MODULE 3 – Banking Systems in Industrial Economies, OECD and Emerging Markets

Introduction

Emerging market societies are the focal point of the globalization process, thus our focal point in this module is to describe the role that they play in this endeavor. The role of the G8 and Organisation for Economic Co-operation and Development (OECD) nations will be elaborated upon. We will examine the role of multinational banking in various industrial nations and how it evolved, and the economic interdependencies that exist among those nations in formulating their banking governance.

Objectives

Upon successful completion of this module, the student should be able to:

• Examine the creation of an OECD country and its purposes.
• Identify the differences between traditional banking and universal banking.
• Describe the banking system in many societies with different value systems, cultures and political agendas, and their role in the globalization process.

According to Antoine Van Agtimal, an economist from the World Bank, emerging markets, also known as developing markets, are those economic systems whose performance is ranked from low to middle per capita income. Based on these statistics, almost 80% of the world’s population is represented in emerging market societies. Because of globalization, emerging market economies are dynamic and in a state of constant change. International trade through globalization facilitated emerging market societies in transforming from closed economies into open economies. Consequently, many aspects of the financial and economic system had to be changed to accommodate global transactions. To name a few, accounting standards, product safety, and exchange rate based on the political and economic condition of the nation, rather than central bank’s interference. For further information, please see Footnote #1. The political vocabulary identifying third world countries comes from the notion that there are three different economic societies: 1) industrial economies that are considered capitalistic economies, such as the US/Canada, Western Europe, Japan, Australia are considered one economic system; 2) industrial economies that are not considered capitalistic economies, such as the Soviet Union, China, Eastern Europe are another economic system; and 3) the nations that are neither, such as Latin America, Africa (not including South Africa), the Middle East and most of Asia. The latter societies became known as third world countries. Later on, to be politically correct, they were named “under-developed nations” (they didn’t like that either), and eventually they became known as “developing nations/emerging markets.” Of course, there are degrees of development, based upon gross domestic products among these nations. For example, Haiti is a developing nation, and so is Argentina. However, Argentina’s economic activity is much greater than Haiti’s. Most of these nations receive economic development aid from the World Bank (WB) and/or the International Monetary Fund (IMF). The main objective of the economic aid is to foster global financial cooperation, financial stability and international trade, sustain economic growth, and reduce poverty. During the past 60 years, the task of promoting economic development by the said agencies has been challenging, since the technological advancement and regional economic agreements helped many nations to advance economically more quickly than others, and many controversial adjustments in loan syndication had to be made in response to
these challenges. The case of Argentina’s economic development with the help of the IMF a few years ago is a good example of the said challenges.

International banks were not immune from the challenges brought about by globalization, economic interdependencies and political unions either. Many new menus of financial services had to be invented to satisfy foreign investment activities and international trade. Thus, the orientations of retail and commercial banking had to be modified.

For example, the new trend in international finance is the convergence of several financial entities into one that offers financial services, insurance services, and other services that traditionally were offered by non-bank financial institutions. For further information, please see Footnote #2. Universal banking appears to be the most important dominant trend in IB in the 21st century, which means the barriers that have limited the banking institutions in undertaking investment activities are gradually fading. Even though the tendency in the global market is for the above convergence, the international bank and its services still remain intact as a powerful source offering financial services. We are going to discuss different banking systems that, though there are considerable similarities, their orientations are different, based upon the political and economic structure of the country in which they are located.

Cultural differences and economical interdependencies force multinational firms to adjust their operation within the boundaries of that particular economic entity to fit within the parameters of that culture in order to be successful economically. This is very true with international banks, whether they have operations within OECD countries, or the banking system in emerging markets. For further information, please see Footnote #3. To elaborate on the issue of operational adjustment, since many nations are experiencing political and economical volatility, international banks are obliged to format their operations based upon these variables. In this module, we are going to also discuss the banking systems of various nations around the world.

**The OECD Banking System**

Established after World War II, the OECD was given the responsibility of functioning as the focal point for economic development in societies where development was urgently needed. Eventually, most industrial nations became members of this organization, and membership in the organization was considered an indication that the country had reached a relatively high point in economic development and industrialization. Gradually, some emerging market economies were allowed to join, and overall membership in the organization meant that either the country was on the threshold of becoming industrialized, or had already reached to that plateau. As OECD membership grew, the banking system within those societies evolved from performing traditional banking practices to gradually embracing universal banking practices.

