BANKS AND FINANCIAL INTERMEDIATIONS' GLOBAL ROLE OF IN MARKETS' GENERAL EQUILIBRIUM

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Abstract

Due to globalization factors, financial intermediations still create many problems to national economies as far as the markets' general equilibrium is concerned. Although the world is divided into more than 200 nations with unequal power, there is less than half a dozen key currencies to go round to facilitate the international financial transactions. Considering that the combinations between the flexible exchange rates and the free circulation of capital and information have made the financial system be strongly interconnected internationally, however, some national economies preserve financial circuits that are not indirectly integrated in the world system.These aspects have led to the analysis of the relations between the financial intermediaries on domestic and foreign markets, the banks and financial intermediations' global role in national economies and internationally.

Keywords: *Neoclassical equilibrium model, Walraien model, Neoclassical financial market, financial system, capital marginal efficiency*

Introduction

Markets mainly function based on two models:

The Neoclassical perfect equilibrium model that comprises the general equilibrium properties belonging to goods markets and the production factors, those belonging to financial markets as well. Both properties have the same form: the atomicity of supplies and demands, the homogeneity of the products, the transparency of the exchanges and the mobility of the financial resources.

In perfect competition, the free allocation of capital allows that its economic performance rise to an optimum level

The basic Walraien model that has several characteristics: the economic and financial decisions are made by rational individuals that are perfectly informed on market conditions at any moment; the so called pure and perfect "competition" excludes all the forms of power on prices; equilibriumd prices are the result of anonymous forces.

In a perfect information system, in other words in a world without any risks and private information, the financial capital is an item with homogeneous and constant quality; pro temporis interest rates are enough to remunerate the lender; the saving supply depends on the preferences for the present and on the consumption desires. The revenues are split up between the payment of capital loans and that of the employment. There is no reason for profits to exist. Companies lose their last individual supplies. Economic agents keep their goods supplies and their accounts that overtake market prices; deficits are stopped without leading to bankruptcy. They become suppliers of different goods; the reconversion is done without unemployment.

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The model offers a possible answer to one of the problems that has been around for more than a century now. This model gives us the opportunity to specifically approach the nature of the relations between the financial market and economic results, considered as a whole.

Literature review

The Neoclassical financial market organizes the meeting between the agents having financing capability and the agents that need financing. Producers, goods sellers are not in the situation of 100% self-financing their equipment expenses. They could spare placing their available capital taking into consideration the supplies. In the model under discussion, the capital supply meets the corresponding demand without intermediaries. One could balance all the savings supplied by the capital and investment market without any loss, with zero intermediation costs. The market could tell between the various possible equilibriums.

Keynes' general theory broke up with the unifying visions summarized under markets' general equilibrium. Consequently, two market sides are totally different. The companies and the private persons are not in the symmetry rapport adopted through Walras to represent the supplies and demands addressed to goods and factors markets. Companies, on the one side, spare their primary savings, and, on the other side, they play a too radical role, differentiated to be able to borrow a very similar rational behavior: companies are mainly collectivities involved in production; their behavior surpasses the strict individual rationality frame. Industrial investment represents a risky action which, in particular, is not directly exposed and which is rarely in the position of being appreciated by means of simple saving.

Under these circumstances, the capital market functions according to all the methods that make this difference as Neoclassical methods that can be imagined. Referring to the orthodoxism characterizing his era, Wicksell outlined the banks' role on the loan market: his distinction between the natural interest rate and the monetary rate asked by banks forecasts the Keynesian developments on the marginal efficiency of capital and the use, which is also available nowadays, of the return on equity.

The duality between the fixed revenues and the variable revenues of financial capital is finally integrated in a repartition theory, which does not comprise opposition of the salaries out the property's revenues.

The capital interest rate includes the first variable risks according to the quality of the debtors. The aversion to risk leads to prudence and restraint; the distrust in the exchange amount, the rationale used to obtain loans and the miracle of capital operations, all these make the economy follow the sub-investment type, if we take into consideration the Neoclassical scheme as reference point.

The imperfections characterising the market information lead to Maltusian practices, which put a hold to growths and degradation that have no use[1].

The global role of banks and of financial intermediations, more widely, is positive when adjusting the capital supplies and demands[2]. As far as the expression "financial system", it also covers the capital market.

A system in which specialized organizations, banks and other financial intermediations facilitate the circulation and the distribution of capital makes a link between these two activities. In general, sparing primary savings is usually done by means of depositing them with some financial

[1] Akerlof, Spencer, Stiglitz
[2] Gurley&Shark

institutions, which act as institutional investors: pension funds, mutual and SICAV funds, speculative funds, insurers, private equity funds, real-estate endorsers, etc.

Banks represent the first source for foreign funds that companies might call for.

Or, banks act in a universe with double risk. On the one hand, like all other companies, the bank has to conform to the constraints imposed by the financial equilibrium; they are concerned with conquering parts of the profitable markets; they compete and cooperate with syndicates on competing markets; they take into account their shareholders: they fully participate in mergers, acquisitions and restructuring[3]. Consequently, they diversify their activities (loans, deposits, conciliations, company re conciliations, financial constructions, portfolio management, etc.), they create different products and services to make better use of their distinctive advantages. The monetary market places new financial tools under circulation; the alternative financial procedures allow corporations to be less dependent on the credit institutions for their treasury needs. To serve corporate clients, banks exploit their compared advantages. The specific advantage of a bank as compared to other financial intermediaries is that of offering two services instead of one: that of endorsing and getting payment tools, which is generally represented by currency, and that of granting loans. Together these activities lead to a reduction in the costs assessing the credit risk, because the history of a deposit account informs the banker on the financial situation of the depositor. The bank is also a coalition of lenders who diversify the credit risks. Taking in consideration their market shares, companies accept indebtedness after banks offer an interest rate inferior to market price, because the bank uses its own confidential information, that in this case signals the company's favorable situation; this confidential sign gives the company the possibility to find financing means on the market. Banks discover that the stock exchange index of a listed company that wants to renew a contract diminishes the banking cost.

These advantages are even more obvious with small and medium-sized companies, known on the financial market as quoted groups (Cotin). On the other side, banks encourage the groups of specific risks, the credit risk and the liquidity risk, respectively. A debtor's insolvency is different from the risk that it is exposed to by buying some common goods whose quality is generally stable and acknowledged.

The bank's relation with its client constantly evolves taking into account the business environment and its solvency.

Banks should offer high-quality services to their clients, services that should provide return, and they should not grand suspicious loans: the liquidity of the deposits should be guaranteed; the assessment of the credit risks and the operational risks should be competently supervised; the clients should be able to partially calculate their loyalty in case the bank gets into difficulty. In case of bankruptcy, a banker seriously affects its clients. It is healthy to keep a low competition on credit market when the debtors' weakness probability stays within tolerable limits.

Foreign currencies, loans and reimbursements on the capital market are a collective product: they are not only accepted to be liberated, to respond to the explanation that Keynes used to summarize the Neoclassical model[4]. The currency value dominates the relations between the creditors and debtors. The Central bank tries to find the middle way in order to balance its lender of last resort role with its "inflation master" mission; this implies that as a "master" it has to increase monetary mass, to supervise the quality of the credits granted within the economy[5].

To summarize, banking and financial intermediations have some particularities in common. They represent various activities that globally allow a decrease in the uncertainty of the depositors, of those that make primary savings and of all potential investors.

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[3] Bienayme, 1998
[4] Skidelsky
[5] Allen&Santomero

Multiplying financial products and their securitization possibilities for a future market resale finally allows adapting market supplies and demands. Financial intermediations aggregate the various small savings, they diversify and mutualize the risks. At the same time, they have functions which, if they are competently and honestly used, generally favor economic efficiency, they stimulate growth and employment usage.

Certain financial intermediation activities characterizing banks generate **functioning costs**. This is due to the fact that the savings belonging to their clients are not wholly transformed into lucrative investments through loans. They can produce a real loss that would lead to a lack of return for the national economy in rapport with the optimum of the Neoclassical type? Of course no, because one does not label financial intermediations as lacking return in cases that are characterized by uncertainty, information asymmetry and other various morally hazardous business situations. These presumably competent and well-reputed specialized intermediaries use the pulled savings, without which they cannot pay off their liabilities.

The financial market is congenitally opaque because the exchangeable assets bear eminently fortuitous future return on investments. Well-experienced financial intermediaries that pool unexpected primary savings bring about security and trust that capital raise needs, otherwise production cannot develop.

Conclusions

In order for the financial intermediation relations to ensure the general equilibrium of goods and financial markets they have to belong to an efficient financial market that should favor instant allocation of resources.

The analysis outlined the fact that only a profound, liquid and transparent market could favor capital allocation and provide more information concerning the resulted value of the daily loans, as well as the projects of the companies with an open market. Moreover, one emphasized the positive global role that both banks and financial intermediaries have when capital supplies and demands are adjusted. This very important role is continued by multiplying the financial products and by securing the debts for being resold on the financial market, which finally allows choosing the capital supplies and demands on the market.

So, the banking and financial intermediations have several particularities, as they are various activities that globally allow risk reduction of uncertainty as far as depositors, those that make primary savings, as well as all potential investors are concerned.