acquisitions increased The revenue and expenses run rates, as well as The balance sheet, risk weighted assets and invested assets. Moreover, a shift in foreign exchange rates, in particular between the U.S. dollar and the euro, contributed to an increase in The reported euro revenues and expenses, with an overall positive impact on net income [6].

As for mergers and acquisitions of this bank, it can be demonstrated through the following facts:

2002. Deutsche Bank con¬cludes the purchase of Scudder Investments Launch of the business units Private & Business Clients (PBC) and Private Wealth Management (PWM)

2003. Acqusition of the Swiss Private Bank Rued, Blass & Cie

2004. Opening of a branch office in Beijing Acquisition of the Russian investment bank United Financial Group (completed in 2006)

2006. Takeovers of Berliner Bank and Norisbank Branch openings in Dubai and Riyadh

2007. Launch of private & business banking in China

2009. Co-operation with Postbank

2010. Acquisition of Sal. Oppenheim [6].

Motives for conglomeration

In a world with perfect capital markets and perfect competition and no information or agency problems, there would be no need for financial conglomerates since they would not create any added value. However, such a world is a theoretical abstraction and financial conglomerates do exist because of cost and revenue synergies, diversification benefits and agency problems. Their existence also creates certain risks, most of which are not unique to conglomerates, but come more to the fore in such organisations because of their sheer size and complexity.

Cost and revenue synergies. Cost synergies can be due to efficiencies of scale or scope. A company may be able to reduce its average cost by providing the same product on a larger scale or by providing multiple products. Some delivery methods exhibit important economies of scale, which may have increased over time due to technological advancements. The same may also be true for tools of financial engineering and risk management. Distribution channels and customer databases, on the other hand, are examples of areas where efficiencies of scope can be realised. If the organisation or group becomes too large, inefficiencies may arise because of coordination problems. Efficiencies of scale or scope may also work on the revenue side. For example, multinational companies may only want to do business with financial companies of a minimum size. Scope efficiencies arise because of cross-selling opportunities resulting from consumption complementarity, the sharing of the reputation associated with a certain brand name, the possibility of developing a close customer relationship, and the preference of a customer to reveal private information to a single group. Revenue synergies are often mentioned as the main reason for the existence of bancassurance groups. Again, there is the risk that at a certain point the efficiencies turn into inefficiencies, for example when one moves away from the core business or when conflicts of interest arise.

Diversification. By diversifying, a company can reduce the volatility of its cash flows. This may in turn reduce the probability of financial distress, thus avoiding certain costs. In the scenario of a bankruptcy, there are direct (legal and administrative) as well as indirect costs (difficulty of running a company that is going through such a process). But even when the company is not entering bankruptcy, management may suffer because of increased conflicts of interest between bondholders and shareholders. Finally, diversification may also reduce the company's need for external finance. It has been argued that companies prefer internal finance because they want to avoid market discipline and the costs associated with issuing securities, or giving adverse signals to the market. Diversification allows companies to tap new sources of revenue, which can complement a stagnating or shrinking core business. For example, by engaging in fee-business such as insurance broking, investment banking or fund management, banks may offset the prevailing disintermediation trend. Banks that have a strong market position may choose to expand in other, related markets in order to avoid intervention by competition authorities [13].

Agency reasons. By engaging in mergers and acquisitions, managers may want to achieve personal goals which do not necessarily coincide with the objective of maximizing shareholder value. One such goal could be "empire building", if a manager's status and compensation are linked to the size of his company. Another goal could be to protect company-specific human capital by reducing the insolvency risk through diversification. Conglomeration also allows managers to complement their skills, thus making them more valuable to the organisation. Finally, management may want to shelter itself from market discipline and corporate control mechanisms, which can be achieved through more stable cash-flows (i.e. diversification) and less external finance.

Risks involved

Regulatory arbitrage. Since conglomerates are managed on a group-wide basis, transactions may be booked in certain entities or deals may be generated to exploit regulatory differences. Intra-group transactions can be set up to formally meet regulatory requirements, but at the same time circumvent the aims of those requirements. Examples which have attracted a lot of supervisory attention include “double or multiple gearing” and “excessive leveraging”. Double gearing refers to the use of the same capital by two (or more) regulated entities in the group. Excessive leveraging can occur when debt is issued by a parent company and the proceeds are down-streamed in the form of equity to regulated entities of the group.

Contagion. Difficulties in one group entity may spill over to other ones. Such a situation can result directly from economic links between entities, such as capital holdings, loans, guarantees and cross-default provisions. Indirect contagion, on the other hand, results from the behaviour of third parties (e.g. customers, investors) to a group entity in response to problems of an affiliated entity. It can result from mere association (e.g. use of common branding and marketing).18 Contagion is of particular concern when it affects regulated entities because of problems occurring in non-regulated entities. One may try to limit the contagion risk through the design of “firewalls”19 but there is the possibility these may become ineffective, especially in times of stress. For example, market pressure may lead a parent company to support its ailing subsidiary although it may have no legal requirement to do so.

Moral hazard. Moral hazard can work in several ways. First, a non-regulated entity may try to gain access to a bank’s safety net (such as deposit insurance and lender of last resort facilities) by being associated with it in a conglomerate. Second, the conglomerate may become so large that it is perceived to be “too big to fail” by market participants. The expectation that the conglomerate will be bailed out by public authorities may stimulate risky behaviour. Third, moral hazard can also work within the group as group entities may expect help from other group entities in the event of financial distress and so behave in a more risky way[14].

Lack of transparency. Because of the group’s size and complexity it may be difficult for markets and supervisors to obtain an accurate picture of its structure and risk profile. The legal and managerial structures of a group may vary (e.g. reporting according to business lines/ geographical areas, matrix structure). Due to the interaction between different group entities, the risk of the conglomerate is most likely to be different to the sum of the risks in the various entities on a stand-alone basis. Intra-group transactions can be used or abused to transfer assets from one entity to another and as a vehicle for cross-subsidisation. Another concern is that important risk positions may be built up which remain unnoticed because they are dispersed over many group entities. The group’s complexity may also make a work-out or winding-down of an ailing conglomerate very difficult. “Firewalls” refers to restrictions placed between a bank and its affiliates to protect against liabilities/losses. More specifically, it also refers to statutory and regulatory limitations on financial transactions between banks and their affiliates. Such limitations are meant to prevent the spread of financial difficulties within a banking group. The restrictions should in particular prevent the group from shifting losses from its non-bank entities to its insured bank entities and potentially to the deposit insurance fund. Moral hazard is the risk that the risk-taking behaviour of parties will increase because of the existence of certain arrangements or contracts.

Conflicts of interest. A conglomerate takes up a multiple of different roles in its customer-dealing which may potentially conflict. The sharing of customer information between group entities may violate privacy laws. However, conflicts of interest also exist in the same organisation so the key issue is whether there are any incentives and opportunities in the organisation to exploit such conflicts of interest. Professional investors may understand such situations and take them into account in their decisions. Competition and fear of reputation loss may also act as a restraint. Other possible measures to limit the risk are disclosure, voluntary codes of conduct and internal structures/procedures designed to ensure that the different business areas are managed sufficiently independently.

Abuse of economic power. Financial conglomerates can lead to greater market concentration, less competition and, ultimately, a less efficient financial system. They can drawn on revenue from many operations and are therefore in a better position to fight competitors. The lack of competition can in turn have a negative effect on innovation. The traditional separation between commercial banking and investment banking in the United States has been defended on the basis of the argument that this model would stimulate competition and innovation within business lines. The concentration of economic power as a result of dominating different financial sectors may ultimately lead to groups that are "too big to discipline" or "too large to fail" [15].

Conclusion

Due to structural factors such as deregulation and the development of financial markets, the linkages between financial sectors in the EU, in particular the banking and insurance sectors, have increased over time. These linkages now have a multitude of different forms: distribution agreements, credit exposures, credit and operational risk transfers, shareholdings, etc. This paper focussed on a particular form of institutionalised relationship between financial sectors, the financial conglomerate, which is often created via shareholder links between banks and insurance firms. The combination of different financial services in one and the same group offers some clear revenue synergies through the exploitation of a common customer base and common distribution networks, which explains why this particular business model has become increasingly popular in the EU. In recent years, in the wake of the poor performance of financial markets, some groups have had to provide financial support to their cross-sector subsidiaries or have even disposed of them. Nevertheless, the business model exhibits strengths that are likely to underpin its continued long-term attractiveness. However, such mixed financial services groups also create certain risks to which the groups and public authorities have to respond appropriately. These risks relate in particular to the transmission of problems from one group entity to another one via intra-group exposures. Insufficient capital at the group level resulting from excessive leveraging and multiple gearing may result in financially vulnerable groups. At the macro-level, concerns relate in particular to the impact of such complex groups on financial markets, on payment and settlement systems and, more generally, on financial stability.

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Yuliya Shkrabalyuk*

EXCHANGE RATES AND INFLATION TARGETING IN THE CONTEXT OF INTERNATIONAL MACROECONOMIC COORDINATION

Анотація *У статті розглянуто питання міжнародної макроекономічної координації та стабілізації в рамках програмної теми конференції: Фінансові аспекти досягнення глобальної економічної рівноваги. Проведено порівняльний аналіз правил вибору оптимальної монетарної політики для трьох видів рівноваги: макроекономічної координації, рівноваги Неша та Штакельберга, використовуючи параметри, що відображають відносні показники розміру та відкритості економіки. Розкрито переваги політики макроекономічної координації та важливість її подальших досліджень.*

Annotation *This paper deals with international macroeconomic coordination and its stabilization within a conference framework: Financial Aspects of Rebalancing the Global Economy. The optimal monetary policy rule for three types of equilibria: macroeconomic coordination, Nash and Stackelberg, using parameters that reflect the relative size and degree of openness of the economies, have been compared. This paper confirms that macroeconomic coordination policy is better than non-coordination rules, and it is a starting point for a promising research agenda.*

Key words Macroeconomic coordination, open economy, inflation targeting, Nash equilibrium, Stackelberg equilibrium, monetary policy rules.

The Mundell–Fleming model (the IS-LM-BP model) shows that macroeconomic policies are not independent from foreign developments and interdependence reduces effectiveness of policy. Visa versus, international policy coordination minimizes negative side-effects of domestic policy and increases power of policy interventions.

Though, a political problem of revealing interdependence appears. Thus at the global level, systematic coordination has never lasted long, but nonrecurring initiatives have taken place. Worth mentioning are the coordinated reflation engineered at the Bonn Summit in 1978, the Plaza agreement of G5 members to amplify the depreciation of the dollar in October 1985, the January 1987 Louvre agreements to stabilize exchange rates, when G6 members temporarily agreed on a system of exchange-rate target zones, i.e., fluctuation bands for bilateral nominal exchange rates which would be protected by central bank intervention at the margin of the bands, and the "Framework for strong, sustainable and balanced growth" initiated in 2009 by the G20 to address global current account imbalances.

The purpose of this paper is to compare the optimal monetary policy rule for three types of equilibriums: macroeconomic coordination, Nash and Stackelberg, using parameters that reflect the relative size and degree of openness of the economies.

The literature on macro coordination is considerable and started with the paper of K.

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Hamada [10] and followed by M.B. Canzoneri and J.A. Gray [3], K. Rogoff [15], P. Kehoe [12], M.B. Canzoneri and D.W. Henderson [4]. One of the first papers about economic coordination among countries was by J. Robinson. It involves a trade game among countries and the strategies and retaliations among partners in response to adverse situations. The main policy instruments are: depreciation of the exchange rate, wage reduction, exports subsidies and tariffs retaliations [14]. This started an extensive research agenda focusing on trade policy cooperation among nations.

K. Hamada analyzed the monetary policy and exchange regimes, using a box called the Hamada diagram, where the potential gains from macro coordination became more visible. Using the diagram, it was possible to show that Nash and Stackelberg equilibriums were inferior solutions than coordination (which were located on the Pareto contract curve) (Figures 1.1, 1.2, 2.1, 2.2) [10; 11].

Home \ Foreign	Somewhat restrictive	Very restrictive
Somewhat restrictive	$\Delta\pi^* = -1\%$ $\Delta U^* = 1\%$ $\Delta\pi = -1\%$ $\Delta U = 1\%$	$\Delta\pi^* = -2\%$ $\Delta U^* = 1{,}75\%$ $\Delta\pi = 0\%$ $\Delta U = 0{,}5\%$
Very restrictive	$\Delta\pi^* = 0\%$ $\Delta U^* = 0{,}5\%$ $\Delta\pi = -2\%$ $\Delta U = 1{,}75\%$	$\Delta\pi^* = -1{,}25\%$ $\Delta U^* = 1{,}5\%$ $\Delta\pi = -1{,}25\%$ $\Delta U = 1{,}5\%$

Figure 1.1. INTERNATIONAL POLICY COORDINATION FAILURS
Hypothetical Effects of Different Monetary Policy Combinations on Inflation and Unemployment

Nash Equilibrium **Pareto-optimal Equilibrium**

Home \ Foreign	Somewhat restrictive	Very restrictive
Somewhat restrictive		8/7 0
Very restrictive	0 8/7	

Figure 1.2. PRISONER'S DILEMMA
Payoff Matrix for Different Monetary Policy Moves

Another example of showing superiority of cooperation is the paper by M.B. Canzoneri and

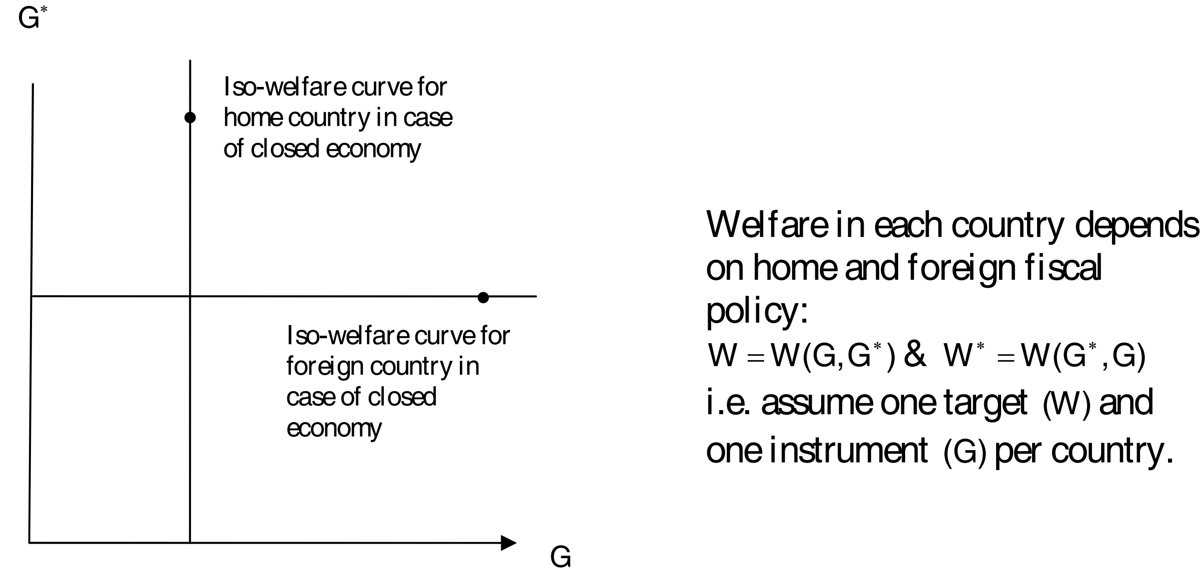

Figure 2.1. HAMADA DIAGRAM

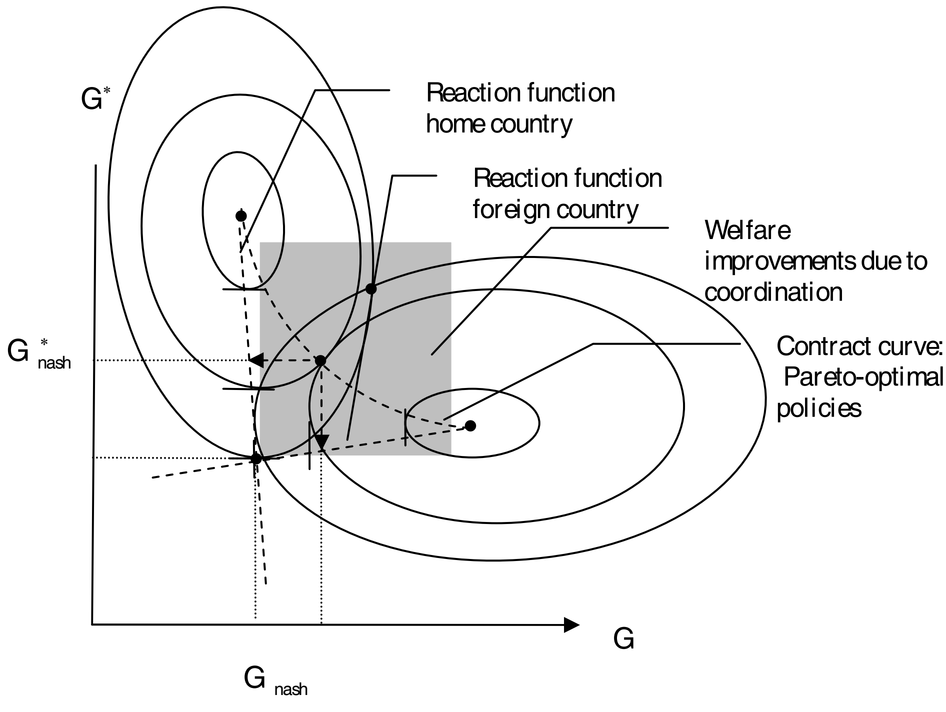

Figure 2.2.

J.A. Gray. They analyzed the result of the same exogenous shock (for example, an oil shock) on two blocks (in the case, the US and the rest of the world (ROW)). The analysis involved three types of externalities of the macro policy decision:

a) externality with a negative symmetry (beggar-thy-neighbor effect), where an expansionary policy in one country exports unemployment to the other;

b) externality with a positive effect (locomotive effect), where an expansionary policy in one country raises the GDP in the other;

c) externality with asymmetry, where the expansion in the US increases the product in ROW, but the expansion in ROW decreases the product in the US.

The authors clearly pointed out that for regimes with positive or negative externalities there is room for coordination, giving superior results than the Nash or Stackelberg equilibria. But for the case of the asymmetry externality, there is not a clear result [3].

K. Hamada [10; 11], C.E. Walsh [19], M.B. Canzoneri and J.A. Gray [3] reached similar conclusions with different models. These models emphasize that coordination is desirable from an economic point of view. The major drawbacks of the mentioned models are: they are static and the policy instruments to control are not clearly defined. All the policy decisions are taken at the same time and do not consider the delay effect of policy transmission. Understanding the macro coordination becomes more difficult when the policy decisions are not synchronized and when they are gradual.

K. Rogoff, using a monetary model, shows that a cooperative solution may be inferior to the non-cooperation, when the authorities do not take into account the reaction of the private sector. When the authorities for both countries try to boost the employment level, the private sector may become afraid of exchange rate depreciation and may adjust the wage and price level, increasing inflation. K. Rogoff claims that coordination involves credibility issues about the commitment of the authorities to fighting inflation [15].

P. Kehoe rejected K. Rogoff's point of view presenting a counter example where a government can maximize the welfare of the economy bringing about better results with macrocoordination than with Nash equilibrium. When there is a common strategy by the private agents and the government, these models raise questions about credibility and intertemporal inconsistency [12; 15].

All the quoted papers are two-country models. When more than two countries are involved the following cases are presented:

a) all the countries work in coordination;

b) there is no coordination among them;

c) only a sub-set of those countries are willing to coordinate their policy.

Partial coordination is only sustainable when no inside country (insiders) or nor outside country (outsiders) is willing to change the status quo. These questions of insiders and outsiders and others related to incentives (free-riding) are addressed by M. Espinosa-Vega and C.K. Yip [6].

In the 90's, there were some papers considering how monetary policy should be conducted. Among them the inflation-targeting approach is the major theoretical and practical reference as a monetary rule and this framework has been adopted in many countries. The inflation-targeting framework allows the researches to treat the interaction among the major variables in a simple manner than that of the big econometric models.

This paper uses the inflation-targeting framework in a two-country model, presented by M.K. Muinhos, E.U. Chang, J.R. Teixeira [13], allowing us to consider macroeconomic stabilization and coordination between two nations and it is an extension of L. Ball research «Policy Rules for Open Economies» [1]. The parameters are set in a way to characterize the difference in size and degree of openness of the two representative countries.

Three optimal monetary rules are used:

a) macroeconomic coordination equilibrium,

b) Nash equilibrium,

c) Stackelberg equilibrium.

The reaction function depends on the output of the two economies, inflation, an exchange rate shock, the lagged exchange rate and in some specific rules on the inflation of the other country, the optimal rules can be found using a linear quadratic model. Several simulations are performed in order to calculate the variances on the inflation, output and interest rates when economies are under demand, cost and/or exchange shocks.

The model shows us that the output and inflation stabilization is more efficient when the coordination rule is used. The greater is the welfare gains the more dependent and open the country is. If macro coordination is impossible, in the case of one country having all the relevant information of the other one, and if it assumes a leader position, there would bring about stabilization welfare gains.

Without coordination, monetary rules with more weight on inflation turned out to get less stabilization on inflation and output than other policies rules. Hence, the more dependent and open is the country, the less weight should be placed on inflation, to avoid an increase in the output and inflation volatilities. The relevance of this kind of model that allows the interaction of two economies is increasing lately, as we move to a more global and integrated world.

Two-Country Model: the core of the two-country model, proposed by M.K. Muinhos, E.U.Chang, J.R. Teixeira [13], is based on L. Ball research, adding up the externalities of the other economy output [1]. The model has five equations: the domestic and foreign country demand, the domestic and foreign supply and the fifth equation that connects both economies by the exchange rate.

The model specification is:

$$y_t = a_1 p_{t-1} - a_2 r_{t-1} + a_3 y_{t-1} + a_4 y^*_{t-1} + u_t \qquad (1)$$

$$y^*_t = -a^*_1 p_{t-1} - a^*_2 r^*_{t-1} + a^*_3 y^*_{t-1} + a^*_4 y_{t-1} + u^*_t \qquad (2)$$

$$\pi_t = \pi_{t-1} + b_1 y_{t-1} + b_2(\rho_{t-1} - \rho_{t-2}) + e_t \qquad (3)$$

$$\pi^*_t = \pi^*_{t-1} + b^*_1 y^*_{t-1} - b^*_2(\rho_{t-1} - \rho_{t-2}) + e^*_t \qquad (4)$$

$$p_t = \theta(r^*_t - r_t) + \nu_t \qquad (5)$$

where

y_t - the log of the output gap (real output minus the potential one),

r - the real interest rate,

p - is the real exchange rate – an increase means exchange rate depreciation in the domestic economy –

- is the inflation rate,

πu - is the demand shock,

e - is the cost-push shock and v is the exchange rate shock;

a_i and b_i are the structural parameters of the economy.

The asterisks mean external variables and parameters.

Phillips Curves: equations (3) and (4) present the Phillips curves. Each one relates inflation with its lagged value, lagged output gap, changes in the exchange rate and the contemporaneous cost shock. A change in the exchange rate affects inflation due to imported prices. The equation merges the imported and domestic inflation.

The specification for the domestic inflation is:

$$\pi^d_t = \pi_{t-1} + by_{t-1} + e'_t \qquad (6)$$

Equation (6) is similar to a Phillips curve for a closed economy. Imported inflation is given for the total inflation of the previous period added to a proportion of the lagged output gap.

Imported prices follow a purchase power parity, so this inflation is given by:

$$\pi^i_t = \pi_{t-1} + (\rho_{t-1} + \rho_{t-2}) \qquad (7)$$

where imported inflation is a result of the total inflation of the last period plus any change in the exchange rate in the last period. In the other hand, inflation in the present period, given by equation (3), is a weighted average of domestic inflation and imported one, taking the share of imported goods as ϕ. The following identities hold: $b_1 = (1-\phi)b$, $b_2 = \phi$ e $e_t = (1-\phi)e_t'$.

Real Exchange Rate: equation (5) connects the two economies by the real exchange rate, which relates it to the interest rate differential. This relationship captures the financial market behavior: an increase in the real interest rate turns the domestic asset more attractive and so causes exchange rate appreciation. Other things that affect the exchange rate are the shocks in the exchange rate, which capture the expectations and the confidence of the private agents.

The balance of payments equation has the current account expression and the capital equations . The current account is positively related to the real exchange rate and the capital equation is positively related to the real interest rate differential. Hence:

$$TC(\rho_t) + MCA(r_t - r_t^* + \rho_t - E_t\rho_{t+1}) = 0$$

The linear approximation of the equation (8) brings us to the equation (5), unless the exchange rate shock. In the absence of the bubbles and under rational expectations give us that $E_t\rho_{t+1} = 0$.

There are other theories about the exchange rate behavior. Some of them are focused on variables as wealth and debt; others consider purchase power parity and the uncovered interest rate. This paper emphasizes the role for the trade balance and the interest rate differential and no attention to the role of the wealth and the debt stocks.

Parameters of the model: the purpose of M.K. Muinhos et al. paper was not the estimation of the parameters of the structural model for a particular economy, so that the calibration was based on results found in the literature. Some parameters are set to capture the difference in the degree of openness and in the relative size of the economies [13].

Table 1 presents the results of the calibration for an open economy.

L. Ball shows the results for American economy [1]; A.G. Haldane and N. Batini for the UK [9]; M.A. Bonomo and R.D. Brito [2]; P.S. Freitas and M.K. Muinhos for Brazil [8]. C.E. Walsh uses data based on other M.K. Muinhos et al. papers and with the exception of this research and L. Ball all the others results are for quarterly models [19].

Table 1.
Parameters of the Structural Model

	L. Ball (1998)	**H&B (1998)**	**B&B (2001)**	**F&M (2001)**	**Walsh (1998)**
a_3	0,8	0,8	0,91	0,73	0,8
a_2	0,6	0,5	0,51	0,39	0,35
a_1	0,2	0,2	0,08	-	0,04
b_1	0,4	0,4	0,32	0,31	-
b_2	0,2	0,4	0,1	0,2	0,2

where:
a_3 – demand elasticity for the exchange rate,
a_2 – demand elasticity for the real interest rate,
a_1 – auto-regressive parameter,
b_1 – inflation elasticity in relation to the demand,
b_2 – inflation elasticity in relation to the exchange (pass-through).

Table 1, comparing all the parameters used in the small-scale structural model, points out the consistency in the magnitude and the sign of the parameters used by those authors. The IS curve and the Phillips curve in the models by L. Ball [1] and by P.S. Freitas and M.K. Muinhos

[8] are backward-looking. A.G. Haldane and N. Batini model has a backward-looking IS curve and the Phillips curve is a weighted average of backward-looking and forward-looking terms with a small weight in the last term [9]. The exchange rate parameter in the IS curve and in the Phillips curve from M.A. Bonomo and R.D. Brito is rather small, showing how closed is the Brazilian economy compared with the US and the UK [2].

Table 2 shows the parameters used in the simulations that are based on those presented in Table 1.

Table 2.
Parameters for the Two Economies

Domestic	Foreign
$a_1 = 0{,}1$	$a_1^* = 0{,}2$
$a_2 = a_2^* = 0{,}45$	$a_2 = a_2^* = 0{,}45$
$a_3 = a_3^* = 0{,}8$	$a_3 = a_3^* = 0{,}8$
$a_4 = 0{,}1$	$a_4^* = 0{,}2$
$b_1 = 0{,}3$	$b_1^* = 0{,}4$
$b_2 = 0{,}2$	$b_2^8 = 0{,}4$

Those parameters are meant to represent two facts: that the domestic economy is more closed, with a smaller pass-through from exchange rate to inflation, $b_2 < b_2^*$; and it is less dependent on the foreign country's output, meaning that the demand of the other economy will affect less the domestic economy than vice-versa, . $a_4 < a_4^*$.

Optimal Equilibrium Rule: in the optimal dynamic solution (about how to obtain the optimal equilibrium rule) of the two-country model M.K. Muinhos at el. used the algorithm of linear quadratic method (based on J. Diaz-Gimenez paper [5]). This method is extensively used in Real Business Cycle Theory (RBC), where the return function is maximized. In case of M.K. Muinhos et al. model, it is a loss function which is minimized [13].

Further details on how M.K. Muinhos et al. implemented the algorithm of obtaining three types of solutions: macroeconomic coordination equilibrium, Nash equilibrium and Stackelberg equilibrium, will be given [13].

Macroeconomic Coordination Equilibrium: two countries obtain macroeconomic coordination when they minimize a joint objective function with same weight on the output gap, under the control of their respective monetary instruments, *r* e *r**. That is:

$$\min_{r_t r_t^8} \sum_{i=0}^{\infty} \beta^i E_t \{ \frac{1}{2} (\pi_{t+i+1}^2 + \lambda y_{t+i+1}^2) + \frac{1}{2} [(\pi_{t+i+1}^*)^2 + \lambda (y_{t+i+1}^*)^2] \} \qquad (9)$$

subject to

$$y_{t+1} = -(a_1\theta + a_2) r_t + a_1 \theta r_t^* + a_1 \nu_t + a_3 y_t + a_4 y_t^* + u_{t+1} \qquad (10)$$

$$y_{t+1}^* = -(a_1^*\theta + a_2^*) r_t^* + a_1^* \theta r_t^* - a_1^* \nu_t + a_3^* y_t + u_{t+1}^* \qquad (11)$$

$$\pi_{t+1} = \pi_t + b_1 y_t - b_2 \rho_{t-1} + b_2 \nu_t - b_2 \theta r_t + b_2 \theta r_t^* + e_{t+1} \qquad (12)$$

$$\pi_{t+1}^* = \pi_t^* + b_1^* y - b_2^* \rho_{t-1} + b_2^* \nu_t - b_2^* \theta r_t + b_2^* \theta r_t^* + e_{t+1}^* \qquad (13)$$

Each restriction equation can be separated in three parts:

a) state variables at time *t*;

b) control variables at time *t*;

c) shocks at time *t* + *1*. Defining the state variables by s_1, where *i*=1, 2, 3 or 4. Then:

$$s_{1t}=a_1\nu_t+a_3y_t+a_4y_t^*$$
$$s_{2t}=-a_1^*\nu_t+a_3^*y_t^*+a_4^*y_t$$
$$s_{3t}=\pi_t+b_1y_t-b_2\rho_{t-1}+b_2\nu_t$$
$$s_{4t}=\pi_t^*+b_1^*y_t^*-b_2^*\rho_{t-1}-b_2^*\nu_t$$

The optimal monetary policy rules with coordination are obtained by simulation using the value function of macroeconomic coordination and the return function with parameters given by Table 2. These rules are function of six arguments $(y, y^*, \pi, \pi^*, \rho_{-1}, \nu)$, shown by expressions below. The coefficients of these arguments are taken for the specific case with $\lambda=1$, the weight attributed to the output gap in the loss function. Therefore:

$$r_t=1{,}6005y_t+0{,}6806y_t^*+1{,}2027\pi_t+0{,}2063\pi_t^*+0{,}1843\nu_t-0{,}1580\rho_{t-1} \quad (14)$$

$$r_t^*=1{,}1734y_t+1{,}2225y_t^*+0{,}7177\pi_t+0{,}8072\pi_t^*-0{,}2860\nu_t+0{,}1793\rho_{t-1} \quad (15)$$

The signals of the coefficients of above reactions functions are all coherent with that point out by literature. The interest rate reacts positively to the output gap and inflation rate to both economies. Recalling that a higher interest rate means less demand and appreciation of real exchange rate, which brings about a reduction in inflation.

M.K. Muinhos et al. generated many samples to output, inflation and interest rate under optimal rules and taking the demands, the supplies and the exchange rate shocks. After that, the variances of inflation and output were calculated [13].

Nash Equilibrium: the Nash equilibrium is a non-coordinated policy. The authorities choose interest rate to minimize loss, taking as given the interest rate of the other country. Each country decides their policy, taking into account that the other nation has already decided and would not change it during this period. The Nash equilibrium treatment in this section is similar that is taken by C.E. Walsh [19].

The home country loss function is:

$$\min_{r_t}\sum_{i=0}^{\infty}\beta^i E_t\frac{1}{2}(\pi_{t+i+1}^2+\lambda y_{t+i+1}^2) \quad (16)$$

and foreign country loss function is:

$$\min_{r_t^*}\sum_{i=0}^{\infty}\beta^i E_t\frac{1}{2}[(\pi_{t+i+1}^*)^2+\lambda(y_{t+i+1}^*)^2] \quad (17)$$

The equilibrium treatment is similar to both countries. M.K. Muinhos et al. took home country to focus, taking the aggregate demand and Phillips curve expression at time *t + 1*, they have got [13]:

$$y_{t+1}=-(a_1\theta+a_2)r_t+a_1\theta r_t^*+a_1\nu_t+a_3y_t+a_4y_t^*+u_{t+1} \quad (18)$$

$$\pi_{t+1}=\pi_t+b_1y_t-b_2\rho_{t-1}+b_2\nu_t-b_2\theta r_t+b_2\theta r_t^*+e_{t+1} \quad (19)$$

Following the same treatment given to coordinated solution, each restriction equation can be separated in three parts:

a) state variables at time *t*;
b) control variables at time *t*;
c) shocks at time *t + 1*. The two state variables s_1 and s_2 are defined as:

$$s_{1t}=a_1\nu_t+a_3y_t+a_4y_t^* \quad (20)$$

$$s_{3t}=\pi_t+b_1y_t-b_2\rho_{t-1}+b_2\nu_t \quad (21)$$

The optimal monetary policy rules to home country, *r*, is a function of five arguments $(y, y^*, \pi, \rho_{-1}, \nu)$ while foreigner country has $(y, y^*, \pi^*, \rho_{-1}, \nu)$ as its rule, r^*. The coefficients of these arguments are taken for the specific case with $\lambda=1$, the weight attributed to the output gap in the loss function. Therefore:

$$r_t = 1{,}28619 y_t + 0{,}11871 y_t^* + 1{,}12117 \pi_t + 0{,}34305 \nu_t - 0{,}22434 \rho_{t-1} \tag{22}$$

$$r_t^* = 0{,}6642 y_t^* + 0{,}0414 y_t + 0{,}7191 \pi_t^* - 0{,}38178 \nu_t + 0{,}28764 \rho_{t-1} \tag{23}$$

Stackelberg Equilibrium: Stackelberg equilibrium, also known as leader-follower equilibrium, is another example of uncoordinated policy. The authorities choose the interest rate to minimize loss, taking into account how the other policy authority will respond to the leader's choice of interest rate. M.K. Muinhos et al. took home country as leader. The external reaction function is given by Nash equilibrium, $r_t^* = j_1 s_{2t} + j_2 s_{4t}$,where *j1* and *j2* are the coefficients that depend on weight attributed to output gap variance in loss function [13].

The optimal monetary policy rules to home country, *r*, is a function of six arguments $f(y, y^*, \pi, \pi^*, \rho_{-1}, \nu)$ while foreigner country has $f(y, y^*, \pi^*, \rho_{-1}, \nu)$ as its rule, r^*. The coefficients of these arguments are taken for the specific case with $\lambda = 1$, the weight attributed to the output gap variance in the loss function. Thus:

$$r_t = 1{,}3458 y_t + 0{,}4272 y_t^* + 1{,}1036 \pi_t + 0{,}3029 \nu_t + 0{,}1744 \nu_t - 0{,}0996 \rho_{t-1} \tag{24}$$

$$r_t^* = 0{,}0940 y_t^* + 0{,}6638 y_t + 0{,}7191 \pi_t^* - 0{,}3817 \nu_t + 0{,}2876 \rho_{t-1} \tag{25}$$

The leader reaction function has the output gap and inflation rate of foreign country as its arguments while the follower takes only leader's output gap on its optimal reaction function.

Results: volatilities of inflation and output are used to measure the performance of different monetary policy rules following J.B. Taylor, L. Ball [1], L.E.O. Svensson [16; 17]. The policy rule that conducts to less inflation and output volatilities is considered the best one.

M.K. Muinhos et al. made a simulation to obtain the inflation rate, the output gap and the interest rate volatilities as shown in Table 3. Each optimal rule is obtained with parameter values given by Table 2 and taking the same weight attributed to the inflation rate and output gap in the loss function [13].

Table 3.
Volatilities of Inflation rate, Output Gap and Interest rate

	Home country			Foreign country		
Equilibrium type	Var (π)	Var (y)	Var (r)	Var (π^*)	Var (y^*)	Var (r^*)
Coordination	3,11	2,57	4,71	2,39	2,46	4,38
Nash	3,25	2,86	3,61	4,43	4,27	2,4
Leader (home)	2,98	2,76	3,98	4,46	4,9	2,61
Leader (foreign)	3,11	3,02	3,72	2,51	2,59	3,8

Table 3 shows that under macroeconomic coordination policy, both countries have less inflation and output gap volatilities than any other types of policy. Nash equilibrium has clearly worse inflation and output gap volatilities than other rules for both countries. But comparing Nash equilibrium with Stackelberg equilibrium, the leader has better performance.

In short, two-country inflation target framework pointed out that macroeconomic coordination is desirable. This result is in agreement with models like the works of M.B. Canzoneri and J.A. Gray [3], D. Fielding and P. Mizen [7], C.E. Walsh [19].

J.B. Taylor brings us a remark about volatility of policy instrument in his analyses of different monetary policy rules [18]. Table 3 shows that the volatility of interest rate is higher in the case of coordination equilibrium. The less volatilities of output gap and inflation rate in coordination equilibrium come from an aggressive policy response to the external shocks. Briefly, the coordination equilibrium conducts to less inflation rate and output gap volatilities but not to interest rate and exchange rate volatilities.

These figures show the efficient frontier of the inflation rate and output gap volatilities under the optimal rules. Each simulation consists of two steps:

1) optimal rules of home and foreign countries are obtained to each type of equilibrium and;

2) using these rules and considering all types of external shocks many sample of variables and then its variances are generated.

The figures also show the increasing volatilities of the inflation rate and output gap while assigning more weight to inflation stabilization (except to macroeconomic coordination policy). This fact occurs when the optimal rule does not consider the reaction of the other country. The simultaneous increasing volatilities of inflation and output do not occur under macroeconomic coordination rule because both countries agree in their objective.

Model's equations point out that the stabilization of output gap and inflation rate occurs in two channels: the interest rate and the exchange rate. Expect coordination rule equilibrium, the lower weight in output (meaning higher commitment with lower inflation) conducts to greater volatilities of inflation and output. In the other hand, higher output gap stabilization does not result in inflation rate destabilization.

Under Nash equilibrium rule, while assigning more weight to inflation stabilization in loss function, the increasing volatilities of inflation rate and output gap are more evident to the foreign country. In other words, a country with "greater" openness and "more" dependent can conduct to the increasing volatilities of the inflation rate and also to the output gap without macroeconomic coordination. For this type of country it is not recommended a strict inflation goal but a flexible target.

The optimal rules coefficients depend on the structural parameters of the model and the weight given to output gap in the loss function. The model points out two structural parameters: the degree of openness and relative size of the country. The simulation takes the parameters as given in Table 2. Needless to say, $a_4 < a_4^*$ characterizes that the home country is less dependent than the foreign country and $b_2 < b_2^*$ means that domestic country is less open compared to foreign country.

Another simulation is made taking the greater degree of openness and greater relative size of two countries than before. The coefficients of these simulations are consistent with the signals and magnitudes of the previous one.

Table 4 shows the coefficients using original parameters and Table 5, using new parameters values.

Table 4.
Nash Equilibrium with $a_4 = 0{,}1 < a_4^* = 0{,}2$ and $b_2 = 0{,}2 < b_2^* = 0{,}4$

	y	y^*	π	π^*	?	ρ_{-1}
R	1,28619	0,11871	1,1217	0	0,34305	-0,22434
r^*	0,09414	0,6642	0	0,7191	-0,38178	0,28764

Table 5.
Nash Equilibrium with $a_4 = 0{,}05 < a_4^* = 0{,}3$ and $b_2 = 0{,}1 < b_2^* = 0{,}5$

	y	y^*	π	π^*	?	ρ_{-1}
r	1,51657	0,071425	1,2459	0	0,26744	-0,12459
r^*	0,11538	0,57524	0	0,6689	-0,41137	0,33445

The more closed is the economy, the less important are the other country's variables, the exchange rate shock, and lagged exchange rate variables. This means that the greater is the degree of openness and dependence of other economy, the smaller is the monetary policy reaction through the interest rate, in response to the inflation rate and the output gap.

The following main conclusions of this paper can be pointed:

1. The macro coordination equilibrium brings about less volatile output and inflation than Nash and Stackelberg equilibrium;
2. The gains of stabilization are greater for more dependent and more open economy;
3. The country which has more information and adopts a leader position presents a more stable economy;
4. In the absence of coordination, a more strict anti-inflation policy results in a greater output volatility, being worse in a more dependent and open economy;
5. A more dependent and open economy responds more aggressively to an exchange rate shock.

Summing up, it became possible to illustrate some questions and derive some conclusions about different aspects of the monetary policy. However, it is worth to stress that some important aspects such as fiscal policy and the structural features of the economy are not taken into account in this paper, but the author believes it to be a starting point for a promising research agenda.

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THE ISSUES OF LEGAL REGULATIONS APPROXIMATION IN THE FRAMEWORK OF UKRAINE AND THE EU ASSOCIATION AGREEMENT IN THE POST-CRISIS PERIOD

Key words. Association Agreement, free trade zone, the national program of acquis implementation, global economic crisis, legislation harmonization.

Objective. Insight into the main problems on Ukraine's way to an association with the EU in the post-crisis global economy conditions, as well as the study of recommendations and legislation adaptation measures in the process of association agreement conclusion and, in particular, in the establishment of the profound free trade zone.

Methods. The work employs comparative-analytical methods of scientific research.

Results. The Ukrainian Government set a strategic objective of concluding a new base agreement with the European Union (Association Agreement). The progress achieved in the negotiations process regarding the Agreement is conspicuous. The signed document, however, is to become a starting point of a more ambitious task, i.e., the introduction of European standards in Ukraine through the implementation of undertaken obligations.

The Association Agreement between the EU and Ukraine can further serve as the model of relations between the EU and other partner states within the framework of the Eastern Partnership initiative, in particular, with Moldova, Georgia, and Armenia, with which the EU would also like to commence negotiations, in perspective, concerning the establishment of a profound free trade zone in order for the parties to be able to move on along the political association line. If the free trade zone fails to be established, the parties shall have no association agreements at their disposal, as a free trade zone is the constituent of such documents.

At present, ongoing are negotiations between Ukraine and the European Union (EU), commenced in February 2008, concerning the conclusion of the Agreement on the "profound and comprehensive free trade zone" (FTZ+), which is an integral and one of the major parts of the Association Agreement Between Ukraine and the EU, and which refers not only to goods trade tariffs, but also to bringing Ukrainian legislation in compliance with EU standards and rules in more than 20 spheres, which is very current to date.

Compliance with the liabilities undertaken under the Agreement, especially those that are concerned with legislation adaptation, will require not only political responsibility, but also the development and realization of a well thought-out system of planning and implementation of these liabilities.

The Association Agreement sets forth particular relations of the state with the EU, since it establishes special privileged ties with a non-member state, which must, at least to a certain extent, participate in the Commonwealth system. The intensity of a country and the EU relations is an important fundamental principle in determining regulatory capacity of international agreement norms in the law and order of EU and its member states, namely their capacity of di-

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rect effect [1, p. 10]. In the long run, this will allow Ukrainian natural persons and legal entities to protect more effectively their rights prescribed by the Agreement.

In the initial European Neighborhood Policy (ENP) documents, the European Union proposed to Ukraine and other neighbor states "fully-fledged participation in the Internal EU market". In return, EPS states would follow the example of the European Economic Zone (EEZ) member states and adapt a great part of acquis that regulates the EU Internal market. Starting from 2006, the EU has not put forward such proposal; instead, the EU documents started emphasizing long-term perspective of an economic community that will be formed between the EU and partner states, also providing it that these countries will selectively adopt respective parts of EU legislation [2, p. 11].

On the other hand, "selective harmonization" can be deemed as a pragmatic approach, whereas Ukraine is not a candidate for the entry into EU and has weaker stimuli than those with the candidate status. Thus, presently, Ukraine lacks the possibility, for example, to adopt EU Environmental Directives in full, since this is to bring about extensive expenses. Firstly, this does not serve basis for signing the EZT+ Agreement. And, secondly, Ukraine shall not be granted access to EU structural funds that would reduce harmonization expenses in the sphere. For these stimuli have played an important role in initiating, legitimization, and assertion of changes in the candidate countries of the Central and Eastern Europe of the time.

Legally, harmonization of Ukraine's national legislation with EU legislation is outlined in Article 51 of the Partnership and Cooperation Agreement between Ukraine and European Communities (European Union) and Their Member States dated June 14, 1994 (PCA) in the following spheres: customs law, companies legislation, banking law, companies accounting, taxes, including indirect ones, intellectual property, labor safety, financial services, competitions rules, public procurements, healthcare and life protection of humans, animals, plants, and environment, consumer rights protection, technical rules and standards, transportation, energy use, including nuclear energy [3, p. 6].

Ukraine's European integration mechanism possesses certain signs that make it different from the structures of former and present candidates for joining the EU. This is primarily manifested in the existence of parallel processes, namely, the Ukraine-EU Action Plan 2005 in the framework of the European Neighborhood Policy (AP ENP) and the National Legislation Adaptation Program (NLAP) regulated by Law of Ukraine No. 1629 "On the National Program of Adaptation of Ukrainian Legislation to European Union Legislation" dated March 14, 2004. The measures set forth by the NLAP are the "voluntary" component, whereas the AP ENP is Ukraine's obligation before the EU.

Despite the discrepancies in expert evaluations and official claims, Ukraine has mainly honored its obligations in the framework of the Action Plan. On the other hand, NLAP measures demonstrate a low realization level. NLAP compliance indexes throughout 2005-2007 were 50%, 25%, and 10% correspondingly [4, p. 6]. Moreover, if under the term "implementation" one understands not only legislative acts adaptation, but the everyday application of EU norms as well, then Ukraine appears to lag behind in terms of both the Action Plan and the NLAP. Very frequently this is manifested through the shortage of lower-level acts aimed at the compliance of adapted legislation norms and insufficient understanding of the essence of new norms. In view of this, as well as taking into consideration the ever more intense complication of the nature of obligations in the legislation adaptation sphere in the framework of the New Enhanced Agreement, the necessity arises to seriously review the mechanism of Ukraine's European integration.

As of the pre-crisis period, an agreement was arrived at by Ukraine and the EU that prior to the conclusion of the Association Agreement, the cooperation between the parties shall be based on the PCA terms and conditions. Thus, with the aim of providing for proper financing and sustainability of the process of Ukrainian legislation adaptation to the EU legislation, the creation of conditions for further advance of Ukraine's integration in the Internal EU market and the taking of necessary steps for the acceleration of the EU Association Agreement conclusion, the Supreme Council of Ukraine (SCU) approved entirely Law of Ukraine No. 852-IV "On Introducing Changes Into the National Program of Ukrainian Legislation Adaptation to EU Legislation" on January 14, 2009, that provides for the prolongation of the first stage of Program for the period until the termination of APC effect" [5].

Overall, within 2005-2009, out of the general volume of acquis communautaire that adds up to over 100,000 pages, nearly 60,000 pages have been translated into Ukrainian [6-10]. Constantly ongoing is work on the replenishment of the translation database in the "Electronic system of European Union documentation translated in Ukrainian".

All the states within the last EU expansion wave and Western Balkan States heading towards EU integration developed a rather unified implementation strategy that served as the main instrument for obligations planning, monitoring, and performance. In the case with the Central and Eastern Europe states, the national programs of acquis implementation, whereas for Western Balkan States (most of which are not official candidates for EU-membership), the name of National Program of Stabilization and Association Agreement is more common. The outlined approach to the performance of obligations is coordinated by the center and is rather transparent.

In a number of studies, such as, for example ІЕД (2006), CEPS (2006), CASE (2007), the profound and comprehensive agreement on free trade zone between the EU and Ukraine is useful in the long-term perspective, as it stimulates the increase of the actual GDP and the growth of economic welfare.

In order to allow the state to capitalize on all free trade zone benefits, attention ought to be shifted away from tariffs towards non-tariff issues, in particular, to technical barriers in the trade, the issues of trade procedures simplification, the intellectual property rights issues, etc. A survey conducted by the International Financial Corporation (2008), demonstrated that technical barriers, in the entrepreneurs' opinion, constitute the major obstacle for business. Moreover, cumbersome technical regulating holds back innovations, commerce and economic growth. Therefore, the maximum full approximation of standards, procedures of compliance valuation, accreditation, and market monitoring effective in the EU by all means belong to the topics of primary importance in the process of negotiations regarding the free trade zone. It should be emphasized, however, that much progress has been achieved in this sphere in the context of the WTO membership, since Ukraine undertook to develop all of its technical regulations on the basis of respective international standards. What is more, since Ukraine joined the WTO, all standards in Ukraine are voluntary, except those set forth in technical regulations designated, in particular, for the protection of national security interests, prevention of fraudulent actions, protection of the health and life of citizens, animals or plants, as well as environmental protection.

The experience of new EU member states and Western Balkan States having performed or performing under minor agreements with the EU testifies to the fact that their governments were preparing for the management of the changes implementation process with the aim of successful compliance with respective agreements. Such preparation possessed multiple common features in different states. In particular, the governments of these countries resolved the following issues [11]:

Establishment and operation of a centralized mechanism (that most often possessed the format of a special executive authority) securing political and administrative coordination of governmental activities aimed at Agreement implementation.

Implementation as a governing instrument of a national program of Association Agreement implementation. The governments of all states performing under similar EU agreements organized their work precisely around the all-national strategic documents – detailed action plans aimed at performance of all obligations undertaken in the context of the association agreement, composed in accord with a uniform structure featuring the division into short-, mid- and long-term priorities.

Building-up of institutional capacity of the executive power vertical in all sectors embraced by a state's obligations under the agreement with the EU, which includes respective central, territorial (regional), and local executive bodies, to develop sector-based parts of the national program and secure their implementation.

At the same time, it is noteworthy that the process of adaptation of domestic legislation to acquis communautaire is connected with the following issues [3, p. 60]:

1. The present-day acquis communautaire implementation state testifies to the fact that this matter is not given sufficient attention on the all-national level. Therefore, it failed to find stable social legitimization and to become the subject of extensive discussion among scientists, non-government organizations, political associations, mass media, and the public on all levels.
2. Implementation presupposes establishing priority adaptation sectors in the framework of a concrete type of politics. However, in the process of national legislation adaptation planning, despite the clear establishment of its procedure, central bodies of power demonstrate insufficient initiative.
3. A serious challenge to the adaptation process is the provision of due quality of translations. According to the experience of the states that have recently joined the EU, it is very difficult to secure uniform approaches to terminology in the conditions of excessive translation volume and lack of respective experience. Moreover, the acquis communautaire acts are the result of multilateral negotiations and contain specific terminology. And the lack of knowledge of foreign languages, English in particular, hinders the negotiations on important sector-specific issues and familiarization with EU legislative acts [12, p. 26].
4. The process of EU regulatory acts translation and interpretation is rather slow, in comparison with Poland, Turkey, and Croatia. The main reason for such delay lies in the necessity to overcome difficulties of legal systems incompatibility of the EU states and Ukraine. Thus, the recommended source of translation into Ukrainian is the German variant of acquis communautaire, since its terminology is approximated to the continental system of law. However, these arguments are too weak. For in the process of adaptation, one should take advantage of the possibility of using the official translations of EU regulatory acts into the languages of some member states (Poland, Bulgaria), the legal system and language structure of which is much related to the Ukrainian one [13].
5. The translation and processing (interpretation, terminology concordance) of acquis communautaire is accompanied by low priority level of the implementation of its norms on the part of the SCU to the national legislation (certain bills implementing EU norms in the national legislation have been under review of SCU committees since 2006, and the State Department for Legislation Adaptation conclusions regarding the compliance of bills with the acquis communautaire norms have no impact upon the process of their adoption).
6. There exists incompliance of regulation spheres of normative-technical and regulatory acts of Ukraine and the EU. Thus, a rather wide range of relations regulated in the EU on the level of directives, are regulated in Ukraine by voluntarily used interstate standards.

For the acceleration of the process of adaptation to acquis communautaire, we deem the following necessary [3, p. 60]:

- To grant the programs of measures connected with the acquis communautaire norms implementation with the National status in order to increase the significance of the issues of national legislation adaptation to the EU legislation and the involvement of a wider range of public, institutions, and organizations in the process.
- On the legislative level, to oblige central executive bodies of power authorized to effect trade policies to submit proposals with the aim of forming "Tentative plan of acquis communautaire acts translation into Ukrainian in the respective year" (in conformity with the acquis communautaire acts translation into Ukrainian procedure approved by Order No. 56/5 of the Ministry of Justice of Ukraine dated June 08, 2005).
- To commission to the State Department for Legislation Adaptation main, guiding, and coordinating functions by way of introducing changes into respective regulatory acts.
- At the same time, to involve in the process of adaptation, taking into account the transparency principle, non-state structures, public organizations and higher education institutions financed within the projects administered mutually with the EU.
- It is expedient to train respective professional staff for the performance of translations of proper quality in view of the difficulty of providing uniform approaches to terminology and in the conditions of excessive translation volumes (translation of acquis communautaire and informational and analytical materials, legislative acts and their drafts into English).
- To change the process of bills consideration by the SCU so that each bill package submitted for consideration to the SCU contains a conclusion regarding its conformity with acquis communautaire; and prior to its direct consideration, the conclusion should be read to the deputies by the SCU chairperson.
- To establish the order of cooperation with national manufacturers regarding standards, norms, and rules harmonization that will allow to preserve funds during the adaptation of the most important standards, in particular, the standards on the basis of export goods groups (as opposed to general harmonization). It is considered expedient to replace the normative-technical documents with regulatory acts, in the cases of spheres the regulation of which is performed on the EU directives level.

Upon the analysis of harmonization costs and benefits for a number of acquis sections, it has been established that:

- coordination of the law on companies and state assistance rules regulation presupposes rather considerable expenses for certain companies, yet, as it appears to be, shall be of benefit for the entire society as such;
- liberalization of capital flows is useful for the state, though there exist liberalization risks pertinent to imperfection of the market;
- there are high expenses connected with the introduction of Basel II rules in Ukraine, which makes the approximation of these norms questionable. It is all the more doubtful at present, when the global economic crisis revealed considerable gaps in the system;
- enactment of stricter ecological standards shall pose biggest challenges to companies that have previously positioned themselves in cheap sectors or produced low-quality products.

At the same time, in view of Ukraine's aim of gaining EU membership, the approximation with European standards and practice must be thoroughly planned. At this, the following consideration should be taken into account.

Firstly, global economic crisis changes the regulatory field of activity worldwide and in the EU states in particular. These changes must be taken heed of in the adaptation of EU norms.

Secondly, since Ukraine shall effect essential reforms in the process of securing the performance of obligations under the Free Trade Zone Agreement with the EU, it is within the scope of Ukraine's interests to secure interest on the part of the EU in lending financial and technical support to these reforms in the country.

In the given post-crisis conditions of the bodies of power functioning, the government can experience the following issues with organizing its performance [11]:

- absence of an effective centralized coordination mechanism. This is manifested in the fact that not a single body for the coordination of European integration politics has been established in Ukraine. To date, there exists a set of detached processes in separate bodies of power that are often performed simultaneously. The majority of European integration politics aspects are coordinated by the Ministry of Economics, the Ministry of Justice, and the Cabinet of Ministers of Ukraine Secretariat (the European and Euroatlantic Integration Coordination Bureau in particular, or presently the European Integration Bureau, the latter being a subunit of the former). Thus, due to such doubling, the entire coordination system appears to be ineffective, and the responsibility for concrete problems and failures is absent.
- Unpreparedness for the development of the national program for Association Agreement performance. Due to the absence of standards and quality control procedures in the existing governmental planning system, particularly strategic and budget planning, it is impossible to use in Ukraine such management tool as the performance of the Association Agreement in accord with procedures and patterns implemented by all countries that are performing or have performed upon the similar agreements with the European Union.
- Institutional incapability of central executive authorities. As of now, no clear-cut tasks have been assigned to central executive authorities to be fulfilled for the successful implementation of programs and plans regarding integration with the EU. At the same time, their internal structure hinders the performance of such tasks, whereas no precise conditions have been established as to who is responsible for separate results needed for the preparation and execution of the national program for the performance of the Association Agreement. Frequently, different structural units undertake the same functions and none bear responsibility for the final outcome.

A separate aspect of central executive authorities' activities is effective functionality of structural units concerned with European integration. To date, no single vision exists regarding the role and objectives of the structural units for European integration in the bodies of state power: European integration is undertaken chiefly by departments that combine this type of activities with international cooperation. In this respect, the following problematic spheres can be singled out:

- The number of employees undertaking European integration issues within the body is inconsiderable (2-3 persons).
- Heterogeneous list of types of activities of the European integration units.
- European integration units perform varied functions (coordination, planning, policies development etc.), often doubling the work of other departments. Being in imbalance, such units have multiple tasks and scarce resources, human resources, for instance.

The negative experience of Ukraine being compliant with prior agreements with the EU in the post-crisis period testifies to a great risk of the failure to comply with new obligations under the Association Agreement. The European party definitely aims at comprehensively harsh control of the Agreement performance. That is why even the best imitation of intense activities cannot conceal real achievements or lack thereof.

Post-crisis phenomena have made the question of negotiation process acute; and the process is still ongoing. Therefore, the political management must realistically evaluate the government's capacity to secure the performance of the Agreement. And for this, the scope of issues causing the risk of failure must be determined, as well as immediate action ought to be taken with the aim of providing a complex resolution of these. Thus, we have come to believe that there is a necessity to take the following steps on the way to government preparation for the EU Agreement performance:

- Developing a centralized model of European integration coordination by way of the Cabinet of Ministers issuing an order on the establishment of a centralized coordination body. Its chief objective will be coordination of the central executive bodies' activities in the sphere of preparation and execution of the National Program of EU Association Agreement Implementation, and the powers of the majority of bodies should be redistributed in order to concentrate them in the hands of the central coordination body.
- Performing transfer to centralized planning of Association Agreement performance through the preparation and adoption of a legislative act that will define the status and place of the National Program of EU Association Agreement Implementation in the state programs and plans system that must receive the priority status in respect of other programs. The said legislative act must contain a reliable definition of objectives, manpower and material needs for achieving the objectives with forecasted results, the functioning of the regular program review mechanism, control of performance of the program development and implementation tasks by respective bodies, as well as proper liabilities for failures to comply.
- Creating institutional capacity of the bodies by virtue of not only regulatory list of obligatory objects and products, reforming of the internal structure of central executive authorities, but also on the basis of changing the role of European integration units in the bodies of power and establishing professional requirements to personnel. This means the necessity of determining the knowledge and skills that officials commissioned with the tasks regarding Agreement performance should possess; also, relevant requirements in typical state servicepersons professional and qualification role profiles should be established.

Conclusions. On the basis of the undertaken research, one can ascertain that, at the present post-crisis stage, in view of the peculiarities of the institutional provision of bilateral relations between Ukraine and the EU, as well as taking into consideration the quality and level of acquis communautaire implementation, it should be pointed out that the quantitative approach to determining the adaptation scope provides no idea of the directions and volumes of implementation works on the national legislation; and all spheres mentioned in the present work require taking into account the provisions of acquis communautaire acts.

The key and top-priority direction of work in the legislation harmonization sphere is preparation for Association Agreement implementation as a legally binding international agreement that will establish all aspects of cooperation with the EU, in the trade and economic sphere primarily, and will provide for economic integration in the internal EU market by way of constant adaptation of Ukrainian legislation to that of the EU.

In view of the above, the process of preparation for the implementation of the Agreement between Ukraine and the EU must necessarily include the development of a centralized coordination model of European integration, the shift to centralized planning of the Association Agreement performance, as well as the creation of institutional capability of central executive authorities.

The delineated solutions are but a part of state administration reforms that call for implementation both at the preparation stage and at the stage of performance under the Association Agreement with the EU. They can mark the commencement point, as they require neither radical institutional changes nor hefty financial expenses, nor much time. However, it is obvious that such commencement can be secured solely by complete implementation of an integral system of European standards of democratic governance into the Ukrainian system of state administration.

Andrii Svetlov*

PAN-AMERICAN INTEGRATION − STRATEGIC DIRECTION OF THE U.S. POST-CRISIS DEVELOPMENT

Анотація. В статті розглядаються рушійні сили, векторна спрямованість та механізм реалізації панамериканської інтеграційної стратегії США у посткризовий період. Проаналізовано співробітництво США з країнами Латинської Америки у сферах міжнародної торгівлі, прямого іноземного інвестування та міграції робочої сили. Визначено, що найбільш дієвим механізмом реалізації США панамериканської інтеграційної стратегії є поступове включення до регіональних інтеграційних стратегій південноамериканських країн, що стимулюватиме інші країни латиноамериканського регіону до кооперації та інтеграційної взаємодії з США.

Ключові слова. Глобальна економічна криза, регіональна економічна інтеграція, регіональний інтеграційний блок, панамериканська інтеграційна стратегія, латиноамериканський регіон.

Annotation. The paper deals with driving forces, vector orientation and mechanisms of realization by the U.S. a Pan-American integration strategy in the post-crisis period. U.S.-Latin America cooperation in such areas as international trade, foreign direct investment, and labor migration was analyzed. Gradual creation of free trade areas with South American countries, which will prompt non-member countries to seek cooperation and integration with the U.S. was determined as the main mechanism of the U.S. Pan-American integration strategy.

Key words. Global economic crisis, regional economic integration, regional integration block, Pan-American integration strategy, Latin American region.

Introduction. The world economic crisis of 2007-2010 marked the transition of the current phase of global economic development to a new level which is characterized by the U.S. global dominance decline, and shaping of a multipolar world order through the formation of new regional economic centers (the BRIC countries, newly industrialized countries). Comprehensive effects of the contemporary crisis on all the subsystems of the world economy exposed the "bottlenecks" in macroeconomic policies of developed countries (particularly, in the formation of loans, and non-optimal ratios of capital accumulation and consumption). The leading trend of the post-crisis period is enhanced competition between developed countries and NICs for the redistribution of key segments of the global market and particioation of developing economies in regional integration. Thus, 59 agreements concerning laberalization of trade and capital flows were negotiated throughout 2007-2010 [10]. It shows that nowadays trade liberalization at the global and regional levels is considered by developed economies to be an important means to restore business activity and prompt recovery. Given the active involvement of developing countries into regional integration processes, in the post-crisis period integration strategies may be

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subjected to transformation, namely, to spatial coverage enlargement, and deepening of integration between exhisting and new member countries. Therefore, for the U.S. a Pan-American integration strategy is considered to be the most favorable due to the interdependence between national economies of the region, their resource capacity and significant role in the global economy.

Problem statement. The works of such economists as S.G. Lora, R. Devlin, J. K. Jackson, A. Jessen, C. Vignoles, L. Yager, D. Lederman, J. A. McKinney W. F. Maloney, L. Servén made a substantial contribution to the studies of Western Hemisphere integration. At the same time, extensive literature on U.S. integration strategies in the Western Hemisphere concentrates on studying purposes, elements, possible effects and reasons of why FTAA got failed. However, the studying of potential U.S. strategies aiming at creation of a Pan-American integration bloc is of high importance due to enhanced competition on regional and global markets in the post-crisis period. Thus, the research objective of this article is to determine driving forces, vector orientation and mechanisms of realization by the U.S. a Pan-American integration strategy in the post-crisis period.

Statement of the basic material. Pan-American ideas are not a product of the last decade, but have their roots in the XIX century. In 1889-1890 the first Pan-American Congress in order to establish closer trade and other ties between the U.S. and Latin American countries was held [15, p. 261]. Since then, the U.S. strategy in the Western Hemisphere has transformed from the Monroe Doctrine, which declared Latin America as the U.S. sphere of influence to the Enterprise for the Americas Initiative (EAI) in 1990s. The goal of the EAI was to establish "…a free-trade zone stretching from "Anchorage to Tierra del Fuego", expand investment and provide a measure of debt relief for countries in Latin America and the Caribbean" [12, p. 1]. The modern U.S. strategy in the Pan-American region differs substantially from its strategy in the XIX century owing to free trade and democratic principles, and refusal from coercive power use.

Since the early 1990s the U.S. strategic priorities in the Latin American region has been opening markets, strengthening democracy, and stemming the flow of illegal drugs. Task Force of the Council on Foreign Relations, however, identifies four priorities of the U.S. policy towards Latin America "…1) poverty and inequality; 2) citizen security; 3) migration; and 4) energy security and integration" [1, p. 7-10]. Therefore, the cooperation between the U.S. and Latin America goes beyond economic areas, and involves migration, political and security aspects. It demonstrates the high importance of this region for the U.S. in terms of possible economic benefits, as well as maintenance and improvement of relations between countries in all areas of social life.

Based on strategic importance of the Pan-American region, and given the comprehensive impact of the global economic crisis on the U.S. economy, we selected two groups of driving forces for the U.S. to deepen economic integration ties with Latin America in the post-crisis period: 1) exogenous; and 2) endogenous (Table 1).

Table 1

Driving forces for the U.S. to deepen economic integration ties with Latin America in the post-crisis period

Endogenous	Exogenous
Massive unemployment	Reduced U.S. dominance in regional integration within the Pan-American region
Dangerously high federal debt	Use of cheap domestic labor and low U.S. import tariffs by Latin American countries
Negative trade balance	High dependence on energy imports from Africa and the Middle East

Trends in the regional economic integration of Latin American countries with all the countries in the world indicate that the U.S. dominance in the integration processes within the region reduces. As of 2010, the EU had free trade agreements with 24 countries of the Pan-American region, India - with 15 countries, South Korea - with 15 countries, Brazil - with 14 countries, whereas the U.S. with only 12 countries [7]. Deepening of Latin America's integration strategies with other than U.S. countries may cause diversion of U.S.-Latin America trade and the restraint in access of American capital to these countries' specific sectors. Therefore, implementation of integration strategies with Latin American countries by the U.S. will contribute to the strengthening of it's geo-economic position, and will provide the country with a competitive advantage through reduction of trade and non-trade barriers.

The next exogenous driving force of the U.S. to deepen integration with Latin American countries is the use of Latin American manufacturers the advantages of cheap labor and low U.S. import tariffs. Thus, amongst 25 leading importers on the U.S. market in 2009 there were four Latin American countries (Mexico, Venezuela, Brazil, Colombia) with a total 14.5% share of U.S. imports. In these countries, income per capita (calculated by purchasing power parity) ranges from 8,600 U.S. dollars. in Colombia to 14,100 U.S. dollars. in Mexico, which is much lower than the one in the U.S. (45,640 U.S. dollars) [5]. Low incomes indicate that Latin American manufacturers have a competitive advantage, which results in low wages. Furthermore, an average U.S. import tariff in 2009 was 3.5% (4.7% for agricultural products and 3.3% for non-agricultural products). Both low U.S. import tariffs and the use of low-paid labor force by Latin American countries provide them with comparative advantage in manufacturing labor-intensive goods. The realization of integration strategies in Latin America by the U.S. will ease it's manufacturers' access to Latin American markets through balancing competitive advantages that are the source of low U.S. import tariffs and Latin American cheap labor.

The third exogenous factor for the U.S. to deepen economic integration with Latin American countries is its high dependence on energy imports from Africa and the Middle East. Given that these regions are characterized by permanent social and economic instability, it threatens U.S. energy security. Energy supplies from these regions account for more than one third of total U.S. energy imports (33% in 2009). Among the countries of Africa and the Middle East the largest exporters of crude oil to the U.S. market were Saudi Arabia, Nigeria, Iraq, Angola, Algeria, and Kuwait in 2010. In comparison with Africa and the Middle East, Latin America is marked to have better socio-economic conditions, and geographic proximity to the U.S. Therefore, in the post-crisis period a strategic priority for the U.S. should be the deepening of integration with those Pan-American countries, which are the biggest energy suppliers on the U.S. market (Canada, Mexico, Venezuela, Brazil, Colombia, Ecuador, Argentina etc.).

The driving forces for the U.S. to deepen regional integration with Latin American countries should also include a group of endogenous factors, since global financial crisis has led to the exacerbation of a number of domestic problems whose solution is of immediate importance for the country in the post-crisis period.

Major domestic problem that the U.S. economy has faced since the start of the global financial crisis is high levels of unemployment (unemployment rate in 2006 was 4.6%, and by the end of 2010 reached 9.6%). The increase in unemployment was caused by companies' and financial institutions' liquidity crises which slowed down their business activities, decreased demand for products and services. Thus, in the post-crisis period, the priority of the U.S. economic development should be to create jobs through increased competitiveness and promototion of U.S. exports.

Another U.S. driving force for deepening integration ties with Latin American countries is a negative trade balance. Though for the period of 2007-2009 the U.S. trade deficit has been reduced by 38%, its rate still was high in 2009 (-506,944 million.U.S. dollars). It is necessary to mention that the reduction was caused by growing exports, and shrinking imports as a result of household income and consumption (including imports) decline. For instance, for 2007-2009 U.S. exports of goods have fallen by 8% (-91,867 million U.S. dollars), while imports − by 21% (-408,115 million U.S. dollars). Thus, the U.S. should stimulte the adjustment of trade balance so that the exports growth would prevail over the growth of imports consumption, which has to balance foreign trade in the long-run period. Key measures to that should be the increase of U.S. manufacturers competitiveness through innovation, the use of energy resources (oil, natural gas) at a lower cost, and alternative energy sources.

The third endogenous driving force for the U.S. to deepen integration ties with Latin American countries is an outstanding level of federal debt. By the end of 2010, the rate of Total Public Debt Outstanding to GDP was 96.3%, which is 31.9% more than in 2007 (64.4%). The rapid growth of federal debt was boosted by budget deficits, negative trade balance and the reduction of financial accounts surplus. Thus, the U.S. should seek to encourage domestic savings, level balance of payments, and federal budget. Put differently, the U.S. should stimulate active operations (exports, foreign direct investments, etc.) of national economic agents. Given geographic proximity, market capacity, and current relatively high trade barriers, Latin America potentially is the most favorable regional partner for the U.S. in achieving this goal.

Quite evident is the fact that the use of monetary policy by Federal Reserve System and fiscal policy by U.S. government in order to restore economic growth after the global financial crisis is limited due to low U.S. interest rate, which is almost zero (0.25% since December 2008), and dangerously high level of federal debt (96.3% in 2010). In this case, the Japanese economy experience in coming out of a decade-long slump in the 1990s may be useful for the U.S. At that time the Japan's recovery was perpetuated by export expansion. Therefore, export promotion and increase in competitiveness of national manufacturers on world markets should facilitate creating jobs, speed up economic growth, reduce trade deficit and federal debt as a result of stabilizing the balance of payments. Nowadays, free trade agreements play a decisive role in trade policies aiming at export expansion. Involvement of U.S. satellites in Latin America to regional integration arrangements, and the formation of a large-scale Pan-American integration bloc in the long-run period will help U.S. to meet domestic and external challenges in the post-crisis period.

Based on the above-mentioned driving forces, the vector direction of the U.S. Pan-American integration strategy should be aimed at deepening cooperation and integration ties in international trade, capital flaws (primarily, foreign direct investments), and labor migration.

Table 2
Macroeconomic indicators of the U.S. and Latin America [2, 4, 8, 11, 13]

Indicator	Country/Region	2006	2007	2008	2009	2010
GDP per capita, U.S. dollars	U.S.	44,805	46,558	47,138	45,918	47,274
	Latin America	3,808.5	6 ,047.2	7 ,038.8	8,090.5	-
Real GDP growth, %	U.S.	2-Лип	1-Вер	0.0	-2.6	2-Вер
	Latin America	5-Чер	5-Сер	4-Бер	-1.8	-
Consumer Price Index (CPI), %	U.S.	3-Лют	2-Сер	3-Сер	- 0.4	1-Чер
Inflation rate, %	Latin America	5-Бер	5-Кві	7-Вер	6.0	-

<table>
<tr><th>Indicator</th><th>Country/Region</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th></tr>
<tr><td rowspan="4">Unemployment rate, %</td><td>U.S.</td><td>4-Чер</td><td>4-Чер</td><td>5-Сер</td><td>9-Бер</td><td>9-Чер</td></tr>
<tr><td rowspan="2">Latin America, highest and lowest rates</td><td>16.2 (Dominican Republic)</td><td>15.6 (Dominican Republic)</td><td>14.1 (Dominican Republic)</td><td>14.9 (Dominican Republic)</td><td>-</td></tr>
<tr><td>4-Чер</td><td>4.0</td><td>4-Січ</td><td>5-Січ</td><td rowspan="2">-</td></tr>
<tr><td></td><td>(Mexico)</td><td>(Honduras)</td><td>(Honduras)</td><td>(Trinidad and Tobago)</td></tr>
<tr><td>Federal debt to GDP ratio,%</td><td>U.S.</td><td>63.9</td><td>64.4</td><td>69.2</td><td>83.4</td><td>96.3</td></tr>
<tr><td>External debt to GDP ratio, %</td><td>Latin America</td><td>23-Сер</td><td>22-Чер</td><td>20.0</td><td>23-Бер</td><td>-</td></tr>
</table>

As shown in Table 2, a number of Latin America's macroeconomic indicators continues to lag behind the U.S. ones, including GDP per capita (45,918 U.S. dollars in the U.S. versus 8,090.5 U.S. dollars In Latin America in 2009), inflation rate (- 0.4% CPI in the U.S. versus 6.0% in Latin America in 2009), unemployment rate (9.6% in the U.S. versus 14.9% in Trinidad and Tobago in 2009). At the same time, Latin America has better such indicators as real GDP growth (4.3% versus 0.0% in the U.S. in 2008, and -1.8% versus -2.6% in the U.S. in 2009), and rate of public debt to GDP (23.3% versus 83.4 in the U.S. in 2009). The most striking feature of the Latin American region is a significant disparity in incomes both within the counries and between them. For instance, the Gini coefficient varies among countries, but stays at a high level, which can be explained by uneven distribution of income and underdeveloped middle class. In 2008 Brazil and Dominican Republic had the highest rates of Gini coefficient (59.4 and 55.3 respectively), and Venezuela and Uruguay (41.2 and 44.5 respectively) had the lowest ones. Despite the high average growth rate of gross regional product (GRP), during 2006-2008 per capita in the Latin American region accounted for only 8,090.5 U.S. dollars in 2009, which is 6 times less than in the U.S.

Thus, Latin American countries are characterized by typical features of developing economies such as dynamic economic growth, export orientation, low wages, large disparities in income distribution, high unemployment rates, low balance of payments and external debt (external debt to GDP ratio was 23.3% in 2009).

The U.S.-Latin America foreign trade correlates with household incomes in both trading partners. Latin America's GDP per capita growth causes the reduction of U.S. negative bilateral trade balance (Table 2 and 3). For instance, during 2006-2009 Latin America experienced growth of GRP per capita by 112% (4,282 U.S. dollars), meanwhile the U.S. balance of trade with Latin American countries decreased by 57.4% (61,577 million U.S. dollars).

Table 3

U.S. balance of trade with Latin American countries (LAC), mln. U.S. dollars

#	Indicator	2005	2006	2007	2008	2009
1.	Total U.S. exports to LAC	190,972	221,843	242,686	287,711	237,317
2.	Total U.S. imports from LAC	290,575	329,117	340,927	374,373	283,014
3.	Total U.S. balance of trade with LAC	-99,603	-107,274	-98,241	-86,662	-45,697

#	Indicator	2005	2006	2007	2008	2009
	U.S. – LAC trade balance of:					
3.1.	manufactured goods	-17,564	-15,944	-12,271	12,218	165,352
3.2.	capital and consumer goods	-30,534	-30,272	-32,343	-13,604	-9,287
3.3.	textiles, apparel, and footwear	-20,489	-9,449	-8,631	-7,346	-6,226
3.4.	primary products	-76,163	-85,053	-81,79	-94,811	-56,772
3.5.	agricultural products	-22,886	-7,506	-5,094	740	-5,189
3.6.	oil and petroleum products	-60,412	-69,286	-67,828	-86,053	-47,643

For the period of 2005-2009 the U.S. balance of trade with Latin American countries was negative, however, tended to contract. Thus, for 2005-2009 the U.S. negative trade balance with Latin America shrank by 53,906 million U.S. dollars. It can be explained by following: 1) growth in purchasing power of Latin America spurred consumption and consequently demand for imports; 2) inflation pace in some Latin Americam countries was faster than in the U.S. what gave Americam goods a cost advantage; 3) reduced demand of U.S. consumers for Latin American imports as a result of ecsalating economic crisis and deterioration of consumers' solvency in 2007-2009.

The commodity structure of the U.S. trade balance with Latin America shows both trading partners specialize on different exports, respectively manufactured goods and oil and petroleum products. Thus, for the period of 2005-2009 the U.S. balance of bilateral trade in manufactured goods transformed from negative (-17,564 million U.S. dollars) to positive (165,352 million U.S. dollars). At the same time, the U.S. balance of bilateral trade in oil and petroleum products was negative. To some extent, it reflects the model of trade between countries on the basis of comparative advantage: endowed with energy resources and labor Latin American countries export oil and petroleum products, and on the contrary, the U.S. having advantages in technologies and access to cheap labor and natural resources exports manufactured, capital and consumer goods. At the same time intra-industry trade based on economies of scale (when the U.S. and Latin America trade almost the same goods) occurs in all the areas of bilateral trade. It demonstrates the complexity and diversity of trade cooperation between the U.S. and the Latin American region.

As shown in Table 4 the share of U.S. trade with Latin American countries in total U.S. trade was growing during 2006-2009. For the period of 2006-2009 the share increased from 0.1871 (18.71%) to 0.1955 (19.55%). Meanwhile, the dependence of the Latin American region on trade with the U.S. declined: the share of Latin American countries' trade with the U.S. in total Latin America trade dropped from 0.4093 (or 40.93%) in 2006 to 0.3475 (or 34.75%) in 2009. The share of intraregional trade also decreased in North America, Latin America (excluding Mexico), and the whole Western Hemisphere. It shows the diversification of Latin America trade relations and reduction of region's dependence on U.S. markets and imports. However, the drawback of the share of intraregional trade is that it does not show how volumes of intra-regional trade are changing in comparison with these countries' trade with the rest or the whole world. Because of that we estimated the following indices of intra-regional trade intensity in the Pan-American region: 1) Intra-regional trade intensity index (Brown, Kojima), 2) Intensity coefficient of intra-regional trade (Anderson, Norhaym, Drysdell, Garneau).

Table 4
The intensity of intraregional trade in the Pan-American region*

#	*Index*	*2006*	*2007*	*2008*	*2009*
1.	***Intra-regional trade share (Si)***				
1.1.	Share of U.S. trade with Latin American countries in total U.S. trade	0.18714	0.18419	0.19153	0.19552
1.2.	Share of Latin American countries' trade with U.S. in total Latin America trade	0.40927	0.38327	0.35877	0.34746
1.3.	Intra-regional trade share in North America	0.41974	0.41039	0.39984	39296
1.4.	Intra-regional trade share in Latin America (excluding Mexico)	0.30220	0.29351	0.29468	0.30082
1.5.	Intra-regional trade share in the Western Hemisphere	0.49779	0.49135	0.48834	0.47905
2.	***Intra-regional trade intensity index (Ii)***				
2.1.	U.S.-Latin America intra-regional trade intensity index	1.93784	1.95172	2.00000	2.00429
2.2.	North America intra-regional trade intensity index	2.45025	2.55686	2.63997	2.61752
2.3.	Latin America (excluding Mexico) intra-regional trade intensity index	9.27485	8.69527	8.02341	8.39673
2.4.	The Western Hemisphere intra-regional trade intensity index	2.44152	2.52934	2.59505	2.57622
3.	***Intensity coefficient of intra-regional trade***				
3.1.	Intensity coefficient of U.S.-Latin America intra-regional trade	2.75182	2.73695	2.80472	2.81132
3.2.	Intensity coefficient of North America intra-regional trade	4.22267	4.33655	4.39876	4.31195
3.3.	Intensity coefficient of Latin America (excluding Mexico) intra-regional trade	13.29150	12.30769	11.37549	12.00935
3.4.	Intensity coefficient of the Western Hemisphere intra-regional trade	4.86159	4.97267	5.07184	4.94527

* *Notes. 1) Intra-regional trade share (Si) calculated as tii / ti, where tii - region i's intra-regional trade; ti - region i's total trade; 2) Intra-regional trade intensity index (Ii) calculated as (tii/ti)/(ti/T), where tii - region i's intra-regional trade; ti - region i's total trade; T – world trade; 3) Intensity coefficient (Ii) calculated as (tii/ti)/((ti-tii)/T), where where tii - region i's intra-regional trade; ti - region i's total trade.*

Intra-regional trade intensity index is the highest for Latin America (excluding Mexico), but tends to decline (Table 4): from 2006 to 2009 the index shrank by 0.87812. In contrast to intra-regional trade in Latin America (excluding Mexico), U.S.-Latin America intra-regional trade intensity index is the lowest and ranges from 1.93784 to 2.00429. However, the dynamics of this index indicates that volumes of the U.S.-Latin America trade are growing comparing to these countries' volumes of trade with all the countries in the world. The intra-regional trade intensity index also grew in North America and the whole Western Hemisphere during 2006-2009.

It is notable that in 2009 the Western Hemisphere intra-regional trade intensity index (2.57622) was lagging a little behind the index in North America (2.61752), where North American Free Trade Agreement (NAFTA) has been functioning since 1994.

The calculated intensity coefficient of intra-regional trade correlates with the rates of the previous index (intra-regional trade intensity index). In contrast to intra-regional trade intensity index, this index compares the share of intraregional trade with the share of the rest of the world's trade. This index is the largest for intraregional trade within Latin America (excluding Mexico), and the lowest for the U.S. bilateral trade with Latin American countries. Thus, intensity coefficient of the Western Hemisphere intra-regional trade (4.94527) is higher than within North America (4.31195). This shows high interdependence and interconnectedness between countries of the Pan-American region and the intensity of intraregional trade. If we considered the intra-regional trade by sub-regions, it would be noticable that intra-regional trade within Latin America (excluding Mexico) is decreasing, while the intensity of the U.S. trade with Latin American trade is rising. Put differently, Latin American countries diversify their trade policies through expanding trade and deepening cooperation with the U.S. The attractiveness of the Latin American region for U.S. TNCs and TNB's is determined by such factors as:

1) High rates of economic growth in the region (an avarage annual GRP growth was 4.3-5.8% during 2006-2008);

2) Region's endowment with energy resources (Venezuela, Brazil, Mexico are among top 20 countries endowed with the largest reserves of crude oil, furthermore Venezuela is also among top 20 countries endowed with natural gas reserves) [6];

3) Region's endowment with low-cost labor force;

4) Deep regional cooperative ties between Latin American economic entities (the share of intra-regional trade amounts to 30% of the region's total trade);

5) Latin American countries' geographical proximity to the U.S., which allows U.S. companies to minimize transportation costs;

6) Historical and cultural commonality of Latin American countries (language, culture, traditions, and shared history).

Table 5

U.S. direct investment position in Latin American countries [13, 14]

#	Region / country	Indicator	2005	2006	2007	2008	2009
1.	Latin America and the Caribbean	U.S. direct investment position in LAC, million U.S. dollars	296,37	330,28	449,653	461,365	536,636
		LAC FDI inward stock, million U.S. dollars	937,42	908,58	1,140,007	1,181,615	1,472,744
		Share of U.S. direct investment position in LAC, %	31.61	36.35	39.44	39.05	36.44
1.1.	South America	U.S. direct investment position in LAC, million U.S. dollars	72,844	80,004	104,116	99,786	125,171
		South America FDI inward stock, million U.S. dollars	451,89	499,49	648,944	633,517	788,121
		Share of U.S. direct investment position in South America, %	41259	40955	41015	15.75	15.88

#	Region / country	Indicator	2005	2006	2007	2008	2009
1.1.1.	Argentina	U.S. direct investment position in Argentina, million U.S.	10,103	13,174	13,692	12,518	14,108
		Argentina's FDI inward stock, million U.S. dollars	55,245	58,604	66,015	76,091	80,996
		Share of U.S. direct investment position in Argentina, %	18.29	22.48	20.74	16.45	17.42
1.1.2.	Brazil	U.S. direct investment position in Brazil, million U.S. dollars	30,882	33,504	48,807	44,532	56,692
		Brazil's FDI inward stock, million U.S. dollars	201,18	221,91	328,455	287,697	400,808
		Share of U.S. direct investment position in Brazil, %	15.35	41197	14.86	15.48	14.14
1.1.3.	Venezuela	U.S. direct investment position in Venezuela, million U.S. dollars	8,934	10,922	12,871	13,473	14,506
		Venezuela's FDI inward stock, million U.S. dollars	46,237	45,398	43,957	41,375	41,214
		Share of U.S. direct investment position in Venezuela, %	19.32	41084	29.28	32.56	35.20
1.1.4.	Chile	U.S. direct investment position in Chile, million U.S. dollars	11,127	10,927	16,337	16,412	22,608
		Chile's FDI inward stock, million U.S. dollars	73,62	80,732	105,558	100,989	121,64
		Share of U.S. direct investment position in Chile, %	41228	13.53	15.48	16.25	18.59
1.2.	Central America and the Caribbean (CAC)	U.S. direct investment position in CAC, million U.S. dollars	223,52	250,28	345,537	280,93	411,465
		CAC FDI inward stock, million U.S. dollars	485,53	409,09	491,064	548,098	684,623
		Share of U.S. direct investment position in CAC, %	46.04	61.18	70.36	51.26	60.10
1.2.1.	Mexico	U.S. direct investment position in Mexico, million U.S. dollars	73,687	82,965	91,046	89,61	97,897
		Mexico's FDI inward stock, million U.S. dollars	209,56	228,6	265,736	294,68	309,523
		Share of U.S. direct investment position in Mexico, %	35.16	36.29	34.26	30.41	31.63
1.2.2.	Panama	U.S. direct investment position in Panama, million U.S. dollars	4,826	4,636	6,171	6,236	7,845
		Panama's FDI inward stock, million U.S. dollars	9,873	12,821	14,611	16,974	18,675
		Share of U.S. direct investment position in Panama, %	48.88	36.16	42.24	36.74	42.01

During 2005-2009 the share of U.S. FDI stock in Latin America accounted for more than a third of all Latin American countries' FDI inward stock. The global economy downturn in 2008 caused the decrease of this indicator. Despite this, during 2008-2009 Latin American countries continued to accumulate FDI, what demonstrates the high potential of this region, which remains to be attractive to investors even in a crisis. The U.S. invests mainly in such countries as Argentina (17.42% of total country's FDI inward stock), Venezuela (35.2% of total country's FDI inward stock), Chile (18.59% of total country's FDI inward stock), Mexico (31.63% of total country's FDI inward stock) and Panama (42.01% of total country's FDI inward stock). For the U.S. cooperation and integration with Brazil is of high importance since this country is considered to be a South American economic leader. However, the share of U.S. direct investment position in Brazil was only 14.14% in 2009.

It should be noted that the share of U.S. direct investment position in Central America and the Caribbean (60.1% in 2009) is much higher than the analogous index in South America (15.88% in 2009). The reason for that could be that the U.S. negotiated free trade agreements with only one South American country which is Chile, while in Central America a free trade area (DR-CAFTA) among the U.S. and 6 countries of the region has been functioning since 2006. Above all, all the U.S. free trade agreements have investment provisions, thus boosting the flows of FDI between member countries.

In order to analyze the U.S. foreign direct investment to Latin America, we estimated the accumulated FDI intensity index (Table 5). This indicator relates the actual U.S. FDI to Latin America to their expected value according to each country's world investment position.

Table 5

U.S.-Latin America FDI intensity index [3, 14]*

#	Region/ country	2005	2006	2007	2008	2009
1.	U.S. FDI to LAC	23377	32874	43862	2.00	22282
1.1.	U.S. FDI to South America	0.84	0.84	0.90	0.81	0.70
1.1.1.	Argentina	0.95	43101	42370	0.84	0.77
1.1.2.	Brazil	0.80	0.79	0.83	0.79	0.62
1.1.3.	Venezuela	40909	46023	23377	24473	20090
1.1.4.	Chile	0.79	0.71	0.87	0.83	0.82
1.2.	U.S. FDI to Central America and the Caribbean	14642	43891	34029	23043	23774
1.2.1.	Mexico	30317	32874	33604	20455	14611
1.2.2.	Panama	19756	32509	13181	32143	31048

*Notes. FDI intensity ratio was calculated as FDIij / ExpFDIij, where, FDIij – Actual amount of FDI stock from country i to country j; ExpFDIij - Expected value of FDI stock from country i to country j; ExpFDIij – FDIwj / FDIww * FDIiw / FDIww * FDIww, where, FDIwj – Total inward stock in the j country; FDIww – Worldwide inward or outward FDI stock; FDIiw – Total outward FDI stock of i country in the world.*

During 2005-2007 the U.S –Latin America FDI intensity index tended to rise, however, the global economic slump in 2008 made the index decline to 1.61, which was lower than in 2005. The high intensity of U.S. FDI to Central America and the Caribbean, and low intensity to the South American countries can be noted. Such disparity might be explained by the fact that 1) Central American and the Caribbean economies are much more open than South American owing to investment provosions under DR-CAFTA; 2) the U.S. has a free trade agreement with only one country in South America – Chile; 3) Mercosur member countries (Argentina, Brazil, Paraguay and Uruguay) position themselves as a sub-regional economic center in contrast to the U.S. dominance in the Pan-American region.

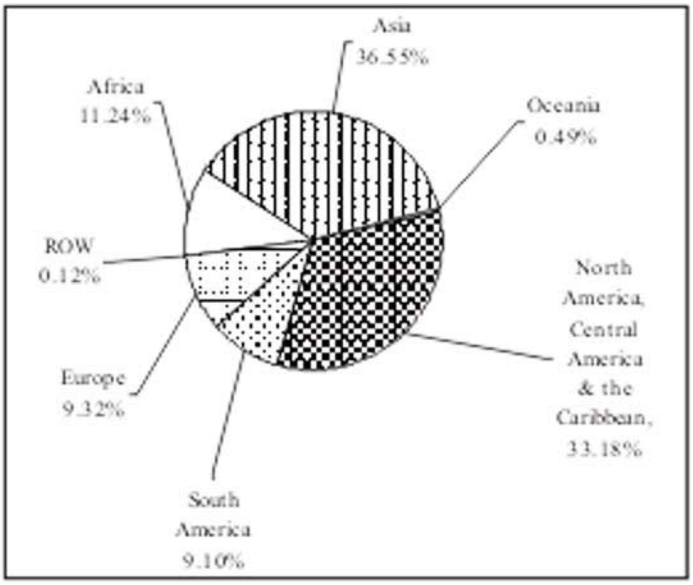

Figure 1. Legal permanent residents (Green card recipients) in the U.S. by country of birth, 2009 [9, p. 12-15]

Given deep economic and social ties, common borders and history among the Western Hemisphere countries, the cooperation in labor migration appears to be urgent for the U.S. and Latin America. As seen from Figure 1, among immigrants who have "green card" in the U.S descendants of the Western Hemisphere prevail (42.28% in 2009). However, Mexican persons occupy the largest share of the Western Hemisphere immigrants in the U.S. (14.58%), while migrants from all the South American countries account for only 9.1%. Analysis of migration between the U.S. and Latin America through data of permanent legal residents does not fully reflect the importance and urgency of cooperation between countries. In 2009 among the total number of deportees from the U.S. (580,107 persons) there were 85% of North American descendants (490,581 persons), and only 0.6% immigrants from South America (3,499 persons). In 2009 80% (465,205 persons) of all deported migrants were deported to Mexico. Among the aliens removed by criminal status (128,345 persons) Central American descendants account for 16% (20,459 persons), South America – for 2% (3018 persons), and Mexico – for 76% (96,965 persons). This indicates disparity of migration flows between Latin America and the U.S., and predominance of migrants from Mexico.

Thus, the analysis demonstrates that trade, investment flows and labor migration between the U.S. and Latin America are enhancing. Indices of intra-regional trade and FDI intensity indicate increasing importance of bilateral relations between the U.S and Latin American countries.

The experience of Free Trade Area of the Americas (FTAA) negotiations in 1994-2005 shows that formation of the Western Hemisphere integration bloc in the short-run period can not be achievable because of several reasons:

1) Deep contradiction between the U.S. and Brazil. Both countries distinguish themselves as leading economic forces in North and South America, and seek to strengthen their positions in the Pan-American region: Brazil through Mercosur and potential cration of the South American Union, and the U.S. through NAFTA, DR-CAFTA and free trade agreements with Latin American countries (Chile, Peru, Panama, Colombia).

2) Economic crises in a number of Latin American countries (Mexico, Brazil, Argentina) during the 1990s and early 2000s which were widely explained by unsuccessful implementation of neoliberal reforms set in "Washington Consensus".

All this factors led to the negative perception of any U.S. integration initiatives by Latin American countries.

Broadly speaking one can distinguish three mechanisms of the U.S. Pan-American integration strategy:

1) Negotiation a free trade agreement among all 34 democratic countries in the region on the basis of consensus and common interests between the major players - Brazil and the U.S.;

2) Deepening of NAFTA to the level of customs union, common market or economic union (the North American Union), what will increase the U.S. bargaining power in negotiations with South American countries;

3) Gradual negotiation of free trade agreements with South American countries, which will cause non-members to seek ways of deepening cooperation and integration with the U.S.

Formation of a Pan-American free trade area through simultaneous negotiation between all the countries of the Western Hemisphere and creation of the North American Union appear to be two extreme strategies. It is obvious that exhisting gap in levels of economic development between the U.S. and Mexico will be preventing NAFTA from advancing to deep integration forms. For the U.S., the North American Union would be detrimental because of potential increase in flow of migrants from Mexico, which only would exacerbate unemployment and criminogenic situation in the U.S. (especially in such southwestern states as Arizona, Texas, New Mexico etc.). For Mexico the transformation of NAFTA into the North American Union would threaten national economic sovereignty through possible access of U.S. TNCs to pumping oil wells.

Since 2003, when a free trade agreement with Chile was negotiated, the U.S. embarked on the third mechanism of the U.S. Pan-American integration strategy. Since the mid 2000s the U.S. has been trying to expand the geographical coverage of free trade agreements. For instance a free trade agreement was created with Central American countries (DR-CAFTA) and Panama; as of 2011 FTAs with Colombia and Peru (members of the Andean Community) are already negotiated but not ratified by U.S. Congress. It is likely that the functioning of U.S.-Colombia and U.S.-Peru FTAs will encourage other members of the Andean Community (Ecuador, Bolivia) to initiate trade liberalization with the U.S. due to the threat of trade diversion. Above all, the elements of free trade agreements between the U.S. and the Western Hemisphere countries are almost identical, which shows the probability of their unification in order to create a Pan-American integration bloc.

Conclusions. The analysis of dynamics and structure of U.S. cooperation with Latin America in such areas as international trade, foreign direct investment, and labor migration in order to create a Pan-Amercam integration bloc leads us to the following conclusions.

Firstly, recovery from the global financial crisis of 2007-2010 is characterized by "bottlenecks" in macroeconomic policies of developed economies (particularly, in the formation of loans, and non-optimal ratios of capital accumulation and consumption). It forces U.S. government to use more effective means to address the crisis and prompt post-crisis development, which is export expansion in order to create jobs, reduce negative trade balance, and solve federal debt problem in the long-run period.

Secondly, the U.S. export expansion in the Pan-American region through the creation of preferential and free trade areas would solve three major domestic problems: massive unemployment, negative trade balance and dangerously high federal debt. At the same time, implementation of regional integration strategies in Latin America will help the U.S. meet such exogenous challenges as reduced U.S. dominance in regional integration within the Pan-American region; use of cheap domestic labor and low U.S. import tariffs by Latin American countries; high dependence on energy imports from Africa and the Middle East.

Thirdly, the economic development of Latin America is characterized by large income disparities and lower level of economic development than the U.S. For instance, the U.S. prevail over Latin America in terms of GDP per capita, unemployment and inflation rates. However, Latin American countries have higher real GRP growth rate, and less level of external debt to GDP rate. This indicates that Latin American countries have typical characteristics of developing countries. This is the fact that should be carefully considered by the U.S. during implementation of free trade agreements (raise requirements concerning working conditions and wages in less developed countries, implement flexible mechanisms for tariff and non-tariff barriers' removals in trade of agricultural, textiles, apparel, footwear, oil, and petroleum products).

Fourthly, taking into account endogenous and exogenous challenges of the U.S. economy exacerbated by the global financial crisis, the most favorable areas of U.S. – Latin America cooperation and integration are international trade in goods, foreign direct investment, and labor migration. U.S. bilateral trade with Latin America is characterized by increasing of its intensity and shrinking the U.S. negative trade balance through boosting manufactured and capital exports. Meanwhile, Latin America specializes on exporting oil and petroleum products, textiles, apparel, and footwear reflecting the trade based on comparative advantage. However, there are several areas where the trading partners export and import similar products, indicating the trade based on economy on scale. The Pan-American region is characterized by the asymmetry of inward FDI from the U.S.. For instance, in 2009 the share of U.S. direct investment position in Central America and the Caribbean accounted for about 60%, while all the South American countries attracted only 15.88% of total U.S. FDI. In the area of labor migration there is predominance of inflows of workers from Central America and the Caribbean to the U.S., and a much less share of South American descendants. The main U.S. problem concerning labor migration remains the flow of illegal migrants from Mexico.

Fifthly, the main mechanism of the U.S. Pan-American integration strategy should be the gradual creation of free trade areas with South American countries, which will prompt non-member countries to seek cooperation and integration with the U.S.

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GLOBAL FINANCIAL IMBALANCES IN SAVINGS AND INVESTMENTS

У статті розглянуто проблеми глобальної фінансової нерівноваги в умовах світової фінансової кризи. В межах даної статті в основу аналізу причин виникнення глобальної фінансової нерівноваги покладено два основних підходи щодо причин їх виникнення: (i) міжнародна асиметрія між попитом та пропозицією на товари; (ii)міжнародна асиметрія в попиті та пропозиції на резервні активи. Автором запропоновано план дій щодо врегулювання проблеми глобальних фінансових дисбалансів у майбутньому.

The article deals with the problem of global financial imbalances during the world financial crisis. In order to analyze the causes of the global financial imbalances author exploited two dominant approaches: (i) international asymmetries in the supply and demand for goods; (ii) international asymmetries in the supply and demand for reserve assets. Action plan as for global financial imbalances issue resolution is provided.

Key words: global economy, global imbalances, savings, investments

Introduction. Since the outbreak of the world financial crisis, global imbalances have taken central stage in the debate on the causes of the financial meltdown and the global economic outlook [1].

At the risk of over-simplifying, we can distinguish two basic views. The first approach emphasizes international asymmetries in the supply and demand for goods – some countries (with the US at the top) spend too much, while others (e.g. China) spend too little. For the most proponents of this view, global imbalances represent an unsustainable phenomenon, whose eventual correction must entail US trade adjustment and a major depreciation of the dollar [1].

The proponents of the second approach rely on international asymmetries in the supply and demand for assets – in particular, pent-up demand by international investors for rich-country (and especially US) assets [1]. Ricardo Caballero, Professor of Economics at MIT, also advocates the second approach and considers the fundamental problem of the current global macroeconomic and financial imbalances to be centered in a shortage of safe assets [3].

The impeccable logic of international financial accounting assures the current-account balance is both a goods phenomenon and an asset phenomenon. After all, if a nation buys more goods and services from the rest of the world than it sells to the rest of the world, there must be an offsetting of assets. The goods-view of global imbalances asserts that it is a goods trade driving asset trade, while the asset-view asserts that the asset trade drives the trade of goods [1].

Generally speaking, global imbalances are disparities between savings and investment in the major world economies. They are reflected in large and growing current account imbalances

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[2]. Financial imbalances, although to a lesser extent, also contributed to this impartial feature of the contemporary world economic system.

Commodities market developments played central role in current account surpluses accumulation in emerging markets and oil-exporting countries of Middle East and North Africa. The remarkable increase in the relative prices of commodities and minerals during the early 2000s resulted in further increases in net savings of oil and commodity exporters, thereby reducing the real interest rate (Figure 1).

The lower cost of risk, and lower interest rate, induced larger current account deficits by counties that were restrained from borrowing binges at times of higher interest rates, resulting in gradual build-up of growing external liabilities of OECD countries (Portugal, Spain, Greece, US, etc.). In contrast, experience of countries is well-supplied with examples of nations where inflows of capital and easy access to borrowing have not succeeded in delivering sustainable growth, and in due course led to crisis (Argentina in the 1990s, and Spain and Greece being the latest example) [3].

The combination of financial deregulation, substantial financial innovation in financial markets, proliferation of growing leverage in the housing market, and floating interest-rate mortgages induced higher real estate demand in the US, thereby appreciating the US real estate evaluation, and encouraging lower saving by households that treated housing capital gains as permanent (Figure 2) [3].

The inflows of capital to the US prolonged the period of low saving in the US, and magnified the duration of the real estate appreciation, deepening the global crisis induced down the road by the growing weaknesses in the US housing market in 2007. In this new environment, profits were determined by the volume of mortgages initiated, and not by its quality [3]. Basically, banks' mortgage lending business shifted from methodology targeted at minimizing the risk of loan non-repayment, towards profit maximization with mostly neglecting the return risk.

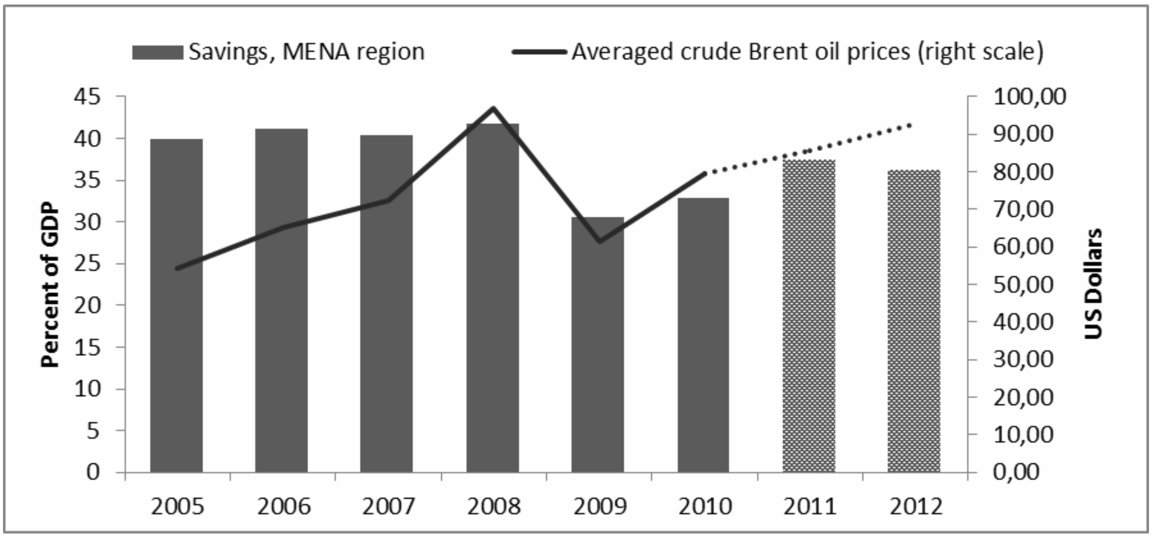

Figure 1. Annual crude Brent oil prices and savings in Middle East and North Africa
Source: author's compilation, World Economic Outlook 2010 data, BP Statistical Review of World Energy 2010
Note: 2011-2012 savings rates are IMF projections; 2011-2012 oil prices are author's projections

A large amount of mortgage lenders developed management compensation schemes supported by large bonuses linked to the amount and volume of mortgages provided to clients. Financial deregulation combined with constant growing rate of both scope and scale of innovative financial products designed spurred financial institutions to increase risk appetites.

The Fed's cheap money policy in the late 1990s and early 2000s was also among the causes of risk appetites.

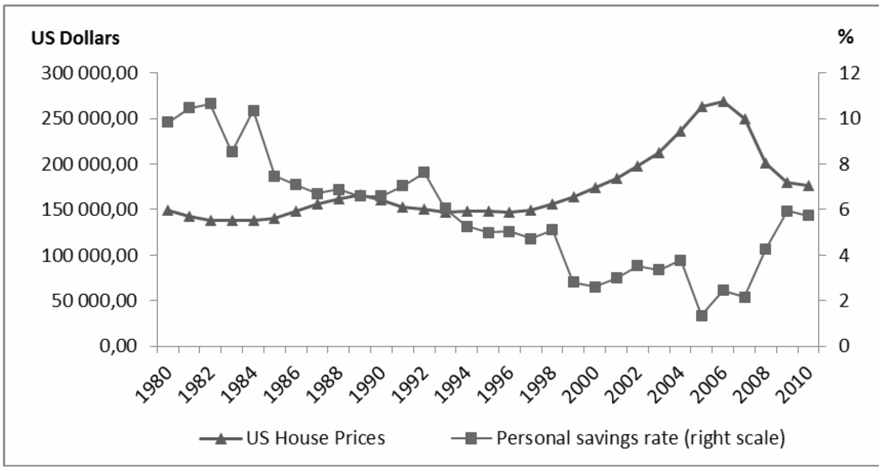

Figure 2. Average US house prices and average personal savings rate, 1980-2010
Source: U.S. Department of Commerce: Bureau of Economic Analysis, Federal Housing Finance Agency, Standard & Poor's

Low interest rates are mainly responsible for fueling a debt-driven consumer boom, and sucking in record volumes of imports, many from the newly industrializing economies of Asia. Funding all this required issuing huge volumes of debt, much of it securitized against dubious mortgages and consumer debts, and sold to foreigners when domestic savings proved inadequate (Figure 3).

The major U.S. debt buyers were emerging markets with China taking the lead. These were surplus countries, resilient on export-led growth. Fed Chairman Ben Bernanke and his adherents blame emerging markets and China in particular for the U.S. growing debt burden. In their view, China's reliance on export-oriented growth, refusal to allow the renminbi to appreciate, accumulation of foreign reserves, and recycling of surplus foreign exchange back into the market for U.S. government bonds and mortgage-backed securities created a "global savings glut". This glut artificially reduced global interest rates and created the perverse incentives for an unsustainable build-up of debt in the United States [4].

While it is tempting to blame China's "mercantilist" trade policies for the crisis, China is only the latest in a long line of countries the United States has blamed for its own trade and financial problems (Germany and France in the 1960s, Japan in the 1970s and 1980s, the Asian Tigers in 1990s).

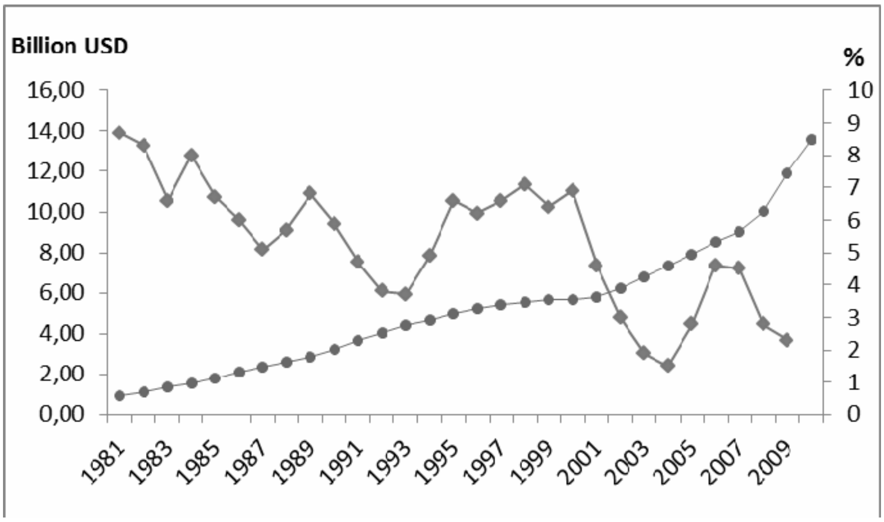

Figure 3. US gross debt and US real interest rates, 1981-2009
Source: US Treasury, World Bank Data

It is possible the rest of the world has been consistently wrong, and the United States has been consistently right. But it seems more likely there is something that makes the United States uniquely prone to excess domestic spending and running large trade deficits that in put pressure on the country's external position.

There are several candidates for the source of American exceptionalism. But perhaps the most obvious cause is the role of the dollar as the global reserve currency. The United States has run larger budget and current account deficits than most other countries simply because as the issuer of the principal reserve currency it can.

The positive side has been the ability to borrow more cheaply and in larger amounts than other countries. The dark side has been a steady accumulation of internal and more importantly external debt that is now a source of enormous financial instability [4].

Among one of the reasons why U.S. has constantly increasing current account deficit is its role as the marginal reserve asset provider for the global financial system. Triffin Dilemma explains it more precisely. Issuing countries of reserve currencies are constantly confronted with the dilemma between achieving their domestic monetary policy goals and meeting other countries' demand for reserve currencies. On one hand, the monetary authorities cannot simply focus on domestic goals without carrying out their international responsibilities; on the other hand, they cannot pursue different domestic and international objectives at the same time [5].

As opposed to the countries from western hemisphere characterized by current account deficits, emerging Asian economies can be characterized by current account surpluses and high foreign reserves accumulation (Figure 4).

The roots of today's current account surpluses in emerging East Asian economies go back to the Asian crisis of the late 1990s. The lessons of that particular crisis were well learnt by Asian economies and resulted in revising of their monetary and external policies, which helped them to more or less smoothly pass through the crisis of 2008-2009. Emerging East Asian central banks in both the crisis-hit countries (Indonesia, Korea, Malaysia, the Philippines, and Thailand) and other countries (China, Singapore, and Taiwan) have accumulated foreign exchange reserves for the following reasons: (i) to be prepared for another capital account crisis characterised by massive reversals of short-term capital that can trigger both a currency collapse due to the drain on foreign reserves and a banking crisis due to the sharp increase in external liabilities on the balance sheets of banks and firms; and (ii) to maintain competitive exchange rates in order to sustain the export-led growth of their economies. The first objective was more important after the crisis, and the second objective has been more or less persistently important [6].

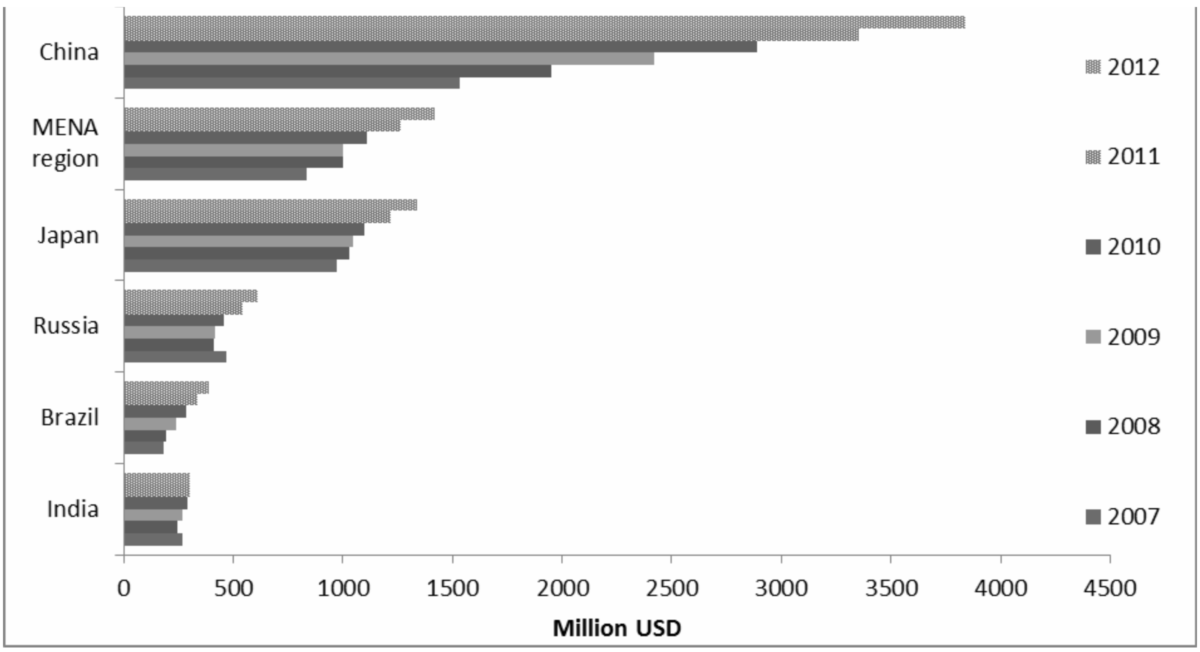

Figure 4. Foreign reserves accumulation by selected countries and regional groups
Source: World Economic Outlook 2011

Japan has also accumulated reserves through foreign exchange market intervention, although for a different reason. It has sought to fight price deflation by preventing the yen from appreciating too much [6]. Moreover Japan is more dependent on export-driven growth than any other country in the world. It is the reason for the Central Bank of Japan accumulates large amounts of foreign reserves to manage its exchange rate, keeping yen devalued.

Recent devastating earthquake which took place in Japan led to yen appreciation and will definitely harm Japanese exports and GDP growth in the first half of 2011 (Figure 5). Japan used a total of 692.5 billion yen ($8.6 billion) in foreign exchange intervention in March.

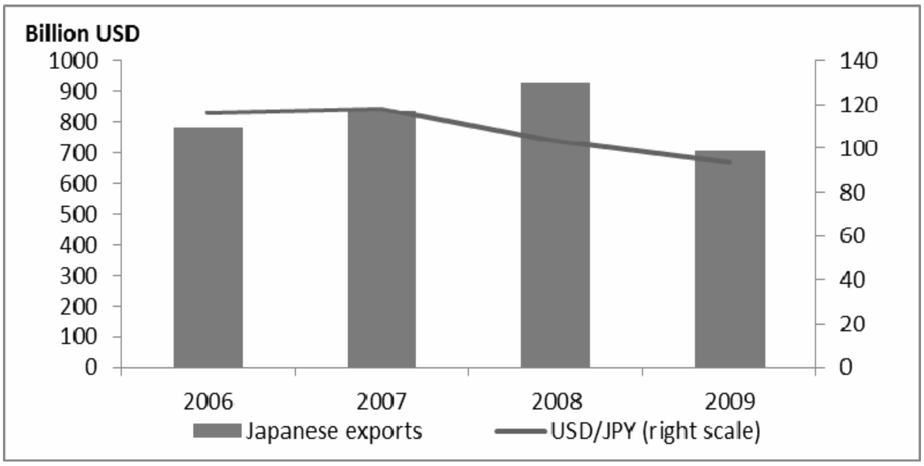

Figure 5. Japanese exports and USD/JPY exchange rate, 2006-2009
Source: World Trade Organization data, IMF data

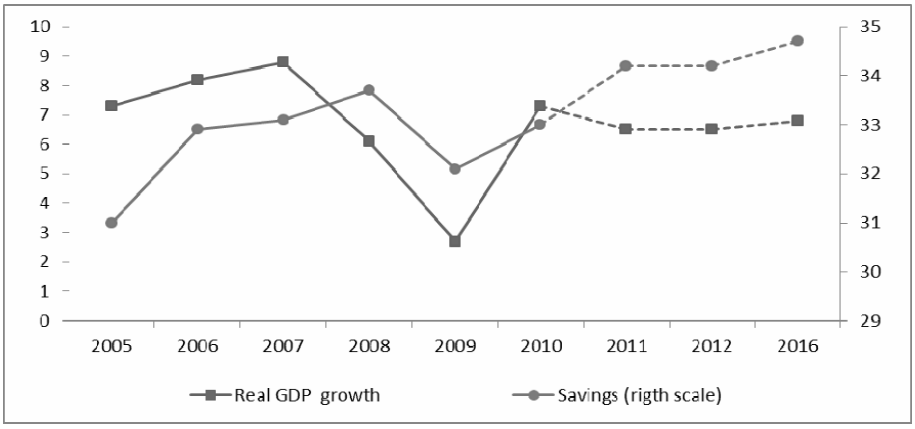

Figure 5. Real GDP growth and savings in Emerging and Developing Economies
Source: IMF data
Note: Real GDP growth illustrates year-on-year percentage change; savings is percentage of disposable income

Besides large surpluses and reserve accumulation East Asian emerging markets contribute to global financial imbalances via high propensity to savings. "Excessive" private savings in the EMEs (emerging markets) are driven by high rate GDP growth in these economies (Figure 6).

Living standards improve at a much slower pace than households' earnings grow, resulting in private savings upsurge. Still it is not the only factor inducing higher savings rate in emerging economies. The weak social protection system of many of these countries forces individuals to save an inordinately large fraction of their income for retirement, or to protect themselves from the risk of unemployment [7].

On the other side, economic growth in the emerging markets is possible primarily to undervalued real exchange rates which preserve export competitiveness [1]. The best way to achieve this is by compressing domestic spending, particularly consumption, which inevitably leads to persistent current-account surpluses and foreign reserve accumulation [8; 9]. Surpluses and savings are exposed to inflation, which prompt these countries to invest them in safety-haven assets like U.S. Treasuries. There two motivators that drive trade direction and capital flows from the EMEs to the U.S.:

1. U.S. is the largest importer of goods and services in the world – the world's largest market in terms of value [10].

2. U.S. obtains advanced financial market which supplies all types of financial services and products for individuals, corporations, institutional investors and governments. Moreover, U.S. Treasuries are considered as benchmark safety assets because the U.S. government has never defaulted on its debt. By the way, U.S. is the major world's reserve currency supplier. It explains why a large proportion of Asian reserves were invested in US dollar assets.

These included particularly US Treasuries, but also, via Asia's sovereign wealth funds, corporate assets. The resultant capital inflow into the US and global markets, together with the US Fed's easy money policy, kept US and world interest rates low, funding ever increasing US and some European government budget deficits and household debt. Cheap money also fuelled "financial innovations" such as subprime mortgages and other risky assets aimed at securing higher returns for investors and their financial intermediaries, which subsequently led to crisis [9].

The capital flow from Asia (and other e.g. commodity-exporting economies) also propped up the dollar and depressed Asian currencies, maintaining Asian export competitiveness, current account surpluses and reserve accumulations, while expanding US current account deficits and national indebtedness [9].

The financial crisis brought about a reversal in the large and growing global imbalances that characterized trade in the years that preceded it. In part, this is purely mechanical. The large drop in trade that occurred in 2009 will cause trade imbalances to retreat if it affects exports and imports proportionately. This suggests that if conditions improve, the worrisome pattern of growing imbalances is likely to re-emerge [11].

Part of the contraction in imbalances is not mechanical but is due to rebalancing of imports and exports. Rebalancing can happen in three different ways.

1. both imports and exports decline, and the larger flow decreases by relatively more than the smaller flow;

2. the larger flow declines and the smaller flow increases;

3. both flows expand, and the large flow expands by relatively less than the smaller flow. The first and second suggest that trade growth may stagnate in the near term as trade flows adjust, while the third offers a future with both positive trade growth and declining imbalances [11].

Countries with large trade deficits have reduced imports to a far greater extent than exports, while countries with large surpluses have reduced exports by relatively more [12]. This type of adjustment is more likely to be sustainable, as it reflects changes to rates of savings and investment [11].

Countries with sustained, significant external surpluses have to search and strengthen domestic sources of growth.

At the international level, governance and other reforms are needed to reduce the incentives of some countries to accumulate foreign exchange reserves beyond what is reasonably needed [13].

International financial system has to develop a new diversified mechanism of reserve currency supply. Theoretically an international reserve currency should (i) be anchored to a stable benchmark and issued according to a clear set of rules, therefore to ensure orderly supply; (ii) its supply should be flexible enough to allow timely adjustment according to the changing demand; (iii) such adjustments should be disconnected from economic conditions and sovereign interests of any single country. The first two functions are perfectly carried out by the major international reserve currency supplier – U.S. monetary authorities. However, Triffin Dilemma, which is directly tailed to the third function mentioned above, has to be resolved. Dr. Zhou Xiaochuan, Governor of the People's Bank of China, pointed out that Triffin Dilemma may be resolved by substituting the role of the U.S. dollar as reserve currency for the SDR. As the result the contradiction between achieving their domestic monetary policy goals and meeting other countries' demand for reserve currencies will be settled [5].

Measures to promote private sector investment and to reduce personal and corporate savings will need to complement any fiscal retrenchment in surplus countries. Conversely, measures to increase savings have to be adopted in deficit countries. More generally, governments will have to decide how much priority to attach to reducing imbalances compared to other macroeconomic and structural objectives [13].

Obstfeld and Rogoff reach the same conclusion using a multi-country, inter-temporal, general equilibrium model [14]. They state that most theoretical and empirical models (including theirs) indicate that a 10 percent depreciation of the dollar would be associated with a reduction in the US current account deficit of around one percent of GDP. They thus argue that reducing the current account imbalance to a sustainable magnitude would require not just a dollar depreciation but also a change in the level of expenditures (e.g. a decrease in consumption in the US) [6].

The US can reduce its budget deficit. Increases in the budget deficit were the proximate cause of the large drop in national saving relative to investment after 2001. A decrease in the budget deficit could help to close this saving-investment gap [6].

To conclude, financial globalization has relaxed the constraints on countries in financing their savings investment imbalances, thus allowing larger imbalances to be sustained for longer. This is in principle welcome in so far as it permits more efficient adjustment over time, and smoothes the impact of economic shocks on business activity and consumption. But it also poses major new challenges for creditors and debtors, both public and private sector [11].

While imbalances are typically viewed as a macroeconomic phenomenon, their persistence in recent years suggests that there may be underlying structural features of national economies and the international financial system that influence their magnitude [12].

Whereas the adjustment process from a trade perspective is moving in a positive direction, some risks remain. Among these are a return to low savings in the US and a reemergence of large imbalances. In China, there is a danger that the import strength is temporary, as relatively cheap natural resources are purchased for future use, and domestic consumption does not expand in a sustainable way. Without these two countries participation, the new pattern of trade cannot take an effect.

A market-driven exchange rate in China would help reduce these risks. A real appreciation of the renminbi would make imports more affordable and exports less competitive, and China's large trade surplus would decline. China has already facilitated some real appreciation during the crisis through fiscal stimulus and ultimately rising wages and prices [15]. A gradual move to more exchange rate flexibility will keep domestic demand on track and promote stable prices. This would be a win-win for both China and the rest of the world.

Despite the fact that some policymakers see protectionism as a tool to cope with current account imbalances, it is highly unlikely to be effective. Unless trade barriers affect savings and investment, they cannot alter the trade balance. In a similar vein, more trade liberalization will not lead to expanding imbalances. As shown in Freund's research, trade has expanded steadily with and without growing imbalances [11]. Opening markets to goods and services facilitates the movement of resources to their most productive uses, raising income levels. It also raises income growth by expanding returns to investment in high-productivity firms and sectors. It is important that efforts to liberalize – unilaterally, multilaterally, and regionally—are kept on track during this period of global uncertainty.

As it was mentioned above, financial pundits have differing interpretations about the origin of the imbalances. It leads to the two different mechanisms to cope with global financial imbalances. On one side the solution lies in a long-term tightening of U.S. credit conditions and higher domestic savings. On the other side, Bernanke and his supporters argue the solution is for China to stimulate domestic demand, appreciate the renminbi and reduce reserve accumulation. In reality, it takes both a lender and a borrower to create a debt crisis; the solution to the crisis lies in balanced adjustments on both sides [4].

Whatever the approaches are, global financial community is to struggle for a more balanced development of the world economy. In today's post-crisis economic environment it is still difficult to forecast whether global financial imbalances are going to vanish or return in the next two or three years. The answer seems to be not that explicit. The future of global imbalances depends on the developments in both real and financial sectors of the global economy. Nevertheless, the evolution of these economic processes is hard to predict. Although we can't be precise in the direction of global imbalances developments, we can definitely think of the two scenarios of global imbalances developments.

According to the first scenario the global imbalances will return in the upcoming years, as economies demonstrate the return of growth. Global financial crisis has demonstrated the effectiveness of the self-insurance strategy pursued by emerging markets. These markets managed to withstand the global storm better than the rest due to large amounts of foreign reserves accumulated. The success of this strategy may embolden other countries to follow suit.

Moreover, emerging markets will pursue the goal of protecting their savings from inflating. As a result they will very likely continue to demand large volumes of financial assets from more developed markets contributing to the "savings glut" [1].

The second scenario implies gradual vanish of global financial imbalances. Although less likely in the short run it is more likely to take place in a long-term. In order to make the scenario work, emerging economies have to refocus on inward-looking growth. In general, an orderly rebalancing of emerging economies with strong external positions and sound macroeconomic frameworks would have to involve an upfront appreciation of the exchange rate [16].

The strengthening of social safety nets which is ongoing in China and other emerging countries is likely to bring down unusually high household saving rates attributable to the EME's. Reforms undertaken by the governments of the emerging markets are aimed to accelerate the development of bond and equity markets, and improve corporate governance. These reforms are expected to reduce corporate sector incentives to retain earnings and thus would bring down corporate saving rates.

Nevertheless, we have to admit the fact that global imbalances issue remains unresolved. There is a lack of countries that can provide financial assets that can be relied on as a store value. German government bond market could become one; however it is not large enough to satisfy the hunger of emerging markets for risk-free reserves [17]. Some analysts assume China could become a regional risk-free reserves supplier for Asian countries in the meantime, while it looks hardly feasible or at least far-fetched for the time being as China lacks developed and sizeable capital markets. Moreover, there are embedded political stability risks in the long run. Therefore, we assume that the world's dependence on the U.S. dollar will continue at least a decade ahead [17].

On the way to strengthening world economic sustainability we should remember that global economy is not a stationary thing. It is constantly moving, inheriting a featured development of a particular time, still never being unidirectional.

The pace of reserve accumulation has far outstripped GDP growth in emerging economies. China now holds more than 50 percent of GDP in foreign currency reserves–up from less than 10 percent fifteen years ago. In South Korea and Russia, the ratio stands at around 35 percent; in India and Brazil it is above 20 percent [17]. This appetite for reserve accumulation clearly distinguishes the latest round of catching up in the global economy from previous ones. Germany and Japan in the 1960s and 1970s grew their reserve holdings at approximately the same rate as output, so that reserve levels remained constant at about 5 percent of GDP, or one-tenth of China's current levels [17].

In order to avoid large global imbalances in the nearest future policymakers have to take actions.

- Strive to make the economic structure of both advanced, emerging and developing economies more balanced.
- Deficit countries and U.S. government in particular have to tighten long-term credit conditions and focus on higher domestic savings.
- Simultaneously, emerging markets with China at head have to stimulate domestic demand, increase social insurance, appreciate the national currencies and reduce reserve accumulation.
- Global economic community has to revise the role of the US as the major reserve assets supplier to the global financial system. It leads to the Triffin dilemma: inconsistency between achieving their domestic monetary policy goals and meeting other countries' demand for reserve currencies. New international reserve currency has to (i) be anchored to a stable benchmark and issued according to a clear set of rules, therefore to ensure orderly supply: (ii) its supply should be flexible enough to allow timely adjustment according to the changing demand: (iii) such adjustments should be disconnected from economic conditions and sovereign interests of any single country.

So as to bring the aforementioned recommendations to life world policymakers have to combine their efforts and cooperate moving towards a more balanced world economy. All in all, the global financial crisis is a good time to address country-specific and global systemic risks on the way to strengthen the world economic sustainability.

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Kyshkan Vladislav*

UKRAINE'S INTEGRATION INTO THE GLOBAL INNOVATION AREA

Abstract. Summarized the gist of the concept of innovation and innovation area, considered strategic priority directions of high-tech activity in the coming years and negative factors that prevent from construction of an effective national innovation system, analyzed the situation and prospects of national production and trade ofhigh-tech products and explored the place of Ukraine in the global innovationspace.

Keywords: innovation, innovation area, the strategic priorities of high-tech activity, the national innovation system, Ukraine.

The importance of subject matter is caused by the rapid growth of the impact of science and technology on the development of the world. Innovation is rapidly and radically changing the structure of the world economy. If the country is unable to promptly restructure of the economy according to new technological patterns, it leads to the inhibition of the development and economic downturn. This problem is very important for Ukraine. So if it doesn't want to be a raw materials appendage of the developed countries in the near future but to be among them, it should be involved in the processes of international technological exchanging, national scientific and technological capacity developing,innovative concept development implementation.

Theoretical researches of the impact of innovation on economic development are reflected in the works of foreign scientists such as T.Brayan, F.Valenta, H.Mensh, B.Santo, B.Tvist, K.Frimen, F.Yansen. The Ukrainian scientists who work in this direction are L.Antonyuka, Yu.Bazhala, V.Solovyova, V.Aleksandrovu and others. Despite a large number of papers on this subject, researching of the Ukraine's role in the global innovation space requires new scientific developments.

The objective of the article is the theoretical generalization of methodological approaches to the nature of innovation development in the context of globalization and identification priorities for innovation and Ukraine's place in the global innovation space.

The innovation is a key factor in the formation of a stable and competitive economy. Scientists of the world since the scientific and technological revolution of the nineteenth century till nowadays release their important role in the economic development of the country what can be proved by the large number of theories of innovation.It should be noted that there is no general and common understanding of this concept in modern society because of different approaches of the authors to this problem. However the most complete and commonly meaning have the following definitions: according to wide (classical) approach, innovation - is the embodiment of scientific discovery, technological invention of a new technology or a new type of product, and according to narrow - the outcome creation and development of a new or upgraded product (innovation) [1].

With regard to economic development and innovation potential core technology of the modern world economy is formed by such countries as USA, Japan, Germany, Britain, France,

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Sweden, Finland, the Netherlands, South Korea, supporting their economies to sustainable high level and ensure competitiveness on the international markets through efficient use of resources and innovative activity, while Ukraine, according to the World Economic Forum is one of the countries which developing due to factors of production and ranked only 89 among 142 countries in the global competitiveness rating in 2011. The most competitive country was called Switzerland which pressed Sweden into second place. Top 5 also includes Singapore, the U.S. and Denmark, while Ukraine dropped by seven positions this year [2].

In the period of globalization increasing of Ukraine competitiveness can be only providedthrough establishing a clear policy of reliable positioning in the global and European levels, which should be directed to timely respond to the dynamic changes occurring in the world economy with a goal to implement targeted measures to secure the releasing of Ukrainian economy on the high level of international attractiveness.Ukraine has to define the priorities for international competitivenessto integrate into the global innovation area as both developing and supporting many innovative directions irrational and even harmful to the state economy. This fact confirms the specialization of countries in the international markets of high-tech products. For example, in the EU market Ireland and the Netherlands specializing in computer and office technology, Britain and France - in the aircraft and spacecraft, Finland - in electronics and communication technology, Sweden, Italy, Austria, Portugal - in weaponry, Denmark - in pharmaceutical products,Germany - in scientific devices.

Mechanism of identification strategic priorities of research and innovative development projects is noticed at the relevant laws: "On amending to the Law of Ukraine" On priority directions of science and technology ", "On amending to the Law of Ukraine "On priority directions of innovative activity in Ukraine ", "On amending to the Law of Ukraine "On the innovation activities". Their consideration and approval by the VerkhovnaRada of Ukraine will intensify activity of research, education, business and other subjects of innovation in this sphere.

The main priorities of innovation for 2011-2021 years are:

1) development of new technologies of energy transportation, energy efficiency, energy-saving technologies, development of alternative energy sources;

2) development of new technologies of high-tech transport systems, space industry, aviation and shipbuilding, military equipment;

3) development of new technologies of materials production, their processing and connectivity, creating nanomaterials and nanotechnology industry;

4) technological innovation and the development of agricultural sphere;

5) introduction of new technologies and equipment for quality medical care, treatment, pharmaceuticals;

6) widespread use of cleaner production technologies and Environmental Protection;

7) development of modern information, communication technology, robotics [3].

As for Ukraine, an important market of high-tech products is a market of military equipment. In 2011 exports of these products was 484 million dollars. This is the twelfth place among world exporters. It should be noted that the main exporters are the United States and Russia, the average export of which for 2000-2010 years - 2.0-2.5 billion U.S. dollars [4]. Ukraine also belongs to the eight countries that have the necessary scientific and technological potential to create the most advanced aerospace technology. It is among the ten largest shipbuilding countries in the world, has a large share of employment in high-and medium-technology industries compatible with the EU countries, but its productivity in fact is several times lower than in these countries. ThereforeUkraine should focus on these priority industries and provide a significant increase in their state support.

One of the main negative factors which preventsfrom building an effective national innovation system and occupation of leading position in the global market innovation byUkraine is insufficient spending on research and development. The overall level of funding for science is one of the key characteristics of the innovative country, its commitment to building a society based on knowledge. Average annual funding of science in 2010 in Ukraine was only 1% of GDP while in European countries with high human development research intensity of GDP are from 1.4% in Ireland to 4% in Sweden. Ukraine has one of the lowest levels of funding for science in the world - $ 11 per capita, in the U.S. - $ 1000, Japan - 900, Finland - 700-800, Russia - 60-66 dollars. The level of implementation of innovation is also extra low: from 40 thousand developments performed annually only 16% are usedin production [5].

It is legislatively determined that expenditures on civilian research in Ukraine should not be less than 1.7% of GDP. However, in practice, the total cost of research and development (from all sources) in Ukraine over the last 15 years ranged between 1 and 1.5% of GDP, and in 2007 - 0.96% of GDP. Thus the state budget has never exceeded 0.5% of GDP (in 2007 - 0.39%).

The success of the innovation policy of Ukraine in the global market is determined by the size of investments, which it receives from the outside and also from internal sources for the development of high-tech domestic production, dynamics of growth of the share of high-tech exports, increased interest of foreign companies and highly skilled professionals to work with Ukrainian companies, as well as the extent of use savings for investment in domestic production. Particular attention should be paid to Ukraine's accession to the European programs to implement their own priority areas of scientific and technological capabilities and a whole European region. For example, currently Ukraine is a member program EUREKA (since June 2006), which task is cooperation for implementation of scientific achievements in the industry. Ukraine has the appropriate scientific potential to join the research trends: genomics (the study of the human genome) and biotechnology in health care, new production processes and devices, aeronautics and space exploration, radiation protection. However, Ukraine needs to use EU developments in the field of information society technologies, quality and food safety, global change and ecosystems.

The fact that ruling in Ukraine are resource-intensive low-tech areas while high-tech areas provide only about 3-5% of the product (the most advanced knowledge-intensive industry - nanotechnology, optoelectronics, biotechnology, genomics, photonics in Ukraine almost absent - their share in GDP is less than 0, 1%) shows that in contradiction to developed countries where 85-90% of GDP provided by the manufacture and export of high technology products, Ukraine's share in the market of high-tech products, which is estimated at 2.5-3 trillion U.S. dollars approximately 0.05-0.1%. Thus the share of high-tech exports in total manufactured exports in Ukraine in 2009 was 13.7%, whereas, for example, in Germany - 42% and in Finland - 22% [6].

Ukraine should increase the share of GDP invested in research and development, at least to the European criterion of 3% of GDP in 2010-2015 to make up positions of high-tech state and the real impact of science and innovation for economic growth, but the following next conditions: firstly, raise the share of the business sector in the volume of investments of at least two-thirds, and secondly, significantly change the funding models of science toward consideration of promising technologies, the expected results of their implementation, competitive selection of projects.

Conclusion. Today Ukraine significantly lags behind developed countries by the level of innovation economy. There are low indexes of competitiveness of the national economy, the country's readiness to function in the global market, the domestic yields of high-tech products, share of high-tech exports of goods and services and the national high-tech products in the world market.At the same time, Ukraine keeps developing to the innovative model of economic. In many fields of scientific research and innovation its positions remain competitive. However, implementation of these opportunities is dependent on the direction of state policy in support of high-tech industries, the choice of a single vector of Ukraine's international integration and increasing participation in international scientific and technical collaboration with leading countries. In this situation European integration can serve as an effective tool to accelerate innovation and consequently economic development of Ukraine.

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Vetchynov O.**

THE DYNAMICS OF THE LABOUR MARKET IN GERMANY IN THE CONTEXT OF THE GLOBAL FINANCIAL CRISIS

Анотація: Стаття присвячена динаміці ринку праці Німеччини протягом останніх років. Вона складається з аналізу загального впливу світової фінансової кризи на економіку Німеччини та дослідження ринку праці Німеччини у періоди до та під час кризи.

Ключові слова: світова фінансова криза, економіка Німеччини, ринок праці, рівень безробіття

Annotation: The article is devoted to the dynamics of the German labour market in the recent years. It comprises the analysis of the general impact of the global financial crisis on German economy, as well as the research of the labour market in Germany before and during the crisis.

Key words: global financial crisis, German economy, labour market, rate of unemployment

This research is aimed at determination of structural changes and the dynamics of German labour market under the impact of the global financial crisis. Various methods have been used in the process of research, e.g. analysis and generalization of macroeconomic indices, forecasts and real results comparison, theoretical estimate of empirical data, systematic approach, etc. There is also a solid basis of used information sources, including various articles in the specialized editions, interviews with well-known analysts and official statistical data, among others. The events mentioned has recently taken place, therefore the research is topical and contributes to profound investigation of the issue of the global financial crisis, its impact and anti-crisis activities.

The global financial crisis that began in 2007 in the USA considerably affected German economy. One should analyse the essential macroeconomic indices of the crisis period and observe the changes caused by the crisis in various sectors of national economy.

Germany felt the impact of the crisis during "the second wave" (at the first stage the crisis affected the countries with the highest share of the sector of financial services in the economy structure (such as Great Britain). "The second wave" influenced the countries with an important role of export orientation of the economy. The world financial crisis was accompanied by the increase of state debt rate and budget deficit. Governments faced problems in carrying out economical and social development policies, securing financial stability, and supporting high employment rates.

German banks suffered when the crisis broke very much, because many of them were connected to US and other banks, e.g. Lehman Brothers that collapsed as a result of the crisis. That's why lots of German banks had tremendous loss, but the saviour for them was a plan adopted by the federal government. It was called SofFin (Special Financial Market Stabilization Funds) and

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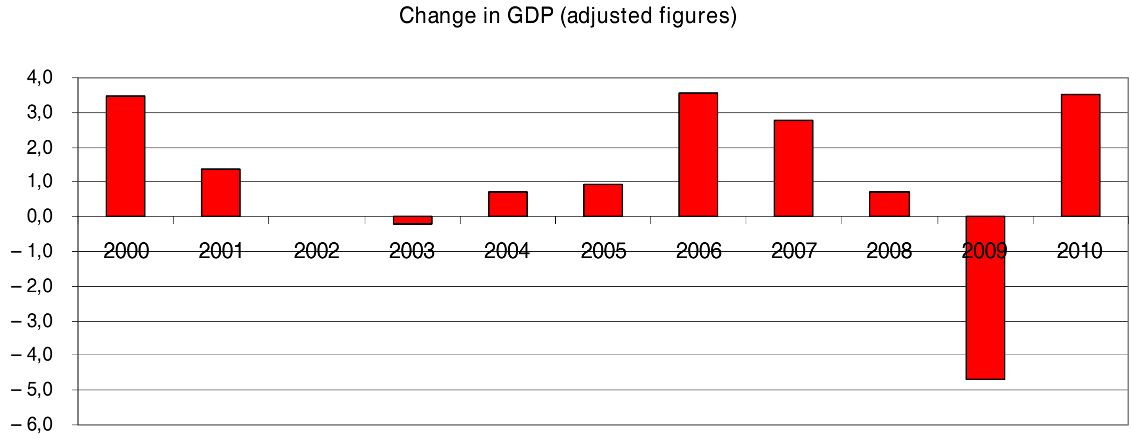
equaled about € 480 billion. This measure stabilized the financial market: 26 banks took the opportunity to protect their stocks. Among them were Hypo Real Estate (for which the crisis' impact was the most painful), Commerzbank AG, Volkswagen Bank, etc. [11]

To make matters worse, problems in financial sector were accompanied by the slump in real sector. Let us examine this slump using the example of machine building and metal working. Thus, the production of steel in Germany as a result of the crisis equalled just 50% of pre-crisis level, the downfall of commodity turnover in machine building was 30%, in metal working – 22%. [19] Such area of comparative advantage for Germany as a motor industry suffered very much from the crisis. Sales of motor cars decreased by approximately 9-10% (according to different estimations) in 2009, which is not a tremendous problem, however the downfall in truck sales was very dramatic all over the world (it can't be compared with any crisis in this branch before. Therefore, the turnover of motor industry in 2009 equalled the result of 2003 (that means a downfall by almost 21%). The positive thing about motor industry is that employment rate decreased by only 3% in 2009 compared to 2008, being a consequence of successful implementation of Kurzarbeit programme, which is scrutinized below in the text. Good news for Germany was also a success of Umweltprämie programme, that involved a considerable sum of government assets spent for the sake of replacing old cars with the new ones. It helped increase the rate of sales of new motor cars by 25% in 2009, however, 40% of these new cars didn't come from Germany. [26] [7]



Graph 1 shows how the global financial crisis has influenced German gross domestic product (GDP).

Here one can observe the dynamics of German GDP during the previous decade. The decrease of German GDP by 4,7% in 2009 can be compared just to the years of Great Depression or the crisis after the Second World War. Cautious forecasts were made after a considerable slump of economy, but the reality surpassed all expectations. The indices of 2010 are evidence of the rapid recovery of German economy that demonstrated an increase of GDP by 3,6% - the best performance of twenty years period. This result was caused by the increase of gross investment rate by 10,7% and consumers expenditure by 0,9%, as well as recovery of external trade (increase of export by 14,2% and import by 13%).[3] [9]

Let us determine the main reasons of the slump in the crisis period. They are as follows:

- export orientation of German economy (on the one hand, due to it the downfall of external trade volume by 14,7% had such a strong impact, on the other hand, it helped overcome the consequences of the crisis);
- decrease of the international investment flow to Germany approximately by 12,5% in 2009.

Other important issues are:

- underdevelopment of the Eastern “Neue Bundesländer” (New federal states of former DDR) that requires huge government spending;
- Germany is a key country of the European Union and one of the key players in the modern globalized world, and of integration and globalization have their pros and cons: in the crisis situation “domino principle” could be distinguished as solitary problems become common in the globalized world. [5]
- structural disproportions of German economy;
- the fact that crisis has taken place both in financial and real sectors of economy;
- state control over the back activities was not impeccable;
- asymmetry of German consumer demand;
- a swift tumble and a slow recovery of trust to the banks, among others.

Germany had considerably increased its dependence on exports before the crisis (the share of exports was 46,9% of GDP in 2007, and only 27,7% of GDP in 1982), three quarters of export and two thirds of import came from the European countries.[8], [23] Downfall of external trade made it possible for China to leave Germany behind to become the world largest exporter.

The dynamics of GDP per capita in Germany is naturally similar to the GDP dynamics examined above. It also indicates the considerable negative impact of the world financial crisis (decrease from $36400 in 2008 down to $34700 in 2009) and later improvement of economical situation (increase up to $35900 in 2010). Calculated using some different methods, IMF data are even evidence of exceeding the pre-crisis level of development in 2010. [12]

The crisis influenced not only GDP rate, but also GDP structure in Germany. 2009 was marked by the decrease of agricultural and industrial sectors shares, and the increase of shares of building and services sectors. The next year the situation was quite the contrary. Having analysed the scale of these changes, one can come to the conclusion that agricultural and building sectors shares haven’t changed considerably during the crisis period, share of industry has decreased while share of services sector has increased.

In addition to this, the crisis has lead to the increase in budget deficit of Germany (whereas before the crisis there had been budget surplus in Germany) up to 3% (€79,4 billion in 2009) and growth of public debt by €116 billion in 2009 (up to €1762,2 billion that equals 73% of country’s GDP). Divided by the amount of German population, the public debt per capita equaled €21489,8 in 2009, which is obviously much and a big burden for the German economy. However, unlike the dynamics of GDP, in 2010 budget deficit continued increasing up to 3,3% of GDP (€80,2 billion), and public debt reached the record level of 83,2% of GDP. Now German government is planning to reduce both budget deficit and public debt in a long-term perspective.[15], [16], [28]

Having examined the crisis impact on inflation rate in Germany, one can conclude that crisis inhibition of German export-oriented economy developed into the prices stagnation. Indeed, in 2008 inflation rate equaled 2,6%, whereas in 2009 – just 0,3-0,4% (according to different estimations), and in several months even deflation took place. But recovery showed itself in gradual growth of consumer prices. The factor that determined the downfall of inflation rate was the decrease of prices at the oil market in 2009. At the same time, the inflation increase in 2007-2009 and 2010 depended mainly on the increase of prices on energy resources and fuels. Therefore one can conclude that German economy is dependant on energy. [2], [8], [9], [13], [14], [17]

After the examination of general crisis impact on German economy, let us pass on to the labour market itself. The dynamics of the labour market contradicted all the pessimistic forecasts of the analysts and turned out to be unexpectedly positive. Current forecasts remain cautious and even inauspicious, but one of the most important reasons of the recovery has been the successful labour market policy.

Labour is a foundation of the entire economic and social mechanism of Germany, as the more employed (and less unemployed) are in the country - the more is the tax filling of the budget, the more assets has the pension fund, the more is consumer demand, the less money is needed for the social benefits to the unemployed people. Thus the proportion between employed and unemployed can be called a basis of the prosperity and welfare of Germany. That's why the research of the dynamics of the labour market in Germany in the context of the global financial crisis is so topical. Thus let us examine the situation with employment and unemployment, beginning with the tools of labour market regulation in Germany.

There are collective agreements concerning labour hours regulation in some sectors of economy, agreements of companies concerning working hours optimization in the form of its special accounting and holidays reducing, etc. Only when all the means to reduce working day are depleted, the statutory rule of shortened working day comes into effect. This rule guarantees the workers some labour hours except those stated in the collective agreement, making up for the losses caused by the temporary production downtime to the certain groups of workers, e.g. builders or seasonal workers. Losses of income caused by the reducing of labour hours are compensated by the subsidies of the Federal Labour Agency. In case the full suspension of production takes place, either 60 or 67% - depending on the marital status – of the latest wage is paid by the state, the rest is paid by the employer. The employer is to preserve all social safeguards; health, retirement and other kinds of insurance. The conditions for this tool to start being implemented are economic difficulties and a considerable downfall of demand for the company production. The both approaches – legislative regulation and collective agreements – are closely interconnected, and that leads to the differencies between the sectors with collective agreements (e.g. building sector), and those without them (e.g. service sector).

Having examined German approaches to the regulation of labour market, let us turn to its dynamics before the crisis that is determined mainly by the so called Hartz concept. It is the key part of Agenda 2010 in Germany. Agenda 2010, in turn, is a set of reforms, intended to change the organization of education, health insurance, pensions, family policy and the labour market. All the changes were made so that the EU could transform according to Lisbon Strategy between the years 2000 and 2010 into "the most dynamic and competitive knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment." [30] The Hartz concept is a set of recommendations. It was worked out by the Committee for Modern Services in the Labour Market (Kommission für moderne Dienstleistungen am Arbeitsmarkt) in 2002. The head of this committee was Peter Hartz, HR executive at Volkswagen AG and well-known German economist. It consists of series of reforms, known as Hartz I – Hartz IV. The reforms of Hartz I-III were implemented between 1 January 2003 and 2004, the beginning of Hartz IV was 1 January 2005.

One can formulate the general major principles of this strategy of modernization in placement services, representing a belated adoption of widespread in other OECD countries concept. They are as follows:

1) An emphasis on activating the unemployed;
2) Profiling and segmentation of services by client groups.
3) Emphasis on improvement of services to employees and job-matching;
4) Increased reliance on outside provision of placement services;
5) Merger of previously fragmented service provision for jobseekers on social assistance in one-stop-shops, the new Job centres.

The motto of the policy was “fördern und fordern” (literally, “promote and require”). The unemployed were to receive more intensive and individualized assistance. However, they were also pressed to search for and accept any available employment. So that it could be achieved, contacts with the unemployed were to be more frequent and improved, especially through reduced caseloads for placement counselors, as well as by improved IT systems and streamlined work organization. There were also such changes as mandatory early contact with the public employment service for persons given notice of termination or on temporary contracts; stricter regulations of long-term unemployment (in order to force the people to accept any job offer); shifting the burden of proof to the unemployed and more flexibility in applying sanctions; and greater availability of self-service information facilities.

Using both qualitative and quantitative profiling, jobseekers were divided into several client segments (job-ready, in-counselling, intensive service) due to their distance from the labour market. Individual action plans and allocations of labour market services are based on this classification.

The areas to improve in placement services for employers were special services for “premium” clients, decrease of reaction time, screening of prospective jobseekers before referral, referral of only a limited number of qualified jobseekers, follow-up contact with the employer, an improved database on job openings and monitoring of adherence to quality standards.

Outsourcing of placement services was promoted through new policies permitting the public employment service to contract out partial or complete responsibility for reintegration of the unemployed to the third parties. Two especially interesting innovations are the placement voucher and the personnel service agencies that are temporary work agencies for the unemployed established on a contract basis with a local service provider. The placement voucher is issued to the persons who have been unemployed for more than 6 weeks. The private agency is paid a maximum of € 2000 for placing the unemployed person in employment of at least 15 hours per week, more €1000 after an employment lasting for more than 6 weeks and again €1000 for at least 6-months employment.

Let us examine all the parts of the reform policy closer.

Aim of Hartz I was to increase the attractiveness and social acceptability of temporary employment by creating equal terms towards both short-time workers and permanent employees. Job Agency supported vocational further education, established subsistence payments and a system of intermediary institutions of temporary employment called PSA (Personal-Service-Agenturen). Hartz I law changed considerably the Temporary work act (literally, Act of leasing of human resources): several prohibitions were lifted, such as prohibitions of term, synchronization, restoration on work and the two-year limit of temporary work. The wage workers whose places of work and current employment are not the same (that means, leased) got equal rights with the employees who work without being leased. Such rights and conditions comprise equal working hours, wage, “equal pay and equal treatment”, and equal right for being on leave.

Unemployment benefits (that included e.g., limit of salary, up to which one can receive benefits), grant for unemployed entrepreneurs willing to start new businesses (“Ich-AG” = “Me, Inc.” or “Me, Self-employer”), a system of institutions called Job Centers and new types of employment with lower or gradually rising taxes and insurance payments were established by implementation of Hartz II. Such new types were called “Minijob” and “Midijob”. “Minijob” corresponds with the level of salary that equals €400 (it used to be €325). Such empoyees are to work more than 15 hours per week and do not have to pay for social insurance at all – their employers pay for them completely. “Midijob” means that an employee earns € 400 up to €800 per month. The more is earned, the more are the payments for social insurance, and at the level of €800 the payments of an employee equal the payments of his employer.

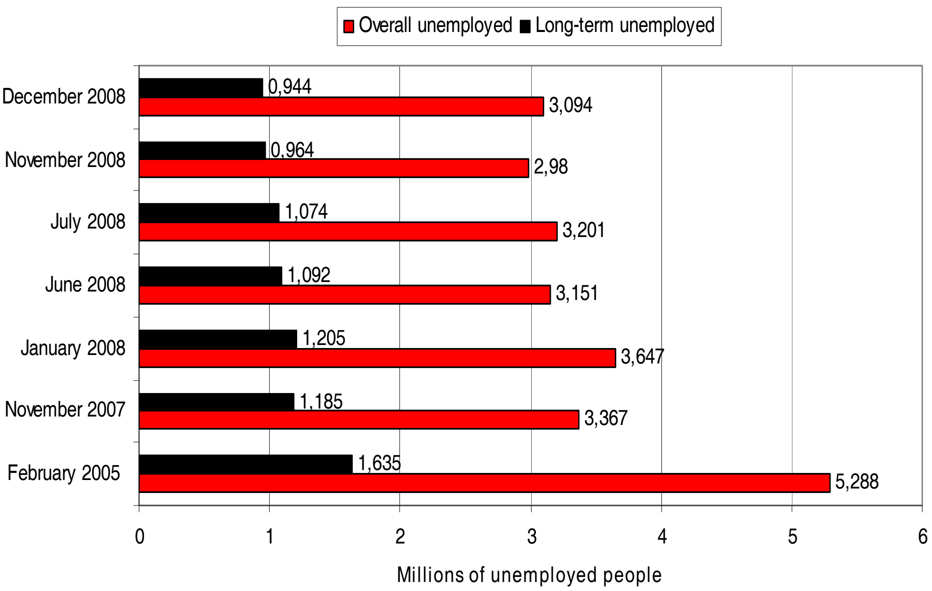
The main focus of Hartz III was restructuring of the Federal Labour Office into Federal Labour Agency (it should serve the purpose of finding work for the unemployed).

Hartz IV was the final and most radical of these laws. It provided a framework for the integrated provision of benefits and labour market services to the long-term unemployed and other employable social assistance recipients. It brought together all social welfare allowances into one sum, called "Unemployment Benefit II." In Germany, responsibility for labour market programmes for social assistance recipients used to be divided between a nationally financed means-tested system of “unemployment assistance” and labour market programmes financed and administred by local authorities for social assistance recipients. New legislation brought to life “Unemployment Benefit II” that became the allowance an unemployed person receives after the official "Unemployment Benefit I," an allowance based on person’s previous income, ran out after a certain period. The reception of "Unemployment Benefit I" was restricted to 12 months in general and for elder unemployed – to 18 months (in 2007 the limit was raised up to 24 months for people over 58). Such restrictions and limits were established in order to make the unemployed strive to find work.

Unemployment Benefit II was to be funded by the federal government and administered by the public employment service in cooperation with the local authorities. Its’ essential level was € 345 per month (now raised up to €359) for single persons with additional benefits for dependent children (60% up to 80% of the benefit) and spouse (90%), adding also a housing allowance.

Hartz IV centralized both these benefits through the Bundesagentur für Arbeit (Federal Labour Agency), rather than separate regional offices. It was intended to prioritize getting people back to work, in whatever form: temporary, part-time or full-time.

There are also other issues regulated by Hartz IV, e.g. specific benefits for the children of the unemployed, with children between seven and 13 receiving 60 percent of the payment, and 14 to 17-year-olds receiving 80 percent, that were declared unconstitutional on 9th February 2010. The receivers of "Unemployment Benefit II" are also allowed to earn extra money – and the allowed limit of salary was raised on 1st July 2011. [24], [18]



Graph 2. Dynamics of unemployment in Germany in pre-crisis period. Source: self-made, using figures from www.destatis.de

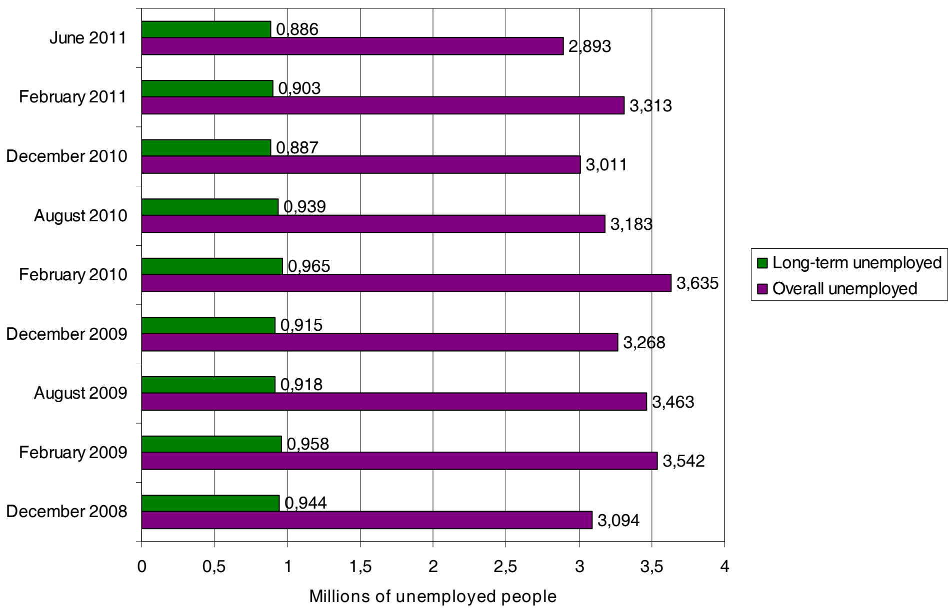
Over a long period of time the inflexibility was the prominent feature of German labour market. It was the main reason for the high unemployment rate. The reason of inflexibility is among others the existence of trade unions that pursue corporate interests, government regulations, etc. At the moment one can state that the situation has changed, if one observes the dynamics of the unemployment rate during the recent years.

There was a slump in unemployment in Germany before the crisis started (from 5,3 million people early in the 2005 down to 3,4 million people at the end of 2007), chiefly due to the labour market reforms included in the 4 Hartz laws – "Modern services in the labour market".[23]

We can see the achievements of reforms on Graph 2, as well as the dynamics of the year 2008 that directly preceded the crisis year. During the whole year the decreasing trend is to be pointed out.

However, the reforms' influence is disputable and attracts criticism in Germany. It's said that the reforms haven't overcome the long-term unemployment (31% of long-term unemployed in 2005, 35% of them in 2007). There were more employed people, but many of them have temporary or part-time jobs. To make matters worse, these reforms are said to reduce the wage level, as it was semi-skilled labour that got most of the jobs. [22]

Now let us pay attention to the dynamics of the labour market during the crisis period and overcoming of the consequences of the crisis. Graph 3, shows us the dynamics of the labour market during the crisis and up to date. Although crisis resulted in a slight increase of unemployment, the situation improved very soon. In 2008 the declining of unemployment rate continued down to approximately 3 million people, and in 2009 the dynamics was rather changeable with 3,6 million unemployed in spring and summer and again in January 2010 That's why the analysts in January 2009 has made pessimistic forecasts for the end of 2010, according to which the amount of unemployed would have been at the level of 3,9 million people. [27] Nevertheless the expectations failed to come true, and the labour market situation hasn't deteriorated considerably. Indeed, in November 2010 the amount of unemployed equaled 2,93 million people, i.e. new record of the labour market was established. In general the unemployment rate in 2010 compared to the previous crisis year has fallen down from 7,4% to 6,8% of economically active population. The average amount of employed equaled 40,37 million people. [6] German economists tend to call the described situation "the wonder of the labour market" ("Jobwunder"). There were about 3 million unemployed in 2011, which means stability on the labour market and is a good result for German economy. In June 2011 a new record on the labour market was established – 2,9 million unemployed people. Modern reformed labour market in Germany is characterized by two different from the recent past features, they are flexible models of working hours and rising anxiety towards lack of labour force.



Graph 3. Dynamics of unemployment in Germany during the crisis and post-crisis periods. Source: self-made, using figures from www.destatis.de

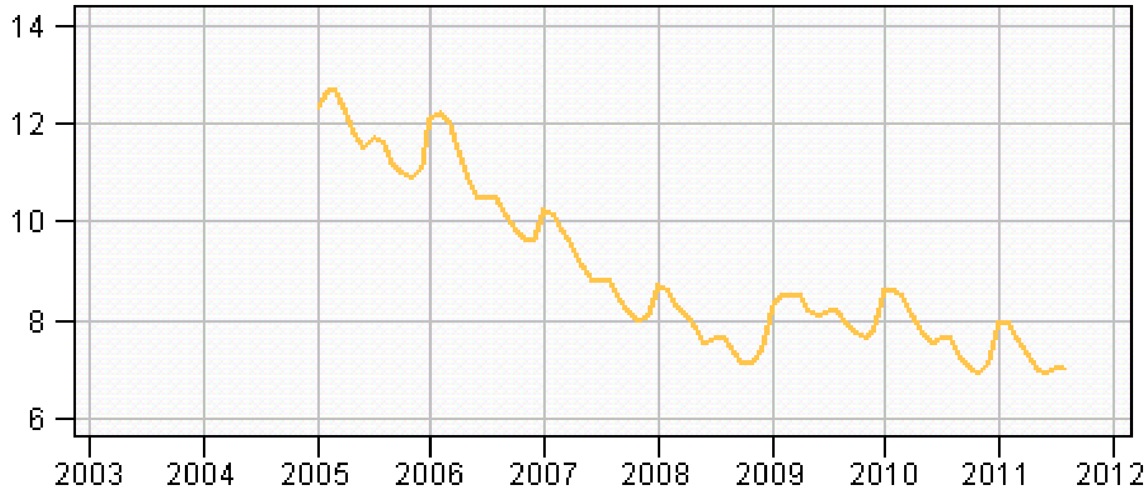
Thus rate of unemployment in Germany during the crisis remained rather stable in comparison with other countries (while the unemployment rate in the average OECD country increased by 3%).

Such results were achieved primarily due to increased flexibility of German firms that allowed them to reduce labour input by decreasing labour hours instead of layoffs. The result of the economic crisis was dismissal of temporary workers, so trade unions tried to find short-time jobs for them. It was the fear to lose important human resources during the crisis that kept enterprises from mass layoffs, according to the scientist of Hamburg institute of world economy Jörg Hinze.

In 2009 short-time working scheme Kurzarbeit was implemented, involving €5,1 billions of government assets, whereby the Labour Office replaced some of the lost income of 1,4 million employees, if they worked shorter hours, and employers who shortened labour hours instead of dismissing employees. It helped preserve about 3,1 million workplaces (7,7%).

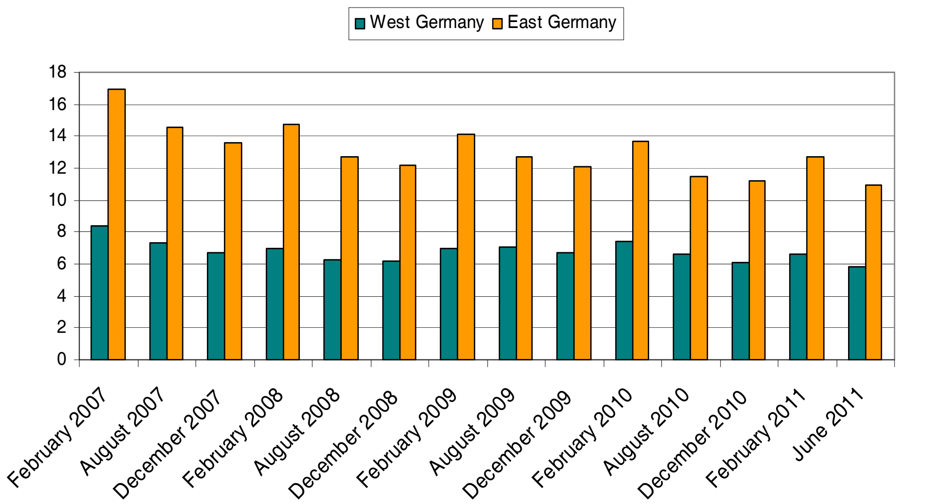
The scheme had various forms. For instance, the amount of working hours could be reduced to none, if this time would be used for further training and professional development. Then the recipient would get 60% up to 67% of the latest net income. From the end of 2008 such opportunity was opened not only for Transferkurzarbeiter, but also for seasonal Kurzarbeiter. These two are the special forms of Kurzarbeit: the first one meaning the allowance to the employees who suffer the long break in working activity owing to the restructuring of the enterprise (they receive it for maximum 12 months) and the second one meaning the unemployed who got such status due to weather and other seasonal problems preventing building sector, landscape designers, etc. they are employed in from stable working activity.

This scheme allowed qualified employees not to lose their skills owing to possible dismissals. At the same time the critics believed that it was necessary to reduce the level of compensation and stop helping noncompetitive enterprises. [22], [10]In opinion of OECD, the scheme prevented the structural changes that accompany considerable economic recessions. Therefore it was seen reasonable to renounce the short-time working scheme as fast as possible, not to extend their action beyond the terms set by law. It was offered to demand from firms joining the scheme to return subsidies partially if they decide to dismiss employees after the end of the short-time working period. [68]



Graph 4. Dynamics of unemployment rate in Germany in 2005-2011
Source: [29]

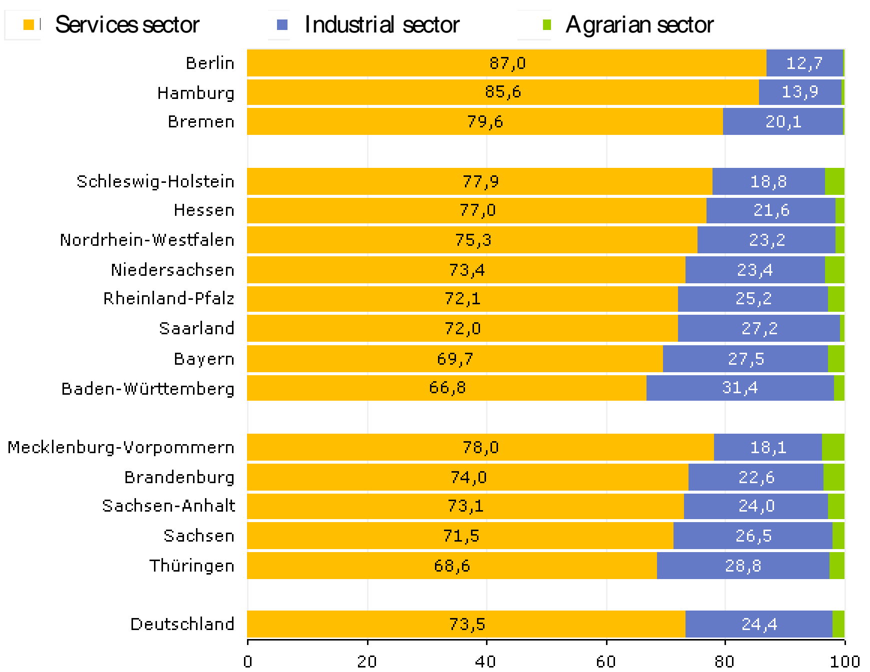
While in the crisis time the rate of unemployment was rather stable and started to increase, now a clear descending trend is obvious. The economists hope it will last in near future as well. However, the situation across the country isn't similar. The rate of unemployment is traditionally high in former East Germany, whereas in West Germany it's twice less. However, there is also a discrepancy in the West: with the minimal rate in Bayern (about 5%) and considerably larger in the Northern federal states.



Graph 5. Dynamics of unemployment rate in Germany with comparison of West and East Germany indices.
Source: self-made, using figures from www.destatis.de

There is also a seasonal trend: there is always more unemployed in winter. It's obvious from the previous two and the other graphs. It can be reduced to the weather conditions and winter as a season itself. For instance, building activity is restricted or cancelled in winter. Also, economic activity is generally poor, employees are more often fired at the end of the year and not so many people get a job. So there is an increase in unemployment every year in Germany by January (in comparison to last December).

The statistical data show the long-term structural change of the German labour market. The rate of workers employed in industrial sector – on which welfare of a country is based –constantly decreases (down to 24,4% in 2010), and the rate of workers employed in service sector rises on the contrary and reached the historical maximum in 2010 (73,5%, for the first time more than 30 million people). The rate of workers employed in agrarian sector remains invariably low (2,1%), but it almost halved over the last 20 years. Such changes are expected to keep taking place in future. [6]



Graph 6. Comparative structure of employment in different federal states of Germany.
Source: [20]

The structure of employment is not similar in different federal states of Germany. For instance, Berlin is the leader in employment in services sector (87%), Baden-Württemberg is on the first place in employment in industry (31,4%), and there is the biggest amount of employed in agrarian sector in Mecklenburg-Vorpommern (3,9%). It's obvious that eastern federal states are characterized by higher unemployment rates than western.

According to the analysts' forecasts in

2011 demand for labour will be increasing and the rate of unemployment will be about 7%. Business Climate Index of Ifo Institute of Economic Research reached its top value in February 2011, allowing to face the future of German economy with optimism.

On the other hand, the big problem is brewing because the positive tendencies of labour market are based on the insecure ground, at the expense of temporal and low-paid employment, but not stable working places.

The economists hope that German economy will continue its recovery and development. That means also a decrease in rate of unemployment. The latest trends show that this decrease will be slowing down and there will be still about 3 million unemployed this year.

So in general the dynamics of the unemployment is positive, however, one should not forget about the unemployment itself that it's worth being cautious when analyzing, as although official figures are evidence of real positive changes, but temporary employed in the so called "1-Euro-Job" programme and participants of the courses intended to facilitate search for jobs are not counted to the unemployed. Of course, such people cannot be considered a part of economically active population, and counted to the real employed population.

From 12 May 2011 all the restrictions for labour activity in Germany concerning the citizens of new members of the European Union are lifted. That will probably cause the flow of cheap labour force to Germany, transference of production facilities of German enterprises into less developed regions of Europe. This situation has a negative impact on the support of idea of global Europe and European integration in German society. [1]

Unemployment rate is known to be related to inflation rate (that fluctuates in Germany between 1,5%-1,8%). There is such index as NAIRU (Non-Accelerating Inflation Rate of Unemployment), showing "natural" rate of unemployment, which can be preserved in a long-term perspective without permanent growth of inflation. It can be concluded that it demonstrates the rate of structural long-term unemployment, and the difference between the real unemployment rate and NAIRU equals the rate of cyclical unemployment. German economists treat NAIRU with mixed feelings. According to Florian Kajuth, it's very hard to calculate this index especially for Germany. W. Franz, the chairman of German council of economic experts (SVR) believes that NAIRU can't be used for shaping economic policies without any correlation to other instruments. E. Niemeier rejects the fact that NAIRU reliably reflects the rate of structural unemployment itself. However, the estimations of NAIRU for Germany fluctuate at about 8%. [21], [25]

Having examined all the key issues, one can conclude the following.

- The crisis had a considerable impact on the economy of Germany, and in particular on the labour market through employment decrease;
- The basis of the labour market politics in Germany is Hartz concept. It forms the system of state institutions, as well as appropriate legislation with the special focus on Unemployment Benefits;
- Kurzarbeit programme allowed to restore the labour market and overcome the consequences of the crisis that became an integral part of the general economic revival;
- The long-term structural change of the German labour market is the increase of employment rate in service sector against the background of the decrease of employment rate in industry and stably low employment rate in agrarian sector;
- The perspectives of the German labour market are rather optimistic, however the positive trends are derived from the increase of part-time, temporary and low-paid jobs amount;
- It would be appropriate to reform the German labour market structrure on the basis of stable employment, its sectoral structure diversification and optimization, developing high technology sector in industry and service sector.

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Tetiana Voloshko*

LARGE CAPITAL INFLOWS TO EMERGING MARKET ECONOMIES: POLICY RESPONSES

The article examines the experiences of a number of emerging countries in coping with capital inflows. It analyzes the mechanism of regulation the large private capital inflows to emerging economies. It describes the nature of the inflows, their implications for macroeconomic and financial stability, and the policy responses used to cope with them. The actions that help to increase the absorption capacity and resilience of the economies and financial systems to the risks associated with the inflows are determined in the article as well.

Key words: private capital, inflow, emerging countries, policy responses, experience, effectiveness.

У статті розглянуто досвід декількох країн, що розвиваються, де спостерігаються притоки капіталу. Проаналізовано механізм регулювання крупномасштабних потоків приватного капіталу до країн, що розвиваються. Розглянуто суть потоків, їх вплив на макроекономічну та фінансову стабільність, і відповідні заходи політики, що застосовуються в даній ситуації. Визначено дії, що допоможуть збільшити поглинаючу здатність та стійкість економіки та фінансової системи до ризиків пов'язаних з притоками капіталу.

Ключові слова: приватний капітал, приток, країни, що розвиваються, відповідні заходи політики, досвід, ефективність.

В статье рассмотрено опыт некоторых развивающихся стран, где наблюдаются притоки капитала. Проанализирован механизм регулирования крупномасштабных потоков частного капитала в развивающиеся страны. Рассмотрено сущность притоков, их влияние на макроэкономическую и финансовую стабильность и ответные меры политики, которые применяются в данной ситуации. Определены действия, которые помогут увеличить поглотительную способность, а также стойкость экономики и финансовой системы к рискам вследствие притока капитала.

Ключевые слова: частный капитал, приток, развивающиеся страны, ответные меры политики, опыт, эффективность.

Formulation of the problem. With the global economy beginning to emerge from the financial crisis, capital is flowing back to emerging market economies (EMEs). Although capital flows to emerging market countries are generally welcome – providing lower-cost financing and indicating market confidence in the fundamentals of the economy – sudden surges can complicate macroeconomic management and create financial risks. On the macroeconomic front, the concern is that the surge will lead to an appreciation of the exchange rate and undermine com-

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petitiveness of the tradable sector – possibly causing lasting damage even when inflows abate or reverse. The main worry from the financial fragility perspective is that large capital inflows may lead to excessive foreign borrowing and foreign currency exposure, possibly fueling domestic credit booms (especially foreign-exchange-denominated lending) and asset bubbles (with significant adverse effects in the case of a sudden reversal).

Analysis of recent studies and publications. In the economic literature much attention is paid to the study of the category «capital», the problem of development and regulation of capital has always been decisive in the activities of practitioners and theorists from the beginning of a new era. The study of capital as economic category was involved in the works of A. Smith, D. Ricardo, K. Marx, A. Marshall, J. Keynes, Joseph Schumpeter, Robert M. Solow, J. Hicks, U. Sharpa, R. Holta, D. Beyli, L. Gitmana, M. Dzhonka, J. Mayera, I. Blanka and others. Further development relating to contemporary conditions as about investment activity and stimulation of investment receipts, regulation of capital inflow is investigated in the works of L. Pashnuka, B. Malinyaka, T. Zatonatskoy, V. Osetskogo, V. Mironenka, V. Mironenka, V. Selskogo, V. Chayki, O. Gavriluka, M. Gerasimchuka, Z. Lutsishin, Y. Makogona, A. Ivashenka, M. Portera. Although a number of studies have examined the policy responses to capital inflows, they have focused mainly on the experience of a few countries during the 1990s. There have been fewer studies on recent episodes and fewer attempts at comprehensive cross-country examination of policy responses.

Methods. Theoretical and methodological basis of research is the dialectical method of knowledge and systematic approach to studying the issues of capital flow, scientific works of domestic and foreign scientists. This work uses general scientific methods of knowledge (analysis and synthesis, comparative, economic-mathematic, method of summing up of data, methods of approach, methods of abstract logic and historical comparison). Research formed on methodological basis of economic theory and theory of world economy, etc.

Setting the task. The strong increase in net private capital inflows to emerging market economies over the past few ten years has restored the "capital inflows problem" to a prominent place in policy debates. The purpose of the work is to review the lessons from the experience of large net private capital inflows over the past two decades, examines the macroeconomic implications of and policy responses to surges in large private capital inflows across some of emerging economies.

The basic material work. These capital flows and capital mobility more generally, allow countries with limited savings to attract financing for productive investment projects, foster the diversification of investment risk, promote intertemporal trade, and contribute to the development of financial markets. In this sense, the benefits from a free flow of capital across borders are similar to the benefits from free trade, and imposing restrictions on capital mobility means foregoing, at least in part, these benefits, owing to the distortions and resource misallocation that controls give rise to [1, p. 4]. While inflows are typically beneficial for receiving countries, inflow surges can carry macroeconomic and financial stability risks. This paper reviews the recent experience of EMs in dealing with capital inflows and suggests a possible framework for IMF policy advice on the spectrum of measures available to policymakers to manage inflows, including macroeconomic policies, prudential measures and capital controls. Illustrative applications of this framework suggest that it may be appropriate for several countries, based on their current circumstances, to consider prudential measures or capital controls in response to capital inflows.

Policymakers often seek to attract external resources on the assumption that they will finance savings gaps and promote growth and economic development. However, evidence of the growth potential of capital account openness is mixed. Moreover, significant increases in capital inflows can make the financial system more vulnerable and overheat the economy. Lending booms, which often follow increased capital inflows, increase financial system vulnerability (a) by exacerbating maturity mismatches between bank assets and their liabilities, and in some cases mismatches between the currencies in which banks lend and borrow, and (b) through associated asset price bubbles. Macroeconomic overheating can be provoked by accelerated economic growth and inflation, and particularly by appreciation of the real effective exchange rate (REER) [2, p. 3]

Although capital flows to emerging market countries are generally welcome – providing lower-cost financing and indicating market confidence in the fundamentals of the economy – sudden surges can complicate macroeconomic management and create financial risks. On the macroeconomic front, the concern is that the surge will lead to an appreciation of the exchange rate and undermine competitiveness of the tradable sector – possibly causing lasting damage even when inflows abate or reverse. The main worry from the financial fragility perspective is that large capital inflows may lead to excessive foreign borrowing and foreign currency exposure, possibly fueling domestic credit booms (especially foreign-exchange-denominated lending) and asset bubbles (with significant adverse effects in the case of a sudden reversal) [3, p. 62]

Aggregated total capital flow is the sum of public and private flows, using data from the World Economic Outlook. We focus on private capital flows which are based on the nature of the recipient sector. That is, only changes in foreign assets and liabilities of the domestic private sector—as recorded in the IMF's Balance of Payment (BOP) database — are taken into account, independently of the nature of the foreign counterpart. The main difference compared to a "source" concept of private inflows is the exclusion of sovereign borrowing (specifically, the changes in the government's assets and liabilities vis-à-vis the foreign private sector) and the inclusion of private borrowing from external official sources. While this difference may be relevant for the early to mid-1990s, it is less likely to be relevant over the recent past, given the decline in sovereign borrowing and official lending.

The net private capital inflows series used in the work are constructed in five steps [4, p. 10]. First calculate (net) foreign direct investment (FDI) taking direct investments into the recipient country and subtracting direct investments abroad. Second, need to strip out assets that are classified under the monetary authority and the general government for each of the remaining categories: portfolio investments, financial derivatives, and other investments. Then do the same for liabilities, in effect yielding assets and liabilities that are private in nature. Third, these series of private assets and liabilities are netted, yielding net inflows for the three categories. Fourth, add FDI to the net private portfolio investment, financial derivative, and other investment categories, yielding our definition of net private capital inflows. Fifth, and finally, need to scale the total net private capital inflows by GDP to get the net private capital inflows-to-GDP ratio.

Private capital flows are the sum of four elements: direct investment in the reporting economy from abroad (FDI), including debt-creating liabilities to foreign investors and direct investment in the form of equity; portfolio investment (PIL), which is the sum of debt instruments issued by the domestic private sector (corporate bonds and other private debt securities) and foreign purchases of equities of domestic companies; current private transfers (PRT); and liabilities to foreign banks (LFB).

The pattern of current account balances across emerging economies has become much more diverse in recent years than during the early 1990s, particularly between emerging Asia and Europe. Most of emerging Asia (especially after the 1997–98 crisis), the Middle East, and some members of the Commonwealth of Independent States have reported large current account surpluses, while large current account deficits are observed mainly in emerging Europe and other countries [5, p. 492].

The divergent current account patterns in emerging Asia and Europe have revived the long-standing debate over the connection between economic development and capital flows – the Lucas paradox. Theory predicts that growth should lead to current account deficits for two reasons. On one hand, high growth and the resulting profitable investment opportunities should make the country attractive to foreign capital. On the other hand, if individuals want to smooth their consumption over time, prospects of continued high growth should lead to higher consumption today because income and consumption can be expected to rise further in the future. Traditional economic theory tells us that financial capital should, on net, flow from richer to poorer countries. In principle, this movement of capital should make poorer countries better off by giving them access to more financial resources that they can then invest in physical capital. Such investment should improve their levels of employment and income. It is natural to expect that as financial globalization – cross-border flows of various forms of financial capital – picks up steam, these flows from industrial to developing countries will increase, making all countries better off. It is right only for emerging Europe, but not for emerging Asia after 1997–98.

The past two decades have witnessed three waves of large capital inflows sweeping through many emerging market economies. The first wave commenced in the early 1990s and ended with the Asian crisis in 1997. The second one was building since 2002 and started in 2003, then accelerated in 2007, and ebbed in 2008 in the wake of the global financial crisis (figure 1). Third wave has started in the end 2009 year and last to present day.

While capital inflows often help deliver the economic benefits of increased financial in-

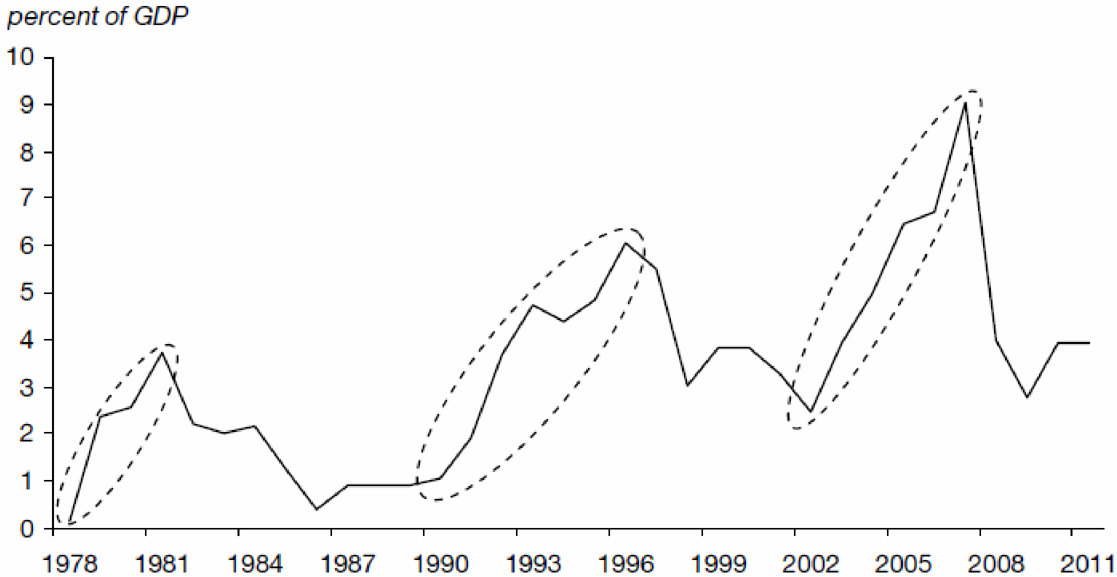

Figure 1. Private Capital Flows Cycles, Net

tegration, they also create important challenges for policy-makers because of their potential to generate over-heating, loss of competitiveness, and increased vulnerability to crisis. Also identify 109 episodes of large net private capital inflows since 1987; 87 of these were completed by 2006.

Looking at the nature and composition of the inflows reveals some interesting differences between the second wave of capital inflows and the one in the 1990s [6, p. 7]. In particular, the latest wave was taking place in the context of much stronger current account positions for most (but not all) emerging market countries, and a substantial acceleration in the accumulation of foreign reserves. The second surge in private capital inflows was also accompanied by a sharp increase in outflows, in line with the global trend toward the increasing diversification of international portfolios. Another important feature of the second wave of net capital inflows to emerging markets – which differentiates it from the 1990s – is the predominance of net foreign direct investment (FDI) flows relative to net "financial" flows (portfolio and other flows) in all four regions (Latin America, emerging Asia, emerging Europe and the Commonwealth of Independent States, other emerging markets). This reflects the continued strength in FDI inflows, together with the rapid increase in financial outflows from emerging markets which has largely offset the acceleration of financial inflows in most of these countries. In sum, the second cycle of capital inflows was different from the previous one, as it involved a larger set of countries, was underpinned by generally more solid current account positions (with the notable exception of emerging European countries), and took taking place in a more financially integrated world economy, where significant financial outflows were at least partially offsetting the inflows of capital to emerging markets (figure 2) [7, p. 8].

Viewed from a regional perspective, these episodes show several interesting patterns, bro-

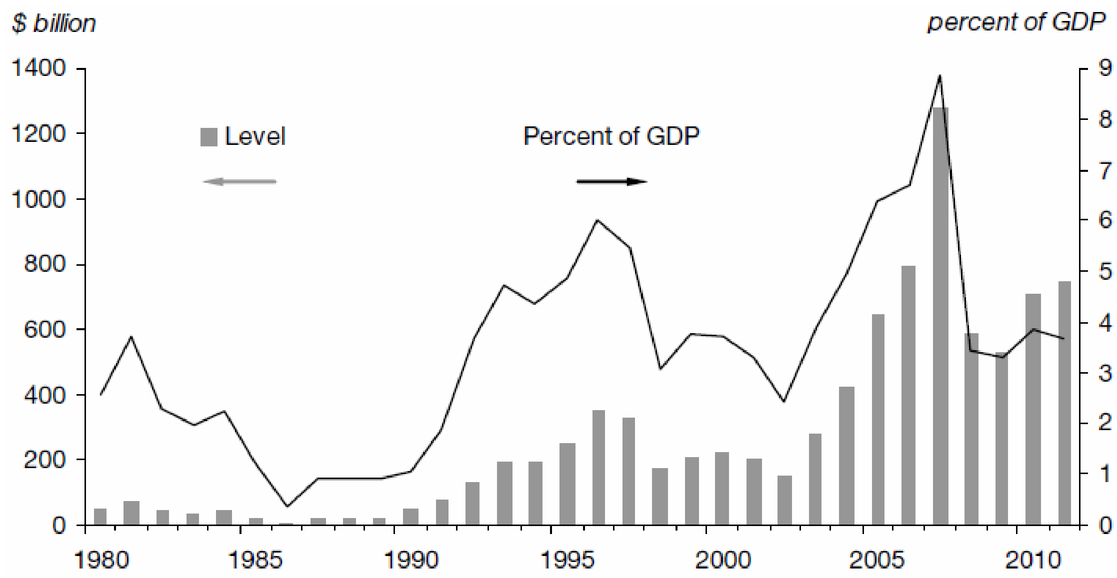

Figure 2. Emerging Market Private Capital Inflows, Net

adly in line with the stylized facts documented above: First, the incidence of episodes over time mirrors trends in net private capital inflows to emerging markets, with two waves of episodes of large capital inflows to emerging markets since the late 1980s – one in the mid-1990s and the recent one, starting in 2002. Second, episodes completed during the first wave (between 1987 and 1998) generally involved a smaller volume of flows relative to GDP, especially compared to episodes that were ongoing as of 2007; but they lasted longer than those that ended between 1999 and 2006. Third, Emerging Asian and Latin American countries dominated the first wave of episodes, while the more recent episodes in two last waves have been more concentrated in emerging Europe and other emerging market countries. Fourth, over one third of the completed episodes ended with a sudden stop or a currency crisis, suggesting that "abrupt" endings are not a rare phenomenon. In particular, of the 87 completed episodes, 34 ended with a sudden stop and 13 with a currency crisis. In 7 episodes, a sudden stop coincided with a currency crisis. Lastly, our findings also indicate that late and ongoing episodes are characterized by larger FDI flows, relative to the episodes completed in the 1990s.

In the last wave that has started in the end of 2009 year the portfolio debt flows have been concentrated at longer maturities in most countries. Institutional investors from the United States and Europe such as pension funds and mutual funds – key players in the current rebound in inflows – have tended to enter into longer-term securities, particularly in Brazil, South Africa, and Asian sovereign bond markets. In addition, Brazil remains the largest recipient of funds from Japanese retail investors. Most of the flows have been intermediated through a few financial centers, mainly Luxembourg, resulting in limited flows coming directly from individual countries.

Today global activity is recovering at varying speeds, tepidly in many of the advanced economies but solidly in most emerging and developing economies. Cross-border financial flows from advanced to emerging economies have picked up, primarily reflecting a recovery from deep retrenchment in 2008. Both equity and bond flows have accelerated since the end of 2008, although syndicated loan issuance remains below precrisis levels. The growth in cross-border flows has come mostly from outside the banking sector, as banks continue to retrench their balance sheets. Key drivers behind the renewed capital flows include rapid growth in emerging economies, large yield differentials in their favor, and returning appetite for risk. The renewed flows have eased financial conditions in many emerging economies and prompted some authorities to be watchful of increasing property prices, in some cases taking measures to rein in domestic credit growth.

Foreign direct investment remains the single largest component of private capital flows to emerging economies (figure 3) [7, p. 12]. Emerging Asia remains the largest recipient of non-resident FDI ($156 billion) and China the single-largest recipient ($90 billion). All other regions enjoy healthy inflows, however, albeit well down from the peak years of 2007 and 2008, when real estate investment featured large in FDI flows. By sector, more FDI is now concentrated in the extraction industries. A number of mature market banks are bolstering the capital in their emerging market subsidiaries, and this is supporting FDI, especially in Emerging Europe. There is no obvious advantage of scale: the BRIC countries combined account for $188 billion of inward FDI flows in 2010, or 51% of the total of our 30 country sample. Remarkably, this is identical to their share of the combined GDP of the group.

In 2010 the recovery of cross-border flows has come with some real effective exchange rate

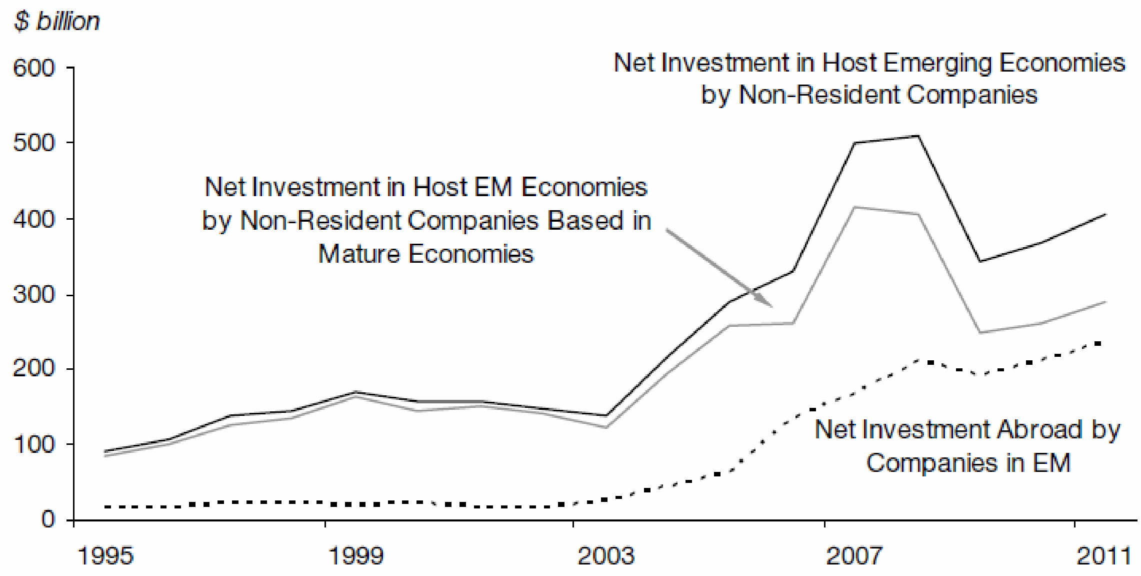

Figure 3. Net Foreign Direct Investment Flows

changes — depreciation of the U.S. dollar and appreciation of floating currencies of some other advanced and emerging economies, but compared with precrisis levels, changes have generally been limited. There are exceptions. The economies in the Middle East saw some significant appreciation, those in emerging Europe some signify cant depreciation, and the Japanese yen appreciated significantly. These changes were generally in line with the medium-term fundamentals for these economies. However, currencies of a number of emerging Asian economies remain undervalued, substantially in the case of the yuan, and the U.S. dollar and euro remain on the strong side relative to medium-term fundamentals.

The influx of large capital inflows has induced policy makers to adopt a variety of measures to prevent overheating and real currency appreciation, and reduce the economy's vulnerability to a sharp reversal of inflows. These measures include exchange rate intervention, sterilization, fiscal policy, and capital controls. A key policy decision for countries facing large capital inflows is to what extent to resist pressures for the currency to appreciate by intervening in the foreign exchange market.

One of the main motivations for intervention is the concern that massive capital inflows may induce a steep exchange rate appreciation in a short period of time, damaging the competitiveness of export sectors and potentially reducing economic growth. Moreover, if net capital inflows take place in the context of a current account deficit, the real appreciation could exacerbate the external imbalances, heightening the vulnerability to a sharp reversal of capital inflows [7, p. 3]. However, the accumulation of foreign reserves required to keep the exchange rate from appreciating may lead to excessively loose monetary conditions, thus creating the potential for overheating and financial system vulnerabilities. In this case, the real appreciation could occur via higher inflation, rather than through an increase in nominal exchange rates. Allowing the exchange rate to fluctuate could discourage short-term speculative capital inflows by introducing uncertainty on the changes in the value of the currency.

The "impossible trinity" paradigm of open economy macroeconomics – the inability simultaneously to target the exchange rate, run an independent monetary policy, and allow full capital mobility – suggests that, in the absence of direct capital controls, countries facing large capital inflows need to choose between nominal appreciation and inflation. In practice, however, given that capital mobility' is not perfect – even in the absence of direct capital controls – policy makers may have more scope to pursue intermediate options than this paradigm would suggest, and they have generally used the foil menu of available measures. When policy makers have intervened to prevent exchange rate appreciation, they have often sought to sterilize the monetary impact of intervention through open market operations and other measures (such as increasing bank reserve requirements or transferring government deposits from the banking system to the central bank). While the motives for sterilization are clear, its effectiveness is less so and it can entail substantial costs. As sterilization is designed to prevent a decline in interest rates, it maintains the incentives for continuing capital inflows, thus perpetuating the problem. Moreover, sterilization often implies quasi-fiscal costs, since it generally involves the central bank exchanging high-yield domestic assets for low-yield reserves. If sterilization is implemented by increasing unremunerated bank reserve requirements, this cost is shifted to the banking system, promoting disintermediation.

Fiscal policy is another instrument available to attenuate the effects of capital flows on aggregate demand and the real exchange rate during a surge of inflows and in its aftermath. Fiscal policy in emerging markets receiving capital inflows is typically procyclical, as a fast growing economy generates revenues that feed higher government spending, thus aggravating overheating problems. By contrast, greater restraint on expenditure growth has at least three benefits.

First, by dampening aggregate demand during the period of high inflows, it allows lower interest rates than otherwise and may therefore reduce incentives for inflows. Second, fiscal restraint alleviates the appreciating pressures on the exchange rate directly, given the bias of public spending toward nontraded goods. Third, to the extent that it helps address or forestall debt sustainability concerns, it may provide greater scope for a countercyclical fiscal response to cushion economic activity when the inflows stop. While discretionary fiscal tightening during a period of capital inflows may be problematic, due to political constraints and implementation lags, the avoidance of fiscal excesses – holding the line on spending – could play an important stabilization role. In particular, fiscal rules based on cyclically adjusted balances could help resist the political and social pressures for additional spending m the face of large capital inflows. In some cases, policymakers in emerging markets have tried to restrict the net inflow of capital by imposing controls on capital inflows or by removing controls on capital outflows. Countries employ such control measures to attain a variety of policy objectives, including discouraging capital inflows to reduce upward pressures on the exchange rate, reducing the risk associated with the sudden reversal of inflows, and maintaining some degree of monetary policy independence.

In dealing with the implications of the inflows, sterilized intervention was the most common response in many of the sample countries, though with mixed success. Foreign exchange (FX) interventions needed to keep the exchange rate targets were sterilized to limit the impact on money supply and inflation. Such interventions proved unsustainable over long time periods, as they kept interest rates high, attracting further inflows, and led to large quasi fiscal costs that could potentially undermine the financial position of the central banks. In the Baltic countries and Bulgaria where the authorities had no independent monetary policy under the hard peg regimes, reserve requirements have been the main tool for sterilization (through adjustments in the rate or the base of the requirement). The ability to sterilize the inflows was in general undermined by the lack of adequate monetary tools, high level of dollarization (euroization), relatively low level of financial sector development that hindered transmission of monetary policy and the presence of foreign banks with easy access to foreign funds. Except in Bulgaria and the Baltic's, exchange rate changes were a common response to the macroeconomic implications of the inflows. Greater exchange rate flexibility helped resolve the tension between various policy targets by letting the appreciation absorb the impact of the inflows. Flexible rates also helped discourage short-term inflows by reducing the implicit exchange rate guarantees provided by the targets. Step appreciations were also undertaken (e.g. in Poland in December 1995) as well as successive reductions in the periodic depreciation rate of the exchange rate bands, to accommodate the appreciation pressures (Hungary, Israel, Poland). In the Baltic's and Bulgaria, fiscal policy has been the main macro policy tool to mitigate the macroeconomic impact of the large inflows, given the lack of independent monetary policy.

A number of countries adopted measures to affect the size and composition of the net FX inflows. Croatia and the Czech Republic imposed some controls on capital inflows in response to a surge in short-term inflows. External trade and FX systems were liberalized by several countries, including through elimination of import surcharges, tariffs, and surrender requirements (Bulgaria (1997), Hungary (1995-96) and Poland (1995-97)). By encouraging imports and permitting FX revenues to stay outside the country, such measures aimed at reducing the net inflow of foreign exchange into the country. In addition, capital outflows were liberalized with a view to reducing the net inflow of foreign exchange into the domestic economy (Bulgaria from 2000. the Czech Republic from 1995, Hungary and Israel in the late 1990s). The liberalizations in Poland and the Czech Republic were in part mandated by their commitments under EU accession and OECD membership.

The macroeconomic effects and policy implication of capital inflows have changed as most sample countries moved to managed or freely floating exchange rates and adopted inflation targeting (IT) regimes as the alternative monetary framework [8, p. 46]. Contrary to the inflationary pressures associated with monetary expansion under a pegged exchange rate regime, capital inflows under flexible rates involve some potential for leading to an undershooting of official inflation targets. The current account in general deteriorates with the inflows through real exchange rate appreciation under both regimes, though via different channels (higher inflation under pegged rates and no or partial sterilization, or nominal appreciation with flexible rates). More flexible exchange rates accompanied by IT regimes have therefore added a new dimension to the challenges faced in responding to inflows. In principle, the following policy options were available in dealing with the macroeconomic implications of the inflows: allowing the exchange rate to absorb the impact of the inflows: intervening in the market to limit the extent of appreciation; reducing interest rates to discourage inflows; imposing administrative controls on the inflows, or tightening fiscal policy to reduce aggregate demand pressures. In practice, feasible policy options have been limited by the difficulty in determining the appropriate degree of monetary easing sufficient to discourage the inflows without undermining the inflation target, in gauging the appropriate role for intervention consistent with a float and an IT regime, and in maintaining fiscal surpluses on a permanent basis. Options have also been limited by the process of integration with the EU and international capital markets.

Several countries let the exchange rate appreciate in response to the inflows under the flexible exchange rate regimes. In these countries (the Czech Republic after 1993, Hungary after 2001, Israel after 1997, Poland since 1993, Romania after late 2004. and Turkey after 2001), more flexible rates allowed the exchange rate to absorb the impact of the inflows, supporting the inflation targets while also helping discourage speculative inflows by imposing FX risks on those market participants that were incurring the risks. Concerns about undershooting the inflation target and adverse implications for external balances at times made the authorities reluctant to allow significant appreciation; (sterilized) FX interventions were used to limit the extent of nominal appreciation (the Czech Republic."' Hungary. Israel, and Poland until June 1999). In cases where the exchange rate was not allowed to adjust fully, clear and consistent communication of interventions in the broader context of the monetary policy regime proved essential in preserving the credibility of the IT regime. Only those interventions motivated by meeting the inflation targets are consistent with a full-fledged IT regime. Intervening for other purposes, such as concerns about competitiveness or exchange rate targets, has undermined the credibility of IT regimes in a number of these countries (Hungary. Israel until 1997, and Romania until 2005). The experiences also show that interventions may be ineffective in countering persistent FX pressures that reflect changes in macroeconomic fundamentals (e.g. in the Czech Republic, Israel, Poland, and Turkey).

The central banks have also actively used interest rate policies in responding to capital inflows under their IT regimes. Several central banks lowered their key policy rates to deal with the threat of undershooting medium-term inflation targets, to discourage, and hence reduce the proportion of interest rate sensitive flows, and to limit the adverse consequences of exchange rate appreciation on the current account (the Czech Republic, Hungary, Poland, and Romania). Such monetary easing through interest rate cuts is consistent with the nature of the IT regime and is sustainable from a medium-term perspective as long as it is motivated by concerns about medium-term inflation targets. In Turkey, as well, interest rates were cut in 2003-05, but motivated mainly by the sharp downward trend in inflation following a successful macroeconomic stabilization.

Nevertheless, some countries experienced difficulties in reducing interest rates in the period of strong capital inflows. The difficulties were associated with the problems in working out the monetary policy transmission mechanism (especially in the earlier stages of the IT regimes when significant structural shifts occurred), and therefore in gauging the appropriate degree of monetary easing that would be consistent with the inflation targets (Hungary, Poland, Romania, and Turkey). There were also concerns about the adverse implications of low interest rates on credit growth, which could fuel inflation pressures (Romania and Turkey). Finally, interest rate reductions could be ineffective in reducing the overall level of the inflows if the bulk of the inflows were in the form of interest insensitive inflows (Israel).

Interest rate reductions hence needed to be undertaken cautiously under IT and be guided by reliable projections of inflation following an interest rate move. In this connection, it would be important to have a predictable and a well-functioning transmission mechanism; well-developed financial markets to transmit the effects of interest rate changes to inflation; a reasonable capacity to forecast inflation; a good understanding and careful monitoring of market conditions and trends for signs of possible future movements in the exchange rate; and adequate capacity to analyze the nature of the inflows (e.g.. to assess how sensitive the inflows are to interest rate changes). The sample countries with flexible exchange rates and inflation targets resorted, to a very limited extent, to fiscal tightening in responding to the inflows. Only Turkey tightened fiscal policy in response to concerns about overheating pressures. In Hungary and Poland, there were no signs of fiscal tightening as a reaction to large capital inflows during most of the period from the mid-1990s. The Czech Republic tightened fiscal policy only subsequently. Loose fiscal policy in turn contributed to slower disinflation (Hungary) and large current account deficits (the Czech Republic), in some cases placing the burden of disinflation on monetary and exchange rate policies (Poland in the early 2000s and Hungary). In Romania as well, the fiscal and incomes policies were not sufficiently supportive of demand management efforts over the past few years, thereby putting the burden of disinflation on monetary and exchange rate policies.

The process of EU accession and membership with the OECD has also limited the available policy choices in responding to capital inflows. In particular, the scope for using administrative measures has been limited for those countries accessing the EU, since the adoption of the acquis has meant that the members had to abolish existing administrative systems for control and authorization of capital movements, and prepare a timetable for removing the restrictions on capital flows. Accordingly, there has been only a limited recourse to such measures in responding to capital inflows. Croatia and Romania took administrative measures in response to short-term inflows during 2004-06, but this was done more on account of concerns about macroeconomic stability and prudential risks associated with the rapid credit growth that had been increasingly funded by bank borrowing from abroad. In both countries, capital inflows and rapid credit growth have persisted.

While the other sample countries did not impose new capital controls, some used the possibility of delaying the liberalization of certain transactions depending on the intensity of capital inflows and developments in international markets. Under the EU accession commitments, the timetables for liberalization would typically allow for some transactions to be liberalized after the entry following an initial mass of liberalizations carried out before entry. Such strategies helped offset potentially destabilizing inflows to some degree, although the slowdown in the liberalization process caused by such sequencing led to tensions in the context of EU accession or OECD membership commitments (e.g. the Czech Republic in 1998).

A number of countries have retained the possibility of imposing new controls under their FX laws, but have not done so in practice (the Czech Republic, Hungary and Poland) [8, p. 65]. The countries in general feared that such measures would be considered a significant step back in their economic development and liberalization process, jeopardizing the financial integration processes. However, the mere possibility of such measures may have had a disciplining effect on markets through moral suasion. In Israel as well, the Chilean type of capital controls were considered on various occasions, but were ruled out to avoid policy reversals that could damage the hard-won credibility. The authorities also considered that such controls would be largely circumvented and hence would prow ineffective. Similarly in Turkey, the authorities have resisted the use of capital (or credit) controls given their EU aspirations, as well as the realization that any such control would be easily circumvented in the presence of a significant offshore market for the lira.

In a number of countries, capital account liberalization was carefully sequenced with the evolution of exchange rate regimes, development of financial markets, and improvements in prudential regulation:

– Capital account liberalization was better coordinated with greater exchange rate flexibility, with long-term inflows liberalized usually before short-term, and liberalization of the latter taking place in tandem with a gradual increase in flexibility. Some countries also used FDI promotion policies to lengthen the maturity of the inflows, which also helped in linking the inflows to the investment needs of their economies (Hungary, Poland, and the Czech Republic after late 1990s). Liberalization of capital outflows helped reduce the pressure from the inflows (Bulgaria, Czech Republic, Hungary, Israel, and Poland).

– Improvements in prudential supervision and regulation have helped enhance the capacity to absorb the inflows (Bulgaria, the Czech Republic, Hungary, Israel, and Poland, as well as the Baltic's). Prudential and supervisory systems were strengthened with a view to increasing the resilience of the financial systems to risks. The process of bringing prudential regulations in line with international standards has been gradual, accelerated through harmonization with EU legislation during EU accession. From the early stages, the prudential frameworks in all countries have allowed banks to manage open currency positions and develop internal risk management systems.

– Countries also took steps to promote the development of their financial markets, thereby also helping to increase the capacity to absorb and manage the inflows. Financial sector reforms (e.g. reform of the nonbank financial supervision from 1998-99 and harmonization of the legislation with the EU in 2004-06 in Bulgaria, and improved access to FX markets in Croatia) improved the intermediation of capital inflows and broadened FX markets, facilitating better management of FX risks.

Some countries also used a variety of debt management measures to cope with the implications of the inflows on the liquidity in the financial system. The authorities shifted from foreign to domestic borrowing sources (Bulgaria. Croatia, Hungary, Poland); bought back outstanding Brady discount bonds (Bulgaria and Poland): used the inflows to over-borrow and moved to medium and long-term domestic borrowing (Turkey); and used part of the privatization receipts to repay international financial organizations (Hungary), m some countries, government deposits were transferred to the central bank and the Deposit Insurance Fund was instructed to invest its cash balances and maturing repos in government debt to deal with the liquidity impact of inflows (Bulgaria).

Given the limited scope for administrative measures and the potentially adverse effect of FX interventions on the credibility of IT regimes, some countries also resorted to indirect intervention practices to limit the exchange rate impact of the inflows. Special accounts for government FX revenues (e.g., from privatization) were set up at the central bank with proceeds converted into domestic currency off the market via the central bank (the Czech Republic and Poland).

These accounts were established after a public agreement between the central bank and government, having also a signaling effect. Moral suasion tools were also used (in Hungary, e.g., if a bank's on-balance sheet open position exceeded 30 percent of its capital the central bank reduced reserves remuneration and warned of stricter reserve requirements to stem inflows). Representing covert operations, such interventions raised at times question of consistency with IT and a floating exchange rate.

The policy responses that provide different emerging countries in different period of time of large capital inflow not always described its effectiveness. All of these measures in each case have different results. For example, in Brazil the empirical evidence suggests that the IOF (a tax on inflows) measures did not have a clear, long-lasting effect on the exchange rate at least relative to its level at the time the various IOF measures were introduced, although they may have eased appreciation pressures when compared with other commodity currencies [9, p. 58-65]. This was apparent from the behavior of the exchange rate in the aftermath of the three episodes when the IOF was introduced or tightened, in March 2008, October 2009, and October 2010. During the first two IOF episodes (March 2008 and October 2009) there was an initial depreciation in the exchange rate, which was however rapidly reversed; in the latest episode (October 2010), only after the tax rate was hiked for a second time (to 6 percent) was there a reversal in appreciation pressure, but again this was short-lived. Broadly similar conclusions can be drawn when the real response is set against the behavior of currencies in other EMs countries during the same period. This may have been due to the fact that the introduction of the IOF did not trigger a significant reduction in nonresidents' positioning in the futures market. With regard to other asset markets, the IOF may have had some impact on local currency debt markets, as the entire local nominal yield curve shifted upwards following its tightening in October 2010. Moreover, despite the IOF relatively less penalizing the investments held for longer periods, adjustment may have been more pronounced at the long-end of the curve, where nonresident investors are more active. This suggests that, at the very least, the tax may have had low incidence on nonresident investors, as higher yields have offset the tax. Market participants have also expressed concerns that the IOF could reduce liquidity in the longer end of the yield curve and in the interest rate swap market.

The IOF may have had an impact on the composition of inflows. While difficult to distill formal empirical evidence owing to the short samples, the difficulty of constructing a counterfactual scenario and other concomitant factors at play there is anecdotal evidence that the IOF had some impact in containing short-term or speculative capital inflows, possibly because of the increased uncertainty about other potential measures that it generated. The IOF has recently been complemented by macro-prudential measures. The carry trade delineated above relies on the resident banks' ability to increase their short spot position in the FX market (that is, to borrow in FX) as a hedge to their positions in the futures market. The new measure is expected to reduce the return to local banks from providing a bridge to nonresident investors investing in the futures market. By affecting its cost, this measure is thus expected to affect an important channel for carry trades that was left open in the original design of the IOF while reducing potential vulnerabilities in the banking sector. This measure has many similarities, both in terms of design and goals, with the macro-prudential measure aimed at limiting external indebtedness linked to carry trades introduced in Korea in June 2010.

In Korea the measures aimed at the banking system vulnerabilities appear to have succeeded in preventing banks' external debt from returning to pre-crisis levels [9, p. 71-74]. In particular, the limits on forward contracts relative to underlying commercial transactions, and ratios on derivatives to bank capital, appear to have contributed to a sizable reduction in outstanding external short-term debt of banks. However, the decline in demand for currency forwards from shipbuilders, due to a smaller order book post-crisis, has also been a contributory factor. Moreover, the measures to limit forward contracts between banks and corporate apply only to onshore entities, allowing corporates to engage in contracts off-shore using non-deliverable forward contracts (NDFs). Offshore banks would still able to offset their short KRW (South Korean won) positions resulting from the NDFs by investing in the onshore government bond market. The impact of the new measures on capital inflows is likely to be marginal. Even with the imposition of the withholding tax as of early 2011, the impact on portfolio debt flows is likely to be limited for reasons elaborated above. Moreover, the macroprudential stability levy is also likely to have a minimal impact, given the relatively low magnitude of the levy as being currently discussed.

In Peru the main aim of central bank's intervention was to limit FX volatility [9, p. 75-79]. This would help reduce the possibility of a negative impact on balance sheets from destabilizing outflows (and consequent exchange rate overshooting), which in turn could also have an impact on macroeconomic stability. The nominal exchange rate has been among the most stable in the region. The authorities have intervened heavily in the market and sterilized the intervention to maintain the overnight rate in line with the policy rate, limiting appreciation spikes and volatility. Measures implemented to limit carry trade operations have been effective. Carry trade operations were done mainly by purchasing central bank short-term paper and through short term deposits in local currency at local banks.

The application of reserve requirements, not only to deposits but also to FX liabilities, helped stabilize credit growth. Credit growth declined from 40 percent before the crisis to 20 percent during 2010. Besides, the measures also helped in extending the maturity of FX liabilities in the financial system. However, the authorities are aware that these measures have their own limitations as they can lead to financial circumvention [10, p.4].

Measures implemented with the purpose of limiting foreign investors' exposure to local-currency-denominated assets were partially effective. Investors shifted from short- to longer-term government bonds following the increase of the fee on central bank certificate of deposits (CDs), thus the measures did not discourage the flows to debt markets. Overall, the imposition of reserve requirements for financial institutions on nonresident deposits as well as the shift of sterilization instruments from CDs to time deposits closed a window for nonresidents to gain exposure to short-term central bank paper.

Recent years have seen substantial changes in the use of these various policy responses, compared with the 1990s. The recent wave of capital inflows has been associated with strong exchange market pressures in all regions, which have been resisted through the accumulation of foreign reserves while also allowing some upward movement in exchange rates. This pattern is significantly different from the earlier wave of net capital inflows, when, for most emerging market countries, pressures on exchange rates were negative, reflecting large current account deficits. During this wave, exchange rates typically depreciated. Emerging Asia was one region that experienced positive exchange market pressures over 1994-1996, but these pressures were absorbed through reserve accumulation.

The fact that foreign exchange reserves increased during the 1990s may indicate an asymmetry in the response to exchange rate pressures, with a tendency to intervene to prevent the appreciation of the currency but not to stem a depreciation (except when the pressures became extreme in a financial crisis, as shown by the large reduction of reserves in 1997 in emerging Asia and, in 2001, in Latin America and other emerging markets) [11, p. 111]. Over the past three years, there has been substantial exchange rate appreciation in the face of high and rising positive exchange market pressures, reflecting the trend toward increasing exchange rate flexibility in many countries, especially in emerging Asia. Nevertheless, the relatively high values of the resistance index over the recent past in all four emerging market regions considered in this chapter reflect a continued, widespread desire to limit the extent of exchange rate appreciation. At the same time, the degree of sterilization has increased over the past few years in emerging Asia, and more moderately in Latin America and emerging Europe and the CIS. The high values of the index in the early 1990s and the early 2000s – the beginning of the two waves of large capital inflows – suggest an aggressive sterilization effort when capital began to pour in. This index subsequently tapered off, perhaps indicating that as intervention continued, the authorities became increasingly conscious of its cost. The pattern of real government expenditure reveals that in the emerging market countries considered in this chapter, real government expenditure growth accelerated over the past few years, especially in Latin America and emerging Europe and the CIS. Finally, the indices of capital controls in emerging market regions suggest that controls on capital inflows have been relaxed since the late 1990s, although in the aggregate the changes have been relatively slow. Emerging European and the CIS countries have relaxed these controls the most, with emerging Asian countries remaining quite restrictive. Restrictions on residents' capital outflows have also been progressively loosened in emerging Europe and the CIS, and other emerging market regions, and only more recently in emerging Asia and Latin America, which started from a relatively more open position.

The main findings are as follows:

– Episodes of large capital inflows were associated with an acceleration of GDP growth, but afterward growth often dropped significantly.

– Fluctuations in GDP growth have been accompanied by large swings in aggregate demand and in the current account balance, with a strong deterioration of the current account during the inflow period and a sharp reversal at the end.

– Consistent with the literature on capital outflows, the end of the inflow episodes typically entailed a sharp reversal of non-FDI flows, whereas FDI proved much more resilient.

– The surge in capital inflows also appears to be associated with a real effective exchange rate appreciation, but the lack of statistical significance in the difference between median appreciation before and during the surge in capital inflows reflects the considerable variation across country experience.

– The mechanism generating real appreciation during an episode has not, on average, been higher inflation. This reflects the fact that for a significant group of episodes, the surge in capital inflows occurred in the context of inflation stabilization plans In light of these findings, an important test of the effectiveness of policies during the inflow period is whether they helped a country achieve a soft landing, that is, a moderate decline in GDP growth after the inflows abated.

– Episodes characterized by a sharper post inflow decline in GDP growth tend to experience a faster acceleration in domestic demand, a sharper rise in inflation, and a larger real appreciation during the inflow period. These episodes also lasted longer, as shown by the much higher cumulative size of the inflows. Hence, the sharper post-inflow decline in GDP growth seems to be associated with persistent, expansionary capital inflows, which compound external imbalances and sow the seeds of the eventual sharp reversal.

From a policy perspective, it is striking that hard landings have also been associated with a strong increase in government spending during the inflow period, whereas expenditure restraint helps reduce upward pressures on both aggregate demand and the real exchange rate and facilitates a soft landing. By contrast, a higher degree of resistance to exchange rate changes during the inflow period and a greater degree of sterilization were unable to prevent real appreciation and were generally unsuccessful in achieving a soft landing. These findings suggest that a smaller real exchange rate appreciation in response to large capital inflows may help reduce an economy's vulnerability to a sharp and costly reversal.

Conclusions. Although countries' responses to a surge of capital inflows depend on the specific nature of the inflows as well as on various aspects of their particular circumstances and objectives, some overall patterns nonetheless emerge from a systematic review of inflow episodes. First, countries with relatively high current account deficits have been more vulnerable to a sharp reversal of capital inflows, because they have been particularly affected by the increase in aggregate demand and the real appreciation of their currencies. Second, there is a clear policy message that public expenditure restraint during such episodes can contribute to both a lower real exchange rate appreciation and better post-inflow GDP growth performance. Third, a policy of resistance to nominal exchange rate appreciation has generally not been successful in preventing real appreciation and has often been followed by a sharper reversal of capital inflows, especially when these inflows have persisted for a longer time. Fourth, the article suggests that restrictions on capital inflows have in general not facilitated lower real appreciation and a soft landing at the end of an episode.

The inflows were often helpful in promoting economic and financial development, but also complicated macroeconomic management and put a high premium on prudent policies. Policy tensions often arose since the authorities in many countries still sought to pursue multiple policy objectives even when opening the capital account. As a result, capital inflows led to rapid monetary expansion, a slowdown in the disinflation process, and wider current account deficits. These tensions have been relieved by the adoption of more flexible exchange rates and IT regimes, but continued capital inflows have still required a careful mix of interest rate and intervention policies to avoid disorderly exchange rate adjustments, while preserving the credibility of IT regimes. Inflows also posed risks to financial stability to the extent their intermediation resulted in a rapid growth of bank credit and maturity and currency mismatches in private sector balance sheets. Institutional improvements have helped strengthen the policy responses to capital inflows. Instead of capital controls, countries have been able to combine macroeconomic policy tools, to the extent available, with efforts to strengthen prudential regulation and supervision of financial systems, develop financial markets, better monitor capital flows, and adopt various debt management measures and some indirect intervention schemes. The review of experience with the policy responses may provide useful lessons for countries in similar situations experiencing large capital inflows.

These findings imply that the stabilization challenges from large capital inflows are most serious for countries with substantial current account imbalances, which currently include many emerging European countries. The most effective tool available to policymakers to avoid overheating and output instability is likely to be fiscal restraint, especially in the context of relatively inflexible exchange rate policies. This article also suggests that even if a central bank initially intervenes to resist nominal exchange rate appreciation when capital inflows begin, this stance should be progressively relaxed if the inflows persist. This is because it becomes less likely that such a policy will succeed in preventing real appreciation and a painful end to the inflows. In addition to the macroeconomic policy instruments discussed in this article, the authorities have other tools at their disposal, which have not been analyzed systematically – notably, financial supervision and regulation, but also a wider range of policies such as labor and product market reforms. The role of such policies in responding to capital inflows would be an important topic for future research.

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THE ROLE OF CREDIT DEFAULT SWAPS (CDS) IN THE GLOBAL FINANCIAL CRISIS

This article considers the essence of credit default swaps (CDS), as a new tool for hedging risks, market development of CDS contracts during 2001-2010, and the role of CDS in the global financial crisis.
Keywords: Credit default swaps (CDS), buyer of CDS, seller of CDS, spread, credit event, default, insurance contract, and mortgage-backed security.

В статті розглядається сутність кредитно-дефолтного свопу, як нового інструменту хеджування ризиків, розвиток ринку КДС, а також роль КДС у світовій фінансовій кризі.
Ключові слова: Кредитно-дефолтний своп (КДС), покупець КДС, продавець КДС, деривативи, спред, кредитний випадок, дефолт, страховий контракт, іпотечні цінні папери.

During the last few years, the credit derivatives market has grown significantly and is now an established derivative market. This market has given some investors a choice on how they should take exposure to the credit risk of a company – either via a credit derivative contract or by buying/selling the bonds of that company. The CDS contract (credit default swap contract) is the building block to many exotic credit derivative structured products and indices.

Firstly introduced in 1997 by JPMorgan, CDS have become the most common form of credit derivative, that were intended to remove risk from companies' balance sheets. The idea was to separate the default risk on loans from the loans themselves. The risk would be moved into an off-balance sheet vehicle. The product was called Bistro, otherwise known as broad index secured trust offering.

JP Morgan Chase with the help of a credit default swap has insured 300 loans granted by the bank blue chips (Ford, Wal-Mart, IBM, etc.) totaling $ 9.7 billion. As a result JP Morgan Chase delegated credit risk to third parties and freed from the reserve fund hundreds of millions of dollars.

Sometimes described as "complex financial instruments", credit default swaps are, in fact, the simplest of all credit derivatives.

A credit default swap (CDS) is a kind of insurance against credit risk. It is a privately negotiated bilateral contract between a protection buyer and a protection seller. The buyer of protection pays a fixed fee or premium to the seller of protection for a period of time and if certain pre-specified "credit event" occurs, the protection seller pays compensation to the protection buyer [1, p. 1].

Assume that there is a Company A, which has issued corporate bonds. Bank B bought the bonds from Company A and now receives regular coupon payments. The Bank wants to protect this position against the possibility that Company A will stop making interest and/or principal payments on the debt. Therefore, the Bank strike a bargain with the third party, for example, an

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insurance company, under which bank (CDS Buyer) regularly pays an insurance company a certain sum of money (premium). An insurance company, in turn, assumes all the risks associated with possible default of Company A on its debt obligations, in the example - its bonds (these bonds are called in the practice of CDS insurance object (Reference Issuer).

For market participants, the advantages of using credit derivatives over the same reference entity's cash assets can include the following:

- They can be tailor-made to meet the specific requirements of the entity buying the risk protection, as opposed to the liquidity or term of the underlying reference asset.
- They can be "sold short" without risk of liquidity or delivery squeeze, as it is a specific credit risk that is being traded. In the cash market, it is not possible to "sell short" a bank loan for example, but a credit derivative can be used to establish synthetically the economic effect of such a position.
- Because they theoretically isolate credit risk from other factors such as client relationships, funding considerations, and interest-rate risk, credit derivatives introduce a formal pricing mechanism to price credit issues only. This means a market is available in credit only, allowing more efficient pricing, and it becomes possible to model a term structure of credit rates.
- They are off–balance sheet instruments. For instance, bank loans are not particularly attractive investments for certain investors because of the administration required in managing and servicing a loan portfolio. An exposure to bank loans and their associated return, however, can be achieved using credit derivatives while simultaneously avoiding the administrative costs of actually owning the assets. Hence, credit derivatives allow investors access to specific credits while allowing banks access to further distribution for bank loan credit risk. [3, p. 3-4].

The rate of payments made per year by the buyer is known as the CDS spread. It is expressed in basis points per annum of the notional value of the contract (and, typically, paid quarterly for corporate credit default swaps or even semiannually.)

The premiums paid on CDS contracts generally follow set standards. These standards include the following:

ü If the trade is effected today, the effective date of the protection is tomorrow, even if tomorrow is Saturday or bank holiday; this recognizes that companies can default on a nonbusiness day.

ü The coupon payment dates are quarterly dates, based on the maturity date of the contract. For example, if maturity is December 20, 2009, the coupon dates are going to be March 20, June 20, September 20, and December 20.

ü The first coupon is a short one (less than 3 months) if the trade date is more than 1 month from the closest coupon date; otherwise it is a long (more than 3 months) coupon [2, p. 9].

Assume the CDS contract with following information:

Nominal value of bond	$ 10, 000, 000
Term	5 years
Reference Credit	Company's 5- year bond.
Credit event	The business day following occurrence of specified credit event.
Default payment	Nominal value of bond × [100 - price of bond after credit event]
Swap premium	3,35%

Suppose now, that a technical default on the Company's 5-year bond is occurred and its price now stands at $28.

Default payment = $10,000,000 × [100% − 28%] = $7,200,000

So, under the terms of the swap, the protection buyer delivers the bond to the seller, who pays out $7.2 million to the buyer.

It is important to note that these spreads are not the same as the yield spreads of a corporate bond or government bond. The maturity period of a typical credit default swap varies from one year to ten years, with five years being the most common time frame.

A “credit event” can be:

- A bankruptcy of a company: the underlying corporate entity becomes insolvent or is un able to repay the debt;
- Failure to pay: the underlying corporate entity is unable to make the outstanding interest or principal payment;
- Debt restructuring: the underlying corporate entity negotiates changes in the terms of the debt obligations with its creditor to avoid default on existing debt. The changes may include postponement of payment, reduction in the principal or interest payable under the obligation, etc.;
- Obligation Acceleration or Obligation Default: the debt obligations of the issuer become due and payable before their initially scheduled maturity date as a result of default by the underlying corporate entity;
- Repudiation/Moratorium: The underlying corporate entity rejects or challenges the validity of the related debt obligation, in effect refusing to pay interest and principal [11, p. 61-62].

When default occurs there are two accepted settlement procedures or “protocols:” The first - physical settlement, which is the most widely used, and the second - cash settlement. In a physical settlement, the buyer of protection delivers the notional value of deliverable obligations of the reference entity to the protection seller in return for the notional amount paid in cash. In a cash settlement, the seller pays the buyer the face value of debt minus the recovery rate of the reference asset; this is also known as the loss given default or LGD. The recovery rate is calculated by either referencing dealer quotes or by observing market prices over some period after the default occurred. [2, p. 2-4]

The main difference between a physical settlement and cash settlement is that in a physical settlement the seller has remedy to the underlying corporate entity as well as the chance to take part in the workout procedure as the holder of the defaulted underlying credit asset.

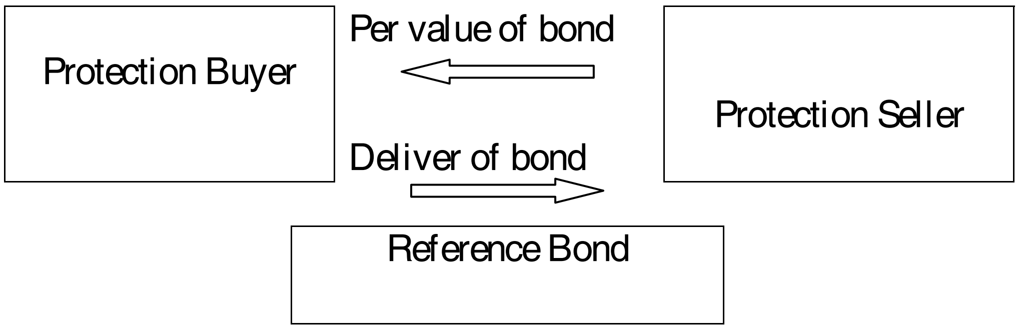
Various market participants have different requirements, and so may have their own preferences with regard to the settlement mechanism. A protection seller may prefer physical settlement for particular reference assets if he believes that a higher recovery value for the asset can be gained by holding on to it and/or entering into the administration process. A protection buyer may have different interests. For instance, unless the protection buyer already holds the deliverable asset (in which case the transaction he has entered into is a classic hedge for an asset already owned), he may prefer cash settlement, if he has a negative view of the reference obligation and has used the CDS or other credit derivative to create a synthetic short bond position. Or the protection buyer may prefer physical settlement because he views the delivery option as carrying some value.

If no credit event occurs during the term of the swap, the protection buyer continues to pay the premium until maturity. In contrast, should a credit event occur at some point before the contract’s maturity, the protection seller owes a payment to the buyer of protection, thus insulating the buyer from a financial loss.

Below is a visual representation of this scenario.

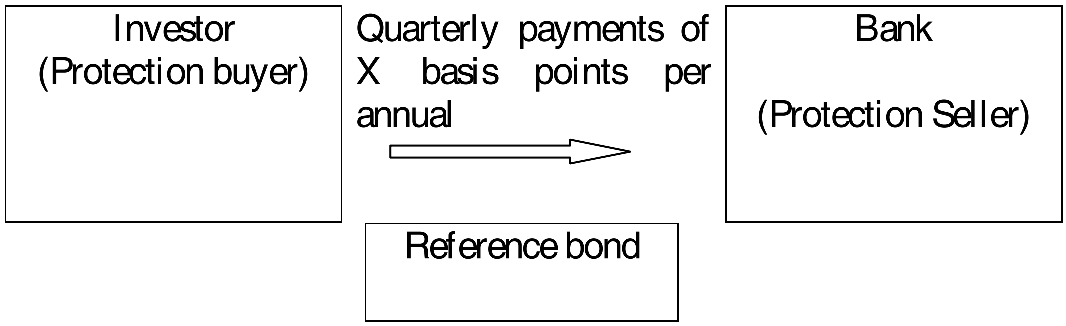
Table 1:

Model of CDS (default)
Table 2:



Model of CDS (no default)

CDS deals are structured over-the-counter products, as opposed to exchange-traded pro-



ducts. It means that transactions are conducted at any time by phone or in any other way. No standardized contract terms. There is no price transparency in the CDS Contracts. There is no transparency of positions on CDS (there is no single registry of transactions with CDS, hence, the degree of involvement in the CDS market for a particular investor knows only the investor). Regulators did not intervene in market activity.

The International Swaps and Derivatives Association (ISDA) compiled standard documentation governing the legal treatment of credit derivative contracts. This documentation specifies key items –maturity, premium, reference name, what constitutes a 'credit event', etc. – as well as technical details such as business calendars, legal jurisdiction or day-count convention. So, Credit default swaps are founded on the ISDA Master Agreement which defines the protection and obligation of the parties.

The CDS is similar to an insurance contract. However, the parallel between insurance contracts and credit default swaps does not hold in some important ways. Firstly, you do not have to hold the bonds to buy a credit default swap on that bond, whereas with an insurance contract, you typically have to have a direct economic exposure to obtain insurance. Secondly, the object of insurance can be absolutely any debt - from contract to supply goods to corporate or municipal bonds, bankers' acceptances, promissory notes, contract for a mortgage, as well as all derivatives debt, which are based on tranches of mortgage loans (CDO, MBS, etc.). And finally, the main difference between CDS and insurance policy is the unregulated status of the CDS: credit default swap contracts do trade over the counter, in contrast, insurance contracts (mostly) are not traded;

The tree main types of CDS are represented in the table bellow:

Table 3:

The tree main types of CDS [5]

The DTCC provides aggregate net notional data for single reference entities. These comp-

Single name	**The reference entity is an individual corporation, bank, or government.**
Index	CDS referring to multiple constitutent entities in the index with each entity having an equal share of the notional amount. The degree of standardization is highest for these contracts.
Basket CDS	CDS with more than one reference entity (typically between three and one hundred names). Specific types include first-to-default CDS, full basket CDS, untranched basket and tranched basket known as a synthetic CDO.

rise the sum of net protection bought (or sold) across all counterparties (see Table 4).

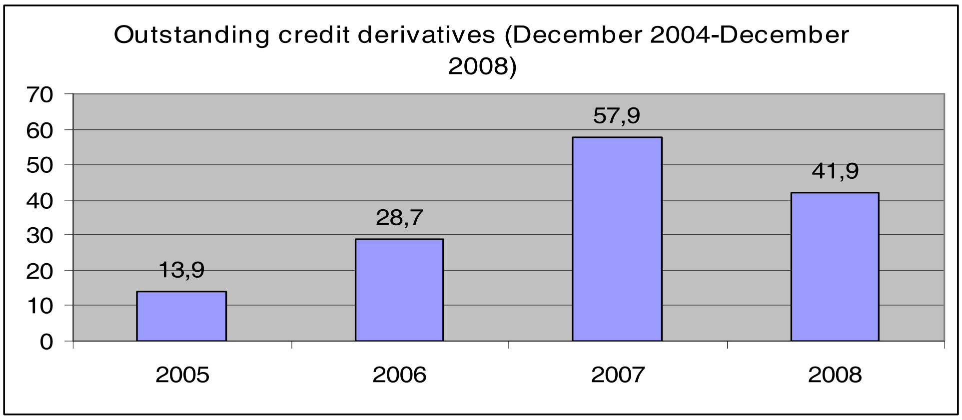
Table 4:
Actual risk exposure (net notional amounts before collateralization); December 2008 [5].

According to the market survey results that ISDA conducted the credit default market has

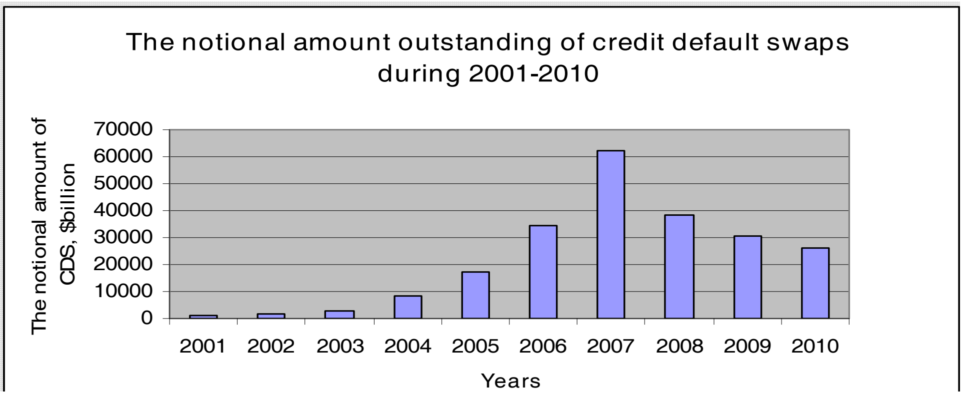
	Gross notional amounts	**Net notional amounts**	**Ratio (net/gross)**
Single-name CDScontracts	14,83	1,477	10%
CDS indices/CDS index tranches	14,328	1,276	9%

grown much faster than other derivative markets, and the gross notional amount of outstanding CDS protection bought and sold at the end of 2008 was seven times than of end-2004.

At mid-year 2001 credit default swaps grew 45% to $918.9 billion from the $631.5 billion reported in June. Chairman of the Board of ISDA, Keith Bailey said that the credit derivative numbers show impressive growth during a difficult period; this is testimony to the value that these products bring to market participants in managing risk in times of volatility and uncertainty.



Picture 1: Outstanding credit derivatives (December 2004 - December 2008) [5].



Picture 2: The dynamics of CDS market from 2001 to 2010, represented by the following [6]:

At 2002 credit derivatives, which consist of credit default swaps, baskets and portfolio transactions, grew 40.17% since the end of June 2002; among firms responding to both surveys, outstanding volumes grew 35.23%. As of the end of June 2002 credit derivatives were $1.6 trillion.

At 2003 credit derivatives continued their strong growth at 25 per cent in the first six months of 2003 to $2.69 trillion, a similar rate of growth to the previous six months.

The notional amount outstanding of credit default swaps at 2004 grew by almost 55 per cent in the second half of 2004 from $5.44 trillion to $8.42 trillion. This represents an annual growth rate of 123%.

At 2005 Notional amount of credit default swaps grew by almost 48% during the first six months of the year to $12.43 trillion from $8.42 trillion. This represents a year-on-year growth rate of 128% from $5.44 trillion at mid-year 2004; 86 firms provided credit default swap data.

In the second half of 2006 the notional amount outstanding of credit default swaps (CDS) grew 32 percent, rising from $26.0 trillion at June 30, 2006 to $34.4 trillion at December 31, 2006. This compares with 52 percent growth during the first half of 2006. CDS notional growth for the whole of 2006 was 101 percent, compared with 103 percent during 2005. The survey monitors credit default swaps on single-names, baskets and portfolios of credits and index trades.

In the second half of 2007 the notional amount outstanding of credit default swaps (CDS) grew 37 percent to $62.2. CDS notional growth was 81 percent for all of 2007.

The CDS market quickly grew from $180 billion in notional value in 1997 to almost $55 trillion by June 2008. Bankers seized upon CDS trading as a way to earn easy premiums, free up capital and shed risk from their books. As a general rule, CDS sellers don't post money up front when they enter a contract; they only pony up if the credit defaults or goes bankrupt. When that happens, the cost of coverage can jump exponentially — what's known as "jump to default." Still, financial firms can hedge this risk by buying CDS protection even as they sell protection to someone else. That way, when a bond defaults, they get money back as they pay out, effectively netting their loss.

By 2007, with credit risk priced at historical lows, many financial firms were selling buckets of CDSs as insurance to cover exotic financial instruments linked to subprime mortgages.

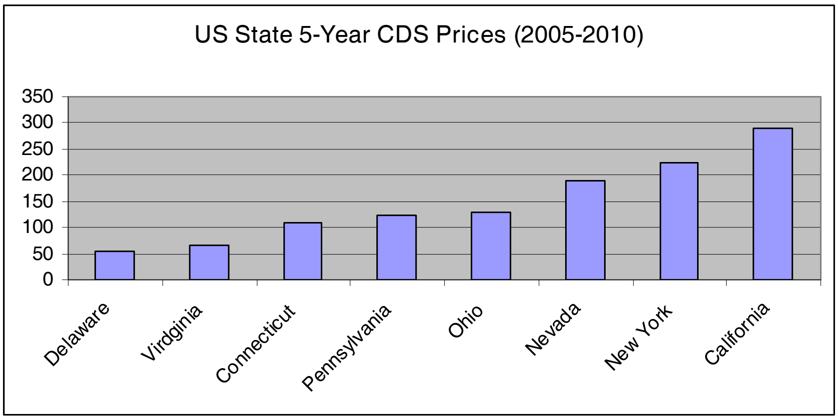
At 2008 year-end the notional amount outstanding of credit default swaps (CDS) was $38.6 trillion, down 29 percent from $54.6 trillion at mid-year 2008. CDS notional outstanding for the whole of 2008 was down 38 percent from $62.2 trillion at year-end 2007. The $38.6 trillion notional amount was approximately evenly divided between bought and sold protection: bought protection notional amount was $19.5 trillion and sold protection was $19.1 trillion, with a net bought notional amount of $400 billion.

The notional amount outstanding of credit default swaps (CDS) was $30.4 trillion at year-end 2009, down 3 percent from $31.2 trillion at mid-year 2009. CDS notional outstanding for the whole of 2009 was down 21 percent from $38.6 trillion at year-end 2008. The $30.4 trillion notional amount was approximately evenly divided between bought and sold protection: bought protection notional amount was approximately $15.4 trillion and sold protection was about $15.0 trillion, with a net bought notional amount of $451.3 billion. Seventy-five firms provided data on credit default swaps.

And finally, at mid-year 2010, the notional amount outstanding of credit default swaps (CDS) was $26.3 trillion, a decrease of 13.7 percent from $30.4 trillion at year-end 2009. CDS notional outstanding for the past twelve months was down 15.9 percent from $38.6 trillion at mid-year 2009. As in past surveys, the $26.3 trillion notional amount was approximately evenly divided between bought and sold protection: bought protection notional amount was approximately $13.3 trillion and sold protection was about $13.0 trillion, with a net bought notional amount of $359.0 billion. Sixty-two firms provided data on credit default swaps. Credit default swaps are 5.6 percent of the total of all derivatives reported to the ISDA Market Survey [6].

Table 4:
The top dozen entities in terms of increases and decreases in percentage terms in the number of outstanding CDS contracts, 2008.
(The list is filtered down to those with at least 1,000 pre-existing outstanding contracts.) [12].

Rank	Decreases	Increases
1	Bank of America Corporation	VNU Group B.V.
2	Sony Corporation	Cadbury Holdings Limited
3	Bank of Ireland	Endesa, S.A.
4	Standard Pacific Corp.	Kingdom of Spain
5	ENEL S.P.A.	Rio Tinto PLC
6	Societe Air France	Banca Italease S.P.A.
7	Fresenius SE	Citigroup INC
8	Toyota Motor Credit	Canadian National Railway
9	The Sherwin-Williams Company	Centerpoint Energy, INC
10	Wendy's International	AT&T INC
11	Wellpoint, INC	Marathon Oil Corporation
12	Southwest Airlines Co.	Morgan Stanley



Picture 3: Let us take a closer look at CDSs prices in some states of Amerika [5]

According to the Global Sovereign Debt Credit Risk Report the top ten most risky sovereigns are [8]:

Position	Country	5-Year CDS MID (bps)
1	Greece	1026,5
2	Venezuela	1009,6
3	Ireland	619,2
4	Portugal	497,3
5	Argentina	602,4
6	Ukraine	509,5
7	Spain	347,7
8	Dubai	417,6
9	Hungary	378
10	Iraq	366,1

And the top ten least risky countries are:

Position	Country	5-Year CDS MID (bps)
1	Norway	23,2
2	Finland	33,6
3	Sweden	34,3
4	Switzerland	40,7
5	USA	41,5
6	Hong Kong	44,7
7	Denmark	45,9
8	Australia	50,1
9	Germany	59,1
10	Saudi Arabia	75,4

CDS contracts are commonly regarded as a zero-sum game within the financial system, as there is always a buyer for each seller of CDS contracts, as with all other OTC derivative contracts. The financial turmoil has shown, however, that both buyers and sellers of CDSs may suffer losses if counterparty risks materialize.

Indeed, with CDSs, both parties are exposed to credit risk derived from the counterparty (or "counterparty risk"), which reflects the potential for the counterparty to fail to meet its payment obligations. In other words, counterparty risk reflects the risk of being forced to replace positions in the market, were a counterparty to default. The replacement cost is of the same magnitude for the two counterparties concerned, but with a different sign.

For instance, if there is a deterioration in the creditworthiness of the underlying reference entity (i.e. spreads widen), a trade will have a positive value for the protection buyer (i.e. that buyer is "in the money"), as the protection it already has is now worth more. This positive value is the additional cost of conducting exactly the same trade with the original spread. Thus, a value of USD 10 billion would mean that it was necessary for a buyer to pay an additional USD 10 million to persuade a seller to take on the trade at the lower spread. Equally, a seller of CDS protection is "out of the money" by USD 10 million, as that party would now require USD 10 million to take on the original trade at the lower spread. If the seller were to then default, the buyer would be entitled to claim from the seller the cost of replacing the trade: USD 10 million. Equally, if the buyer were to default, the seller would still be required to pay USD 10 million to the buyer. This requirement to pay even if the money is owed to the defaulting party is a legally binding obligation under the ISDA Master Agreement.

Dealers hedge market risk exposures resulting from a CDS by means of offsetting transactions with another party. If the second party is also a dealer undertaking additional hedging transactions, a chain of linked exposures will arise in which the market participants know their direct counterparties, but not the parties further along the chain. A number of structural features in the CDS market have helped to transform counterparty risk into systemic risk. First, the majority of the CDS market remains concentrated in a small group of dealers. Second, the case of Lehman Brothers has shown that the interconnected nature of this dealer-based market can result in large trade replacement costs for market participants in the event of dealer failures. Third, as regards the euro area banking sector, euro area banks appear to have become net sellers of standard single-name and index CDS contracts (although for limited amounts), which would imply exposure to market risk if there is a general increase in CDS spreads – for instance in the event of a dealer failing within the CDS market. Given the limited net values, this could change in the coming months, although the net position of euro area banks remained negative at the end of June 2009. In addition to the shift from those institutions' historically net positive positions (i.e. as net purchasers), it should also be noted that banks seem to have been net sellers of protection for sovereign CDSs, which may in some cases constitute wrong-way risk. Finally, the low levels of liquidity resulting from the crisis and the current high levels of concentration in the market have both increased trade replacement costs and resulted in significant bid-ask spreads for market participants, particularly for non-dealers.

In the CDS market, as in other OTC markets, the major banks (i.e. dealers) trade actively among themselves and account for a large share of the daily turnover in these markets. Indeed, the CDS market is concentrated around a few large players. In 2008 the five largest CDS dealers were JPMorgan, the Goldman Sachs Group, Morgan Stanley, Deutsche Bank and the Barclays Group. This ranking has been calculated on the basis of public filings and seems to be comparable to that listed in Fitch's 2009 derivative survey [5, p. 21]. A recent survey of U.S firms by Fitch also indicate that 96% of credit derivatives exposures at the end of Q1 2009 of one hundred surveyed firms was concentrated to JP Morgan, Goldman Sachs, Citigroup, and Morgan Stanley and Bank of America.

According to DTCC data, the five largest CDS dealers were counterparties to almost half of the total outstanding notional amounts as at 17 April 2009 and the ten largest CDS dealers were counterparties to 72% of the trades.

Table 5:
Top risks or vulnerabilities related to the CDS market [5, p. 21].

Large banks (Notional amounts of CDSs bought and sold exceeding €500 billion.)	**Medium sized banks** (Notional amounts of CDSs bought and sold exceeding €200 billion.)	Small banks
Counterparty risk		Counterparty risk
	Reduction of liquidity	
		High correlation between underlying and counterparty

As regards BIS data, the market share of major players seems to be larger in Europe than it is for the total global market. This, however, is explained by the difference between the BIS and DTCC data in terms of scope.

Table 6:
Top five CDS dealers [5, p. 21].

Institution	**Bought**		**Sold**	
	Notional	**Gross Market Value**	**Notional**	**Gross Market Value**
JPMorgan	3,834	514	3,668	479
Goldman Sachs Group	3,43	N/A	3,17	392
Morgan Stanley	3,2	432	3,093	399
Deutsche Bank	6,191	411	N/A	363
Barclays Group	6,033	269	N/A	248

The current high levels of concentration in the CDS market probably exceed those observed before the crisis, as the market has seen the exits of the independent CDS dealers Bear Stearns, Lehman Brothers and Merrill Lynch. This has also coincided with the reduction of proprietary trading activities by several European banks and reduced amounts of CDSs sold by hedge funds and exits from the market by large CDS sellers such as AIG, the monolines and the CDPCs.

Market participants have indicated that a number of hedge funds were increasingly pursuing credit-oriented strategies in the run up to the financial crisis, and that these players accounted for significant daily CDS trading volumes. This was also the finding of a Fitch survey in 2006. The level of CDS trading activity has, however, fallen sharply in conjunction with financial deleveraging and fund closures. A record number of hedge funds were levered less than once during the months of September and October 2008 in the face of investor redemption requests, losses, aggressive deleveraging and – potentially – reduced credit lines extended by prime brokers and increased margin calls. This, in combination with bilateral collateral management procedures, may have prevented considerable concentration risk from materializing within the hedge fund community in relation to the CDS market. In the absence of detailed CDS-specific corporate disclosures by institutions, it is not possible to

Credit default swaps often referred to as the main cause of the global financial crisis. Many assert the fall of Bear Stearns, the bankruptcy of Lehman Brothers, the government bailout of AIG, and the registration of several major broker/dealers as bank holding companies were in part a result of their activities in the CDS market.

The main characteristic feature of these instruments is their unregulated status, which allows to sell and to buy CDS contracts privately (over the counter) an unlimited number of times.

CDS market has doubled annually and reached in 2000 $100 billion. This figure is quite impressive, but it is logical, because it reflects the objective benefits created by CDS in the market of corporate loans and debt.

During the period of rapid development of the mortgage market in the U.S., key players: federal agencies, banks, mortgage companies and other financial and credit institutions were guided by a strong desire to cash in on a booming market. A significant development of the mortgage market made a mortgage accessible to every American, even with a bad credit history. To transfer risk of a "bad loans" bank have used financial innovations, namely securitization of debts, CDO, MBS and CDS.

Qualitative change in CDS contracts volume was associated with a connection to the CDS market the whole mortgage sector – from the simplest mortgage credits to the complex credit derivatives such as CDO. In addition, home prices, during last years went only in one direction (up), as a result almost all were engaged in selling and buying CDS: the insurance companies, investment banks, mutual and pension funds, hedgers and just speculators. This concentration reached a maximum with American International Group (AIG). On September 30th 2008, the aggregate net notional amount of credit derivatives sold by AIG was USD 372 billion [7, p. 36]. This staggering amount was almost double the aggregate net notional amount sold by all other major dealers combined at the end of October 2008. AIG made two cardinal errors. First, it was long CDS exposure — a whopping $372 billion worth — meaning that it hadn't hedged the protection it had sold to firms that had piled into toxic subprime-mortgage-related debt. Second, it didn't reserve capital to cover that exposure if something went wrong. When Goldman Sachs and others came knocking for big margin payouts to cover spiraling losses. AIG Company needed not just more money than was available for covering its debts, but even more than worth all of its liquid assets. As a result, AIG's share prices had fallen over 95% to just $1.25 by September

16, 2008, from a 52-week high of $70.13. If not for a $180 billion bailout by the U.S. government, AIG would have collapsed beneath its enormous CDS exposure, with potentially dire consequences for the global economy. The company reported over $13.2 billion in losses in the first six months of the year. These high levels of concentration have raised legitimate concern among regulators about counterparty risk in the CDS market: in such a situation, the default of a major dealer may have a large impact on the rest of the market.

In 2008 the turnover of credit-default swaps accounted for about $ 62 trillion, surpassing the volume of world GDP of $ 55 trillion [6].

Credit default swaps have been repeatedly blamed for fomenting financial instability and generating systemic risk.

Nowadays, the most controversial question is: whether CDS is an effective tool in a macroeconomic sense, or is still speculative, that should be prohibited?

CDS were criticized from the very beginning, when they were introduced. Martin Mayer considered these contracts as a major source of the almost unlimited leverage that brought the world financial system to the brink of disaster last fall. Warren Buffett described these instruments as a "weapons of mass destruction," time bombs that threaten the economic system."

These ideas are supported by the following facts:

- Originally conceived as a means for banks to reduce their credit exposure to large corporate clients, CDSs quickly became instruments of speculation for pension funds, insurers, companies and especially hedge funds;
- Unregulated status of CDS;
- CDS deals are structured over-the-counter products, as opposed to exchange-traded products. It means that transactions are conducted at any time by phone or in any other way;
- No standardized contract terms;
- No price transparency in the CDS contracts;
- No transparency of positions on CDS;
- No serious guarantees of solvency and adequate reserve funds of companies, which issued CDS. A repeated sale and resale of CDS created a situation where the buyer swap elementary did not know from whom to receive money for the default object of insurance;
- The CDSs market is highly concentrated in the hands of small group of dealers, a dozen as of end 2009. The 10 largest dealers account for a significant portion of gross notional trading volume.

However, there is another opposite opinion, that CDSs are an important tool for measuring and diversifying credit risk and these contracts under no circumstances should not be prohibited. According to Alan Greenspan, the widespread and equitable distribution of risks in the economy is achieved through the use of new financial instruments, including CDS.

So, I completely share the second point of view. In my opinion, the negative impact of CDS contracts, first of all, is connected with a lack of government regulation and the lack of transparency of these transactions. The global financial crisis has shown that the role of swaps in this crisis was substantial, however, it is necessary to emphasize, that the danger of using these contracts is not connected with the essence of this instruments. The huge amount of CDS contracts in the market is the result of unregulated status, systemic risk, a chain of bankruptcies of major financial institutions is the result of irrational policy of management of these institutions. Before CDS were introduced, banks have only one way to protect themselves from credit risk - to form a reserve. The problem is that the more loans the bank grants, the more money the bank should reserve in special funds in case of default on payments. Ideally, banks would like to keep the loans only in terms of interest income, but the risks of these loans banks would like to transfer to someone else.

Exactly with the help of CDSs, the buyer can separate the credit risk from the loan interest, to unfreeze money in reserve funds, insure the loans cheaper than with the help of traditional insurance.

For making market of CDS efficient and good-working, a lot of affords should be undertaken. Some of them are:

- Creating a system of modern and adequate regulation. In particular the creation of central clearing centers, in order to increase liquidity and transparency of the market for credit default swaps. A clearinghouse (or central counterparty) acts as the buyer to every seller and seller to every buyer of protection, thereby isolating each participant from the default of other participants;

AIG became the sign for why the OTC derivatives market needed to be more closely regulated. Meanwhile, Lehman Brothers, which did collapse, showed how clearinghouses could be part of the solution. On September 15, 2008, the morning that Lehman filed for bankruptcy, LCH.Clearnet woke up with $9 trillion in interest rate swaps from Lehman — trades it was able to unwind at no cost to itself.

- To increase capital requirements for non-centrally cleared CDSs.
- Standardize counterparty requirements. Right now each bank makes up their own rules which causes annoyance to clients and creates an environmental where the (with the weakest posting requirements) is really the loser (most at risk);
- Listing and trading of certain standardized high-volume CDS, indexes, or single names on exchanges. Exchange trading would bring more price discovery, increased liquidity, and increased transparency to CDS transactions;
- Require the exchange to report information on the exposures of each counterparty to regulatory organizations;
- To improve netting capabilities. To use clearing rules to other standardized types of derivatives beyond CDSs;
- Confirmation of the solvency of both parties (buyers and sellers of CDS). Using standardized trading rules of stock exchanges, making a certain amount to the account in order to create protection fund against default;
- Publish real time market data. This transparency will increase liquidity which is greatly needed right now. It will also make it easier for anyone involved to correctly market-to-market positions, something which is not done consistently yet.

Following all of these recommendations, CDS market can be really efficiently working market and prevent – rather than produce – future global financial shocks.

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METROPOLIZATION PROCESSES IN EUROPE: NEW MODELS OF URBAN ECONOMY SPECIALIZATION

В статті розглянутий вплив глобалізації на розвиток передових агентів світових економіки – метрополісів. Презентовані результати аналізу урбанізаційних процесів в світі, представлене трактування таких термінів, як урбанізація, метрополізація, метрополіс, глобальне місто, глокалізація та інших з позицій міжнародної економіки. Оскільки ЄС є найближчим центром глобалізації для України, то нами проведено та викладено результати аналізу побудови механізмів регулювання міським розвитком в ЄС, прослідковано еволюцію принципів та стратегій стимулювання розвитку великих міст ЄС. Класифіковано інструменти та напрямки міського розвитку згідно з нормативнихми документами, в т.ч. хартіями урбанізаційного регулювання ЄС. Зроблено аналіз різних наукових підходів до моделювання спеціалізації метрополісів глобального рівня або глобальних міст. Особлива увага приділена розвитку такої ключової функції сучасних метрополісів як креативна. Розроблена класифікація стратегій розвитку креативної функції в європейських містах, наведені приклади Шеффілда, Білбао, Страсбурга, Лейпцига, Глазго, Барселони та інших. Запропонована авторська модель полі-структурної конкурентоздатної спеціалізації глобальних міст на основі передових наукових концепцій Р.Флориди, П.Тейлора, С.Сассен і Т.Ямагуті. В результаті зроблені висновки з досвіду метрополізації в ЄС та наведені принципи адаптації авторської моделі для розвитку великих міст в Україні.

Ключові слова: метрополіс, метрополізація, урбанізація, глобальне місто, спеціалізація, четвертинний сектор, передові послуги для бізнесу, креативна локальна середа

Since cities are the exact place where global economy is produced and redistributed their economy is highly resistible to any negative changes in state of the world market. What causes this steadiness effect is specific specialization model in contemporary peculiarities of global urban competition. The analysis of sources and structure as well as agents of regulation is presented in the following report. In the article there was analyzed the evolution of governmental strategies in urban systems development according to challenges throughout the XX century, grounding of hierarchy specialization model of modern global cities and search for crucial successful factors which enable the proper level of urban functions realization. Touch upon existing EU effective models of creativity and analyzing their differences and performance. The hierarchy specialization model of competitive urban economy developed by the author, the actual mechanisms comparison of creativity models realization are presented in the following article.

Key words: metropolis, metropolisation, global city, specialization, forth-sector services, advanced producer services, creative local environment

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In all regions of the world the three last centuries of economic globalization, whish had started on the beginning of 17 century were related with industrialization, urbanization and polarization of economic growth. In the begging of 20 century A. Marshall was investigating the well-known effect of agglomeration, pointing out significant culmination of roles of cities as engines of trade, recourses and welfare accumulation of contemporary emperies.

The exceeded development of industry during last centuries had led to unprecedented increase in number of world population and its concentration in cities. Also the world urbanization was enforced by progress in medicine, transport and communication, active development of architecture and culture. Since 1800 till 2010 the number of world population had risen from 800 mln. to 6,9 bln.people, total urban population - from 29 mln. to near 3 bln. [13]. Taking into consideration the rate of urban population change from 3.6 in 1800 to 50.6 in 2010, the prognoses for the 2050 reach 70 %. [1].

After analyzing numerous scientific approaches we formed our opinion from the standpoint of international economy theory the notion of urbanization should be understand as as a process of urban population growth and polarization in a global scale and increasing of big cities number as well as getting the prime actors role by cities in international economic relations. [2]

The special attention in description of urbanization is given to the increase of big cities number. But not only the number meters but also the shift in functions and forms of the cities. This process in general is commonly called metropolization and it is connected with metropolises formation. Metropolis is a special form of territorial organization of community which is developed on the basis of big cities and usually characterized by flexibility and diversification of component structure, specific peculiarities of social-cultural environment (easy-contact, social mobility, diversification), which reveals in scope of city functions , great scale of their influence (often it reaches global level). In this way metropolization – is the process of metropolises and metropolitan regions formation, the last include the range of administrative – territorial units with high concentration of population and economic activity and special social-economic role playing out of its basic region. Correspondingly there are several types of metropolitan territories: with one center and satellite small cities, rural territories (London, Seul, Los-Angeles) and poly-centric metropolis, which include several agglomerations. ('Rurh-stadt' in Germany, 'Bo swash' in USA, 'Rasischtadt' in Netherlands, 'Italian Corridor' in Italy (Milan-Venice), 'Hong-Kong Triangle', 'Tocaydo' in Japan, 'Golden shoe' in Canada etc. [3,170]. Ukrainian researcher Denisenko O. connects metropolization with "getting new special organizational, informational, spiritual-cultural, and communicational function" and to converge with European model Ukraine should deeper rethink functional model of its cities.

Convergence of economic systems is divided into two types concerning the sphere of influence: the convergence of real sectors of economy and convergence of regulatory sphere [4]. The last is perceived as process of assimilating of countries in sphere of social-economic institutes functioning, e.g. formal institutes, as well as informal institutes, obligatory in national economies. While convergence of regulatory sphere occurs to be fairly homogeny notional category, the convergence of real sectors of economy stands out as more differentiated and in its turn being divided into real and nominal. The last is revealing in exploratory research of real spheres of economy and paradigms influence. Real convergence of real spheres of economy can be equated to the reduction process of disparities between the levels of economic development and quality of life in different countries. In this context economies can converge absolutely if they are characterized by similar structure parameters, e.g. technology, levels of savings, natural accretion or depreciation of physical capital, etc. and they move toward balanced growth with sustainable levels of capitals and production per capita. However relative convergence opens lots of opportunities of harmonized growth and appears in situation when countries structure parameters differ. Thus any country inclines to have its own way of balanced growth. As it was mention above there is also a nominal kind of convergence in real spheres of economy and in economic analysis it's connected to convergence criterions, formulated in Maastricht Agreement of EU which orients on countries and territorial cohesion.

The convergence of urban development policies of Ukraine with European refer primarily to convergence of regulatory system and after only to convergence of real spheres of economy due to its post-soviet legacy and contemporary level of city development. Despite the fact that Ukraine ranks 19th place in list of countries with big number of megapolises, these days it is hardly ever possible to give an example of a city that performs its functions appropriately and assure the residents proper standards of life and services. Almost all cites fail to achieve the equilibrium between economic development and protection of a safe environment. On the contrary, the overwhelming majority of Ukrainian cities face quite a number of problems: the poverty of city residents, the destruction of historical centers, the excessive concentration of motor vehicles, air, water and soil contamination, lack of sufficient accommodations at fair prices, as well as problems in the field of health care. High levels of unemployment especially among the young and growing level of crime and law infringement are also common problems. Over 60 % of total Ukrainian population is city-dwellers. It has 349 small depressed towns with a population of 10.000-50.000, comprising 22% of the population [5]. Regarding the tendency of disparities increasing between the level of localities development and qualitative indicators of life and business Ukraine lags behind from developed countries and in some cases can't compete with developing countries. The model of economic growth based on reloading of old industrial forces, privatization of governmental ownership, speculation with land raising cheap bank loans has proved its inefficiency. Ukrainian big regional centers and megapolises,- which list is headed by Kyiv, Kharkiv, Dnipropetrovs'k, Odessa, Donetsk, L'viv (more than 12 mln.ppl. that is equal to 27% of total population),- they are developing horizontally in quantities dimension of space, and comparing between themselves they show growth [6]. However regarding to European tendencies and quality standards they evidently degrade in demographic, infrastructure and economic dimensions.

The formation of the urban self-government institutions in Ukraine are among the most complicated tasks of new state development [7]. There exists a complex of problems: economic (nonconsecutive character of market relations), financial (restriction of revenues and misbalance of city budgets), social (destruction of existing social infrastructure; the decline of living wage), and political (trust of the population) [8]. The institution of local self-government occupies an increasingly important position in Ukrainian society. However, the contemporary system of local self-government in Ukraine is still not consistent with the principles of the European Charter of Local Self-government [9]. This problem is connected with the heritage of Soviet Union in face of hard centralized management system, which in fact still operates on the all levels of government. Inevitable market transformations in many spheres were not undertaken and resulted in deepening of social-economic problems in rural areas, small-, and medium- and even in whole regions [10]. In these circumstances evolution of European regional policy that is connected with urban development strategies serves as role-model experience for positive changes and convergence of Ukraine and EU. Moreover in terms of new support agreements in sphere of regional policy development between EU and Ukraine set in 2010, which have planned allocation of €10 mln. for the period of 2011-2013[11], the complex EU experience analysis starting with a very origins becomes of a vital importance.

Considering the history of European countries collaboration till EU formation and till nowadays it reveals that the strategic view onto development of urban territories has been changing substantially and has formed into three waves and governing policies of development stimulation and restriction (table1). Regarding that 70% of expanded EU inhabitants are city-dwellers its cities are assumed as the motor that drives regional growth and the key to increasing the EU's competitiveness worldwide. But still they suffer from demographic problems, social inequality, social exclusion, lack of affordable and sustainable housing and environmental problems [7]. The policy of urban regulation on the national level appeared in the European countries as reaction on world finance crisis of 1929-1932.

Starting with 1930s some European countries, e.g. Great Britain considered their agglomerations and even certain regions as overdeveloped. The high density of population and business activities concentrations in them started to be regarded as the main problem of regional policy in first decade after II WW in France, Netherlands, Italy and Hungary and others except for German Federal Republic, Switzerland, Austria and Belgium[12]. The main reasons for establishment the policy of main agglomeration "offloading" served such phenomena as decline of life quality standards and economy functioning connected with troubling of new economic areas creation because of old industrial potential domination without any perspectives of further realization, such as production spaces, transport limits and ecological dilemma (McCrone G., 1969)[13]. In its turn situation has been troubling by crisis deepening in peripheral regions which did not have agglomerations (e.g. South Italy) and certain depressive territories (North territories of Great Britain and France). The "offloading" was of a quite discursive value for business as they wanted to displace their actives to hinterland not far away regions with bad image, low level of infrastructure development and quality of workforce. Thus the main role was devoted to governmental stimulation of mobile capitals and in this period the term "production migration appeared"[14].

Table1.
The waves of urban development policy evolution in Europe

Period	Policy main-streams	Main initiatives
1930-1950s	"Offloading" of agglomerations and development of depressive	- Special permission for establishing business in city
		- Subsidies and preferences for starting business in depressive regions
		- Replacement of governmental and educational institutions out of agglomerations
		- Restriction methods of registration controlling
		- Creation of "cities-gardens" around existing agglomerations and inverting their poly-structure development
1970-1980s	"Inner-areas" development in agglomerations	- Transformation of depressive areas of cities into new functional areas
		- Stimulation of assimilation of marginal groups by formation formal and informal organizations
1980s - present	Extended support of main agglomerations development	- Developing great scale infrastructure projects
		- Increasing of workforce quality
		- Enhancement of place image
		- Stimulation of SME activity

Source: developed by author on the base of [12].

The "offloading" measures occurred to be quite successful but their effect was exceeded by natural process of suburbanization, when reach layers of society inclined to live in private houses in "green zones" out of city. It is important that in European employer traditionally followed their target employees not the other way and it also accelerated "production migration". However the new phenomena replaced old problems in regional policy. It was the decline of certain inner city areas. The social segregation appeared to be so strong that even nearby streets could serve dwelling for super reach and super poor citizens, so called crisis areal. It led to social exclusion and marginal groups appearance, as well as could not afford relatively expensive apartments in suburbs and extremely expensive in central areas of the city. This challenge was an urgent problem in Italy, Great Britain, France and Belgium and it led to formation of "inner city areas development" strategy which became the leitmotiv of regional policy of European counties till the beginning of 1990s[15].

The new realities were brought by globalization tendencies exceeding and consequent expanding of capital mobility possibilities. Accompanied by informational revolution of 80-ies all this could not help influencing the role of cities in maintaining of country competitive advantages of a global scale. Thus the dual nature of urban development revealed by shift from exclusive providing positive changes in crisis inner-areas to more extended development projects, e.g. place marketing and huge infrastructure projects implementation, etc. This strategy found its further development as a part of Regional Policy of EU, exactly in EU Cohesion Policy as a Community Initiative Programme 'URBAN' in 1994[16].

Integrated urban development formed as a central to European cohesion policy and a goal which is supported throughout its urban programs. It means simultaneous and fair consideration of the concerns and interests which are relevant to urban development, thus a process in which the spatial, sector and temporal aspects of key areas of urban policy are co-designed and co-ordinated by all levels of governing. Cities and regions across the Union use integrated policy-making to support sustainable, inclusive and innovative urban development. The last two decades have seen a flurry of EU initiatives launched in support of urban development. These kicked off with the Urban Pilot Projects (1989–99), which focused on economic development, environmental action linked with economic goals, revitalization of historic centers and exploitation of the technological assets of cities. In two phases, 59 projects were supported in 14 Member States.

The URBAN Community Initiative (1994–2006) built on the experience gained from the pilot projects in 200 cities across Europe [17]. In the two programming periods, URBAN offered €1.6 billion in Community assistance. URBAN mainstreaming (2007–13) saw the main legacy of the URBAN Community Initiative included in the national and regional Operational Programs (OPs) under the Convergence and Regional competiveness and employment objectives and for its realization €10 bln. were allocated. This important step allowed the integration of different sectoral and thematic policies in cities throughout Europe. For the first time, all European cities became potential beneficiaries of the European Regional Development Fund (ERDF).

The urban development network program URBACT (2002–13) has given additional support to the exchange of knowhow and experience between cities and urban experts across Europe. Since 2003, the Urban Audit provides a solid evidence base to assess the state of European cities and now offers comparative data for 321 cities across the EU. In 2010, this was complemented by the publication of the Urban Atlas, which offers detailed digital maps for more than 300 Urban Audit areas based on satellite imagery.

The 'Leipzig Charter on Sustainable European Cities' (2007) recommended making greater use of integrated urban development policy approaches and paying special attention to deprived neighborhoods[18]. A promising initiative in this respect was launched in 2008 in Marseille, where the Member States agreed to establish a common European Reference Framework for Sustainable Cities to foster the implementation of the Leipzig Charter at local level. This framework is currently being developed on a broad participatory basis involving cities, the Member States, the European Commission, and urban experts. On a voluntary basis, it will offer cities a practical tool to help them to apply an integrated approach when developing strategies and projects and to balance different needs and interests.

The analysis of urban policy evolution and functioning in Europe allows making several general conclusions important for Ukraine. First of all, European experience shows that government can accelerate or slacken natural processes which take place in cities and towns, but they are incapable of changing their trend. All regulatory urban policies where first directed onto the development of depressive regions by restriction of big agglomerations growth, further globalization dictated the strategy of competitive integrative development of cities network which focal points are big agglomerations of a global meaning, so called global cities. There are decades needed for notable positive changes in urban development. The effective urban development should be integrated into strong regional policy and the main facto of success is connected with decentralization of power and functions and functioning between the multi-level governing systems. Fairly well, that it is easier to develop the territory of city than obtain the development of marginal groups. As the instruments of urban development restriction-prohibiting measures appeared to be less efficient than encouraging.

There is a set of instruments and principles which have already proved their worth during almost 60 years of regional policy experience. They are indispensable for further improving the competitiveness of EU cities and can serve model for Ukrainian cities development.

Table2.
Set of effective instruments of EU urban development policy

Tasks	Instruments	Principles of implementation
Greater use of integrated urban development policy approaches	Creating and ensuing high-quality public spaces	- Decentralization and multi-level governing
		- Multi-annual projects
		- Sufficient critical mass of population and associated support structures
		- Stimulating of innovative approach
		- Strong inclusive local partnership
		- Integration and synergy with other initiatives
		- Sharing experience
		- Social-balancing
	Modernizing infrastructure networks and improving energy efficiency	- Appreciation of diversity
	Proactive innovations and education policies	- Sustainability of impact
Development of deprived neighborhoods within the city	Pursuing strategies for upgrading the physical environment	- Integration of economic, social, environmental, security and transport aspects, including equality of access to education and training
	Strengthening the local economy and local labor market policy	- Equality of opportunities between men and women
	Proactive education and training policies for children and young people	- Flexible and open process
	Promotion of efficient and affordable urban transport	- Local community participation and commitment
Funding	Structural Funds: European Regional Development Fund, European Social Fund; Cohesion Fund	Urban development funds and SME funds by JESSICA and JEREMIE initiatives

Source: developed by author on the base of [15-23]

Regarding the information presented in table above there are important conclusions can be made for Ukraine in context of efficient urban development policy. It is vital to insure state-local authorities-local business-local community co-operation on all levels of urban development projects design and realization. Importantly all cities of the urban network should be perceived as equal in face of city-region development. As well Ukrainian government should organize efficient funds for urban development not only by state budget planning, but also arranging financial engineering instruments to leverage private capital into urban strategic plans which European analogs are JESSICA and JEREMIE initiatives [13]. It is basically important to design dual nature projects of city development which base on general and neighborhoods upgrading and revitalization.

It should be admitted that the one of globalization effects reveals in weakening governmental influence on urban development inside its countries. While the distance losses its meaning and technologies progress the peculiarities of territories get new importance. [24;25;26].

While globalization stimulates the spreading of centers production processes all around the world, such advanced services for producers as consulting, insurance, financial operations, advertisement, research demonstrate tendency to concentrate in cities, to be specific in certain cities of the world – metropolises. [25]. This phenomenon is called glocalization which means dialectic inter-relation between local and global scales of economic, politic, and cultural processes, as well as governmental decentralization strategy, due to which cities get more capabilities in managing their own development. [27]. Glocalization is practically implemented in shift from policy of exclusively direct governing if urban development without involving (managerism) to the policy of business-partnering of local authorities. (entrepreneurialism).

The ideology of «entrepreneurial cities» was extremely popular in 90-ies and the beginning 2000-ies in many cities of USA and Western Europe, namely Germany, Netherlands, UK, Spain and Turkey, excluding only France and Italy. This model perceives city as a product which should be marketed and promoted, as well as should have competitive advantages. These entrepreneurial cities foster economic power quite in a short period, and conceder other cities as competitors whose achievements in infrastructure, architecture or the level of consumer services provision should be immediately realized in own local environment. But it showed its incapability in many aspects. Trying to get more international capitals resulted in economic segregation and social exclusion, thus conflicts inside the city, as well as straitening of economic-territorial polarization inside the country, because investors attention can be driven to any other entrepreneurial with a same possibility. [28].

The illustration of weakness of this model can be made on example of economic restructuring of Leipzig after Germany reunion. The colossal amount of money was put into renovation of infrastructure, living and commerce real estate, as well as stimulation of suburbanization. However the local community of Leipzig did not believe in perspective of such changes and started to emigrate massively. New infrastructure was not profitable, the commerce real estate stayed unused. Till the beginning of new century city had been unattractive and had lost over 100 thousand ppl. The private investments appeared to be more effective than governmental huge projects. The association of Leipzig with I.-S. Bach and personages of Faust and Mephistopheles gave the unexpected stimulation of development as center of informal culture of neo-gots and great musician concerts and cultural events. In a close time even local community which had left city some time ago, started to get back from suburbs. This way city has become German prime cultural, capital. This way gentrification processes, determined by private initiative, proved its efficiency in city development.

«Entrepreneurial cities» paradigm has changed into «livable cities», or cities, which development is connected with maintenance of equilibrium between economic development, ecology needs and local community interests. This means the end for competition between cities minimum as principle of urban development strategy. Traditional factors of success as mono-specification, natural resources, low labor costs and qualified personnel, low transport costs are more and more unimportant comparing. In the same time social- cultural parameters f city – as quality of public places, level of cultural and social life differentiation, politic stability, low level of crime, positive image, transparency of decision making in authorities etc. – stand forward[26;28;29]. The development of cities is obviously more determined by individual life strategies of citizens aand here should not be ignored investments into their development when talking about stable economic growth, especially in terms of post-industrial economy, oriented on non-material production.

Consequently, globalization result in conflict between interests of local communities and global economy conjuncture. This forms diffused precondition for city development which needs to be considered by local administrations. The idea of self-government and active position of local community lies in the base of stable urban growth. It practically reveals in number and importance of different kinds of NGOs in city. The strong relationship between number of NGOs and economic growth of cities was proved on the data about US states [30]. This kind of relationship can be explained with the fact, that more decentralized local authority and active local partnership stimulate transparency, democratization and integrated approach to plan urban development and community control over projects realization and gives ability to integrate creativity.

Convincing prove was presented by R. Florida, who showed that the main driving force of contemporary metropolis economy is creative class of young, qualified and mobile professionals, who have diverse ethnic origin and open-minded lifestyle. Metropolises, which are able to maintain attractive local environment for the representatives of creative industries, as well as special lifestyle and values, they get most profitable perspective in long-term period. [31]. One of the recent examples is a Nissan production-management choosing the center of location between Perm and Saint-Petersburg. One of the main criteria was providing employees with high life standards, which included highly developed cultural environment. This way the priority was given to Saint-Petersburg, even not regarding the higher level of land and labor costs.

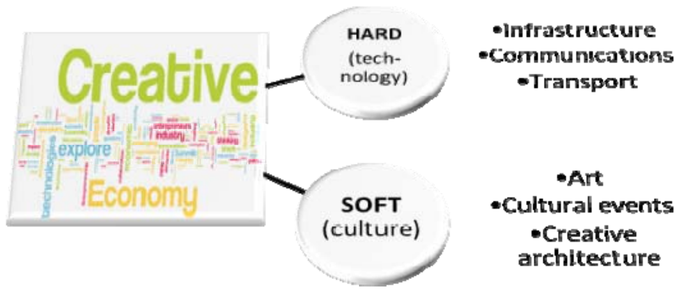
Creativity is a special characteristic of metropolis economy which provide equal chances for cities of different sizes, continents and primary development level. This is proved by European examples of mono-functional depressive cities development into metropolises- Sheffield (GB) and Bilbao (Spain).

Both cities started their revitalization from the same position of economically and ecologically degraded industrial territories, with common phenomenon of ethnic and social conflicts [32]. Corresponding image of ‘rebel’ Sheffield and ‘museum of ecological horrors’ Bilbao influenced much the fact that foreign investors lost the way to reach it and local community disappointed in possible changes. Both cities had chosen the model of cultural creative revitalization. First this kind of strategies had been used in USA in 1970-1980 on example of Baltimore. In some period this model became popular in Europe in projects of Glasgow – European culture capital of 90-ies, and Barcelona. Although the revitalization strategies appeared to be successful in both cases, the strategies and tactics differed much, which effected the stability of positive changes. First of all, regarding the political ideology, Sheffield administration was inclined to partner with local community and business. Instead Bilbao which opposed vertical model of managing revitalization projects. Second, Sheffield main purpose was to amortize the negative effect of industrial decline, Bilbao was first of all determined to create knowledge based high-tech industries. Third, the goal of cultural regeneration in Bilbao was attracting tourists and foreign investment, to support this goal there was established the Guggenheim Museum. While in Sheffield the goal was to use culture as the agent of social changes and social integration in society. This practically realized in rebuilding of Winter Gardens and Garden of the world, the Millennium museum development, as well as national lottery sponsored museum of contemporary music culture, which appeared to be unsuccessful and was finally closed. Consequently, social policy in Sheffield was actively including programs of depressive regions reintegration, for example developing accessible habitation possibilities, uniting marginal groups into non-profit organizations and stimulating the development of informa6ional systems about vacancies and re-qualification opportunities. Bilbao rarely launched such socially meaningful projects, except for migration stimulation on the governmental level and ecological projects. In depressive regions attention was paid on improving transport infrastructure.

Finally the evaluation of cultural revitalization strategies of both cities let to do make a conclusion that they had led to significant improvement of metropolitan economy's performance. However it is fair to notice that project of attractiveness improvement through establishment of Guggenheim musem in Bilbao justified itself but had let to real estate prices rising to the level higher than in Madrid. This newly created image had not been back upped through adecvate social policy and thud did not guaranteed stable economic growth. This kind of side effects of upgraded infrastructure is precisely described by Hire as 'carnival mask', when zeal for creative architecture just hides social troubles of the metropolis. [27]. On the contrary the main cultural revitalization stress had not justified in the case of Sheffield and modern music museum had been closed. However the multi-oriented social policy aimed at solving social segregation problems in local community had given more stable base for economic growth and further metropolitan development.

Strasbourg (France) metropolization process is also quite significant as effective strategy. It was regional center of its national economy and became the heart of European Union. [33]. The upgrade of architecture environment design was stressed on saving the charm of authentic mid-century legacy of Alsace style accompanied in harmony neighborhood of super-modern building of European Parliament, concert-hall, railway station of national meaning, numerous museums and historic monuments etc. As a center of multi-national community the special attention is paid on social policy of tolerance cultivation and marginal group's self-expression. As a center of high education institutions Strasbourg became the place of young professional concentration, which stimulated further development of creative industries, especially in sphere of services. Significant success was achieved in greening of Strasbourg and maintaining of ecological metropolis transport, social living real estate. Numerous parks, green architecture along the bank of river L'Ill and outstanding project of noiseless broad tram system implementation , computerization of public services, together with cultural differences appreciation have prepared fundamental base for creative local environment arising for talented class living and free realization, which consequently have to stable economic growth.

Thus the cases of European cities presented above show than not regarding the starting political, economic and infrastructural level of development can significantly influence their further growth by stimulating creative local environment. Gaining unique differentiating advantages and parallel improvement of community integrity and social engagement with the 'destiny' of metropolis brings local authorities to make a choice how it can revitalize its local environment to be more competitive in global urban competition for factors, as talents, technologies and investments. To our opinion strategies used in European metropolization with aim on creative function development can be elementary presented by two models: hard creativity - with a more stress on technology and infrastructure - and soft - with a more stress on culture and social policy. (pic.1)



Pic.1. Differentiating the hard and soft models of urban economy creativity.

The analysis of urban policy evolution and functioning in Europe allows making several general conclusions important for Ukraine. First of all, European experience shows that government can accelerate or slacken natural processes which take place in cities and towns, but they are incapable of changing their trend. All regulatory urban policies where first directed onto the development of depressive regions by restriction of big agglomerations growth, further globalization dictated the strategy of competitive integrative development of cities network which focal points are big agglomerations of a global meaning, so called global cities. There are decades needed for notable positive changes in urban development. The effective urban development should be integrated into strong regional policy and the main facto of success is connected with decentralization of power and functions and functioning between the multi-level governing systems. Fairly well, that it is easier to develop the territory of city than obtain the development of marginal groups. As the instruments of urban development restriction-prohibiting measures appeared to be less efficient than encouraging.

The polarization of global economy is accompanied by localization of most of factors in limited number of places, which leads to divergence of inter-city development in all countries of the world and resulted in global cities formation, so called command centers of international economy. The attractiveness of urban lifestyle is explained by more employment opportunities, by variety and concentration of cultural experience, ease to reach main transport and communication infrastructure. Thus prime meaning of city taxon in global economic environment is logical. However the sources of inter-city economic development still sick for explanation in frames of overall location theory.

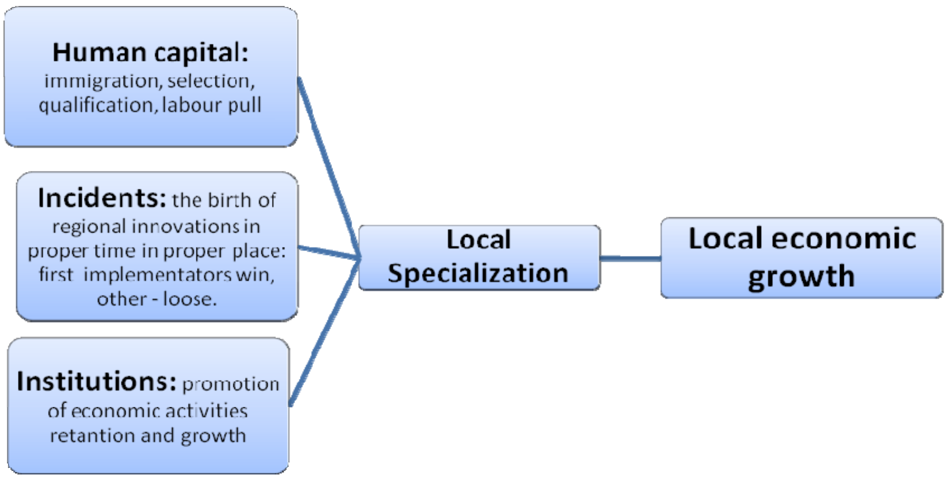
In USA for example income per capita in San-Francisco is three times higher than in Bronxville, Texas. But these cities belong to different structural classes. While the same indicator for San-Francisco is 1/3 bigger than the same indicator for Los-Angeles, and they relate to the same classes. [34]. This seems strange from the standpoint of regional economic theory, that there is observed such significant inter-city income divergence in economy with the high rate of inter-regional investments and mobility of labor, more over inside on functional class.

The obstacles for income convergence between territories international economy theory explains as result of labor and capital mobility limits. Since these limitations are touched upon, this theory refers to differences in level of specialization as an explanation for asymmetry in cities development: including all differences, starting with comparative advantages to human capital, institutions and technologies.

However the sources of economic specialization of territory stay the holy grail of economic development theory. Considering comparative advantages, there are always several territories with the same comparative advantages. Theory of economic agglomeration explains, that since some economic activity is launched somewhere it has a tendency to long-term development thanks to production and trade externalities effect for all economic actors [35].

The researches of this type inductive empiricism present the range of sources, which are thought to make an imput to territorial economic specialization. City is supposed to be specializing when the concentration of specific labour in that or another sphere or the rate of economic activity growth on the local level exceed the overall national. The list of factors, such as prices for land, governmental regulation, business climate are perceived as the source of city economic base evolution. While specialization is calculated on export base or multiplicator's effect.[36] Consequently the ratings on the base of land cost, prices and earnings, number of commerce operations, even business- servicing companies give uncertain analytic evaluations why those or other cities from the same functional class are more specialized, but not the theoretic grounding.

In the researches on comparative growth there was formed pragmatic position concerning of territorial development divergence as a result of three forces: specialization, human capital and formal/informal institutions [37]. The leading scientist M. Storper finds territorial specialization as accidental thing: being in the right place attracts sectors to the place. It conditions the dualistic character of specialization sources: internal and external. Unique peculiarities of territory, as unique skills, unique events (for example, place of making invention or talented scientist residence) or unique historic experience form the 'sead' of specialization. The asnalysed concepts of territorial specialization, M.Storper presents the model of city specialization as the main force of economic growth. (pic.2.)



Pic.2. Internal sources of city specialization by M.Storper
Source:[34]

Meanwhile this seed can be implemented in several territories in the same time. W. Paul shows the example of minimum 10 US regions, where there had been registered the most of bio-technologic patents and other consumer services in past. But only 3 of them appeared to become the center of high-technology producers agglomeration. [38]. Thus the question of why some of territories appear to be more successful in developing specialization than other still sick for explanation.

Classic mono-functional typology of cities, built on city creating function (export function) appeared to be unable to explain the growth of metropolises in the end of XX - beginning of XXI century, moreover to explain the forming of global cities as New-York, London, Tokyo. Their source is openness to exogenous effects of international economy typical to globalization era: hyper-migration, hyper-concentration of capitals and information, multi-culture, multi-functional specialization, etc.

In the beginning of 60-ies the distinctive feature of metropolis economy was the domination of so called third sector – services. On the other hand industrial production was moving into the suburbs, till the progress of communications and technologies, evolution of organizational systems of TNC, did not spread it all around the world. In that very period the prime meaning global management function concentration in the city was realized. Cities hosted old and competed for new headquarters of TNC, international organizations, etc.

Thus the structural analysis on the base of numeric evaluation of activity presentment comparing to national scale can not serve objective grounding for modeling specialization of metropolises. Their multi-functional economic structure is connected with differentiation of TNCs specialization, and the key function is about the center of redistribution of global factors flows, including information. (table 3). But the presence of higher headquatrs of the TNCs in cities is explained by concentration of advanced producer services or so called forth-sector services (such as banking, advertising, consulting, logistics, research, etc.) The very advanced producer services sphere development in the city and the need for personal contacts provides positive effect of agglomeration externalities, which keeps international 'command-tanks' inside any taken metropolis. [15].

But, as far as development of such industries as advanced producer services is connected with presence of creative labor, local environment features should fully fulfill their requirement for lifestyle and work style. [39]. To be specific this conditions the need in high level and quality of infrastructure, communications, transport, education, culture and leisure development. In T. Yamaguti interpretation – all this together can be called as base for providing enlarged reproduction. [40]. The great role in its realization is played by formal and informal institutions development, which stimulate integrity of millions of population living in metropolises and gives platform for human potential realization, enables the spill-over effects in knowledge exchange between employees of different sectors of economy, stimulate innovations and 'events' by M.Storper.

Table 3.
Three-level system of metropolis specialization

Meaning for global power of metropolis	Functions	Details
Key	Global political and business command center	The highest levels of headquarters of TNC, political and non-political organizations, as well as think tanks and news beuros.
Supporting	The center of advanced business services	Forth-sector firms which operate to service production throughout the world: research and development agencies, insurance, marketing and design, logistics, banking, etc.
Enabling	Local creative environment (maintaining the enlarged reproduction)	Comfort of infrastructure, medicine, education, differentiation of culture, leisure, opportunities for self-expression and other creative industries.

Source: [developed by author]

Contemporary metropolises, more over global cities, are greatly depended on external influences of international environment in their development, definitely more than on effects of region or country they take origin from. For example, the decisions about replacing headquarter of TNC s, other international organizations, the power of international flows of information, human capital, investments, etc. To our opinion the real contemporary metropolises specialization is inter-foldering three-level model. The high rate of advanced producer services concentration and differentiation in city form precondition for agglomeration of TNC and international organization, as well as informational bureaus headquarters. The last embody real global power of metropolises and key specialization – command center of global economy, politics and information transmission. This model of specialization is revealing consequential relationship in multi-structural specialization model as well as claims for correspondence to actual growth characteristics in era of globalization – creativity. It needs further specifications with mechanisms, their interrelation, action steps and, importantly, indicators of success. Still, as far as we concerned, it is the first try to uniform sources of metropolis' global leadership in consequential multi-functional specialization model basing on location theory, regional and international economy theory and the most significant developments of spatial economists, economic geographers for now.

Conclusions. Contemporary metropolises are the important agents of world economy and embodiment of globalization. Tendencies of polarization deepening make a challenge to boost competitiveness. But gomogenization condition the effectiveness of creativeness in planning, realization and monitoring of development strategies of metropolises. Using of creative approach and developing on its base economic specialization model provides stable growth and integrated development in global environment.

The essence of creative metropolis economy is about increasing the role of creative industries, attracting and retaining talents, open-mended atmosphere and high-level of technologies development. But this model is impossible without provision of partnering relationships with local community, business and local administrations, as well as without active social policy, oriented on declining of social segregation and depressed city regions reintegration. Entrepreneurial cities determined to get positive image and international capitals first of all choose 'hard' creativity, or increasing of technological level of infrastructure, transport and communication. However concentration only on these measures can lead to even deepening problem of economic segregation and polarization in city development. On the other hand, cities, which choose 'soft' creativity strategy – stimulating of modern architecture and design, arts, cultural events, etc. also get relatively short-term economy boost effect. It's explained with a 'carnival mask' of cultural revitalization being unable to change, just to hide social-economic problems. Both strategies are ineffective to build real creative economy, as far as it seek for strong social institutions, starting with interests, motivation of the exact local community representatives and their involving into the process of planning their own local environment changes. Creative economy can be properly build just in terms of multi-level partnership and corresponding level of democratization of power, as well as realizing that investment in human capital (people's self-expression, realization and education) is the most profitable actives of effective city development and their stable economic growth.

The general level of Ukrainian city development should be connected with creation of high-quality public spaces. For its realization interaction of architecture, infrastructure planning and urban planning must be increased in order to create attractive, well-designed, safeguard, user-oriented public spaces and achieve a high standard in terms of living environment. Modernizing infrastructure networks and improving energy efficiency is connected with initiatives aimed to insure sustainable, accessible and affordable urban transport with a city-region transport networks. Also technical infrastructure, especially water supply networks, must be improved at an early stage and adapted to changing needs in order to meet future requirements for high quality urban living. Energy efficiency of buildings must be improved in addition to renovation of housing stock and large prefabricated, old and low quality buildings. As well cities must contribute in spatial and urban planning which prevents urban sprawl by strong control of land supply and of speculative development. It is of sufficient value to enhance citizens' quality of life and attractiveness as business locations by making use of sophisticated information and communication technologies in the field of education, employment, social services, health, safety and security, etc. Proactive innovations and educational policies should insure opportunities for lifelong learning, the excellence of the universities and non-university research institutes and transfer network between industry, business and scientific community.

In managing of Ukrainian cities deprived neighborhoods economically and to integrate them socially it is urgent to upgrade their inner-city physical environment and transport infrastructure, that will stimulate the start-up of new business in this area. The access opportunities to local labor markets must be improved by offering demand-oriented trainings. There should be paid a special attention to proactive projects of children and young people education improvement in deprived neighborhoods.

Evidently the whole period of independence of Ukraine served for strengthening of urban polarization. But due to economic crisis the economic potential of different cities has been equalized. Accompanied by unprecedented deepening of ecological problems these raise the indispensible aspect of regional policy efficient planning and governing need. The real value of natural and global meaning advantages of Ukrainian cities arise – the same high esthetic and physical development of public places, the level of social culture and local citizenship education, favorable community infrastructure throughout all regions of the country. The competitive model of sustainable urban development first of all starts with decentralization of power. This implies the process of delegation of functions and competencies to local level with parallel straightening of its rights, e.g. in sphere opportunities or local budgets formation. This process serves the main goal of optimization and increasing of socially meaningful projects, timely and qualified providing of services for local communities members, fulfillment of local interests, transparency and democracy providing in relations of local authorities with their communities. Thus the constructive model should find place in contemporary system and it will serve functional division into central (political, strategic, control) and local (economic, performance, report).

Finally, the productive decentralized, not redistributing economy, which bases on qualitative growth characteristics and innovations should be designed and realized. Its efficiency can be ensured by integrated long-term projects and effective multi-level management as well as strong local partnership. European experience which proved its efficiency in long time period serves role-model for design and implementation of integrated urban policy in Ukrainian realities.

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