European economies were in the forefront of practicing universal banking, which meant not only were they deposit takers and loan packagers, but they also offered insurance services and security underwriting. This form of banking operation gave the title of “one-stop financial supermarket” to the banking system in European economies. For further information, please see Footnote #4.
The United States’ Banking System

The banking system in the U.S., since its inception in the 1780's, has gone through massive changes from being decentralized and regionally supervised banking operations to centralized control by the Federal Reserve System from 1913 to the present time. The U.S. banking system has endured many banking panics and financial crises up to 1913, when the U.S. enacted the Federal Reserve Charter that assigned responsibility to that entity for regulating and establishing centralized control of the banking system, hoping banking crises would be averted. For further information, please see Footnote #5.

However, in 1929 the U.S. experienced a massive economic downturn, known as the “Great Depression,” that became a catalyst for the Federal Reserve’s involvement in a complete overhaul of the operations of the banking system throughout the U.S. The Glass-Steagall Act, established toward the end of the Great Depression, prohibited commercial banks from underwriting corporate securities. For further information, please see Footnote #6. This law was intended to guarantee that the reserve of the banking system that was received from depositors was not used by the bank in their investment activities in the securities market. In addition, the Glass-Steagall Act established the Federal Deposit Insurance Corporation (FDIC) which prohibited bank managers from tapping into depositors’ deposits for the purpose of expanding the bank’s profitability through the purchase of securities for speculative purposes. Enactment of the Glass-Steagall Act completely removed any speculative agenda by the bank managers from the bank’s daily operation. This law brought confidence to the financial market, since investors were guaranteed not only that their deposits were insured, but also that the bank manager’s power for underwriting corporate securities was eliminated. In the contemporaries, studies show that, contrary to popular opinion, the bank manager’s involvement in the securities market was not entirely the responsible agent for the collapse of the banking system and financial market at that time.

There were several attempts at repealing the Glass-Steagall Act during its tumultuous life, and eventually it was amended by permitting U.S. banks to establish a separate entity that deals with the speculative portion of a customer’s portfolio, while the bank itself guarantees and safeguards the depositors’ deposits and conducts its operation by receiving deposits and packaging loans. The Glass-Steagall Act was eventually sunsetted in 1999. After repeal of the Glass-Steagall Act, the U.S. financial market has been experiencing full participation of the banking system in the financial market for speculative purposes. Federal Reserve and Securities Exchange Commission (SEC) examiners ensured that proper internal controls were in place between these two operations of the banking system. For further information, please see Footnote #7.

The U.S. banking system is regulated and supervised by the Federal Reserve and the Office of the Controller of the Currency (OCC). The OCC is the primary nationally chartered bank supervisory agency, whereas the Federal Reserve has authority over bank holding companies. The Federal Reserve conducts its monetary policy through banking institutions, and provides regulations for the bank’s required reserve. The FDIC and some various committees of the U.S. Congress also have authority over the banking system in the U.S. All foreign banks in the U.S. are under the jurisdiction of the federal and state banking authorities. For further information, please see Footnote #8.
Japan’s Banking System

Even though the Japanese banking system experienced a tumultuous period during the 90's, they are still considered a powerful force in financial, economic and lending activity throughout the world, especially emerging market nations. Japanese banks dominated the top ranks of banks, in terms of asset size, throughout the first half of the 90's before the Japanese banking crisis crept in and caused major restructuring and substantial changes in the late 90's and early 2000's. Their banking orientation is to provide finance for Japanese multinational corporations and loans to governments and corporations all over the globe. Cultural issues play an important role in the Japanese political, economical and industrial interaction in that society. For further information, please see Footnote #9. Japanese multinational banks are in close economic relationship with non-banking corporate entities, and this relationship is sanctioned by the Japanese government. The main focus of the Japanese banking system is similar to any other traditional banking system’s operation of taking deposits and packaging loans. Ever since the banking crisis of the 1990’s, the Japanese banking system changed their orientation from traditional banking activities to the new model of the banking system known as the universal model, which encompasses traditional banking operation plus securities market activity and industrial development loans. These changes revolutionized the Japanese banking system from the disastrous undertakings of the decade of the 90’s. For further information, please see Footnote #10.

Eventually, the universal model was eliminated and Article 65 was enacted. Article 65 was similar to the Glass-Steagall Act, separating the securities industry from the traditional banking operation. In the 90's, measures were taken to dismantle Article 65, similar to the measures that were taken in the U.S. for repealing the Glass-Steagall Act. For further information, please see Footnote #11. Globalization of the financial market caused the decline of traditional banking operations in Japan, those of deposit taking and loan packaging, and introduced Japanese banking into the global market as a provider of a wide range of financial services.

Large Japanese corporations held a large amount of shares of a particular banking system (city banks), and the banks carried out a large percentage of the financial activities of the said corporations. This close relationship guaranteed the financial health of both entities. Though, from an operational standpoint, everyone benefited from this relationship, it closed the door for any outsiders to establish a relationship with the banks, especially in acquiring equity. The consequence of this close-knit relationship was enormous, as far as the Japanese economy was concerned. For instance, Japanese corporations’ dependence on bank financing created a situation in which the Japanese economy became dependent on the financial support of large Japanese banks. This, coupled with the high level of corporate debt, provided an obstacle for the capital market to become stimulated.

The Japanese banking system implemented a complete overhaul of its operational orientation in the late 1990’s, after experiencing a tumultuous era in the early and mid 1990’s. The overhaul included measures to be more prudent in loan packaging activities. Also, the overhaul brought a series of checks and balances within the banking system by establishing the Financial Revitalization Commission (FRC) that placed the Financial Supervisory Agency (FSA) under its control, which is the primary bank supervisory agency. For further information, please see Footnote #12. We can conclude that the Japanese banking system is a great testimony to the
process of globalization of financial services and banking activity that one cannot escape. Since Japan is a member of the G-8 industrial countries, measures are being taken to eliminate the functional barriers for banking operation that have existed between Japan and the other members of the G-8.

**European Banking System**

The banking orientation in the European Union (EU), like every other advanced industrial nation, is universal in nature, which makes no distinction between the securities market and traditional banking activities (underwriting securities, insurance services), and is governed by the rules and regulations enacted by the EU. For further information, please see Footnote #13.

Because of their geographical proximity and several hundred years of historical commonality in the evolutionary processes of IB activities, all nations within the EU are experiencing a high level of economic development that guarantees long-term financial health of the international banks which have a presence in large European cities.

Like every other commonality that exists among the European nations, such as political, economical and social, the IB system is also experiencing standardization that can compliment other aspects of the EU’s financial and economic life, such as bank consolidations and inclination towards incorporating financial market activity into the operation of the banking system. This new menu of financial services offers customers portfolio packaging coupled with traditional banking services of deposit taking and loan packaging. Additionally, standardization of the currency (Euro) is creating a ripe environment for economic development and financial activity by the IB system that is removing some of the cultural barriers that existed before the European unification. All foreign banks fall under the jurisdiction of the banking authority of the EU. For further information, please see Footnote #14.

**United Kingdom**

Because of its historical importance, and a banking system with economies of scale, England is the most important member of the EU, as far as IB is concerned. The United Kingdom’s banking system can be categorized into four (4) different groups: 1) clearing banks (active in financial services such as export finance, corporate finance, foreign exchange, advisory services, and IB); 2) building societies (active in the residential mortgage market, life insurance, pensions and investment products) with 200 years of banking services experience; 3) investments banks (active in providing financial services to United Kingdom corporate entities); and 4) foreign banks (providing security and investment services, since London is the host to several hundred representative offices and security houses, thus making London the leading financial institution internationally).

The Bank of England is the primary regulatory institution within the United Kingdom. The regulatory authority over building societies is the Building Societies Commission. The regulatory bodies of the banking system in the United Kingdom were consolidated and known as the Financial Services Authority (FSA), working under the auspices of the Bank of England. For
further information, please see Footnote #15. Since England is a member of the EU, its banking system falls within regulatory authority of the EU Banking Commission.

**France**

France, as an EU member and one of the largest industrial economies of the world, plays a very important role within the EU and globally, as far as IB and finance are concerned. Like every other international bank, whether in the EU or outside, the French banking system has gone through considerable changes, such as privatization and consolidation. Like their European and international counterparts, the main orientation of the French banking system is universal banking, which offers a wide variety of financial services to its clients within France and the EU as a whole in addition to the traditional banking services of deposit taking and loan packaging. The French banking system is comprised of savings institutions, retail banks and specialized banks.

The major catalyst for changes that occurred in the French banking system in the past 20 years was the advent of the socialist government in 1981. This major political change was the responsible agent for the banking system to become nationalized, which resulted in the massive deregulation of the banking system. Even though these changes significantly helped the social fabric of the French society, the idea of banking system nationalization eventually evaporated.

Aside from being regulated by the EU Banking Commission, the French banking system is under the jurisdiction of the Commission Bancaire, which is a subsidiary of the central bank in France known as Banque de France. Banque de France has jurisdiction over the Credit Institutions and Investment Firms Committee, which is responsible for approving credit for investment institutions. The Banking and Financial Regulatory Committee is responsible for enacting regulation for both credit and investment institutions. The activities of these two institutions and their staff are coordinated by Banque de France. The Commission Bancaire has authority over all credit institutions and their financial health. The Central Bank of France (Banque de France) has the function of lender of last resort, similar to the function of the Federal Reserve System in the U.S. For further information, please see Footnotes #16 and #17.

One can conclude that any political changes in France will most likely influence the banking structure and its orientation, since economic ideology is very strong among French nationals.

**Germany**

As with many other European counterparts, universal banking is predominantly practiced in Germany. The German economy is the strongest among EU nations and the third largest in the world. As a result of being highly industrialized and being the third largest economy in the world, the role of the German banking system in the domestic economy and worldwide involvement in trade and loan syndication cannot be ignored. The German banking system can be grouped into commercial banks, savings banks (local, state and central) and cooperative banks. As such, aside from playing a major role of providing financial services (universal banking), German banks are also involved in a traditional banking operation of deposit taking and loan packaging. Having the flavor of a socialistic economy, German savings banks’ main
orientation is towards enhancing economic development that advances the welfare of the society from its foundation. Major international banking activities are conducted by Germany’s commercial banking institutions. The German banking system is regulated both by the institution known as the Supervisory Office and the Central Bank of Germany. For further information, please see Footnote #18.

Since the globalization of economic and financial activities reduced the gap between major industrial nations and emerging market societies, special attention is given to the relationship between the banking system and economic and industrial development. At this point, we will discuss some of the banking systems in emerging market economies.

**Mexico**

Historically, the Mexican banking system, like every other developing nation’s banking system, evolved from the traditional banking activities (deposit taking and loan packaging) into offering financial services and portfolio management (universal banking). Mexican financial regulation authorizes foreign banks to operate in Mexico. In the past two decades, the Mexican banking system has gone through major changes, such as nationalization, privatization, and economic crisis, and almost collapsed during the early 1980's. Mexico was forced to reschedule its external debts, since it was experiencing a severe economic crisis at the time. Consequently, the government nationalized the banking system in order to control economic decline. This process provided a cheap source of funds to the government agencies for their expenditures. A massive vacuum was created as a result of this process that led to the crowding-out of private investment (known as the crowding-out effect, which means when the government borrows a large amount of capital in the financial market, it leaves private investors with little opportunity for borrowing activity). For further information, please see Footnote #19.

Mexico’s banking system was deregulated in the 90’s, and the major focus of the banking operation was directed towards loan packaging and credit services. Deregulation, coupled with major corruption in the political and financial systems, incompetence, and a lack of central control, resulted in major risk taking by the banking management and brought a banking crisis into the Mexican economic theater. The high interest rates in the Mexican economy at the time forced the private sector out of investment activity, which compounded the problems with the Mexican banking system. For further information, please see Footnote #20.

The banking system in Mexico endured serious hardship from the 1994 peso crisis (the Mexican currency). The economic system, in line with the banking system, suffered a great deal since a higher interest rate made borrowing and the cost of capital very high. The demand for economic products declined, and the private sector’s borrowing capability declined drastically. Consequently, the Mexican bank’s loan portfolio declined significantly. As a result, several entities were established to monitor the banking activity and provide a system of checks and balances. This was similar to the U.S. banking crisis of the 80's, where the U.S. government created an entity known as the Resolution Trust Corporation (RTC). Though its function was different, its existence helped the consolidation and overall health of the banking system in the U.S. Also, a major campaign concerning the health of the Mexican economy was conducted to allow foreign investors to invest in the Mexican economy, an activity from which they were
previously prevented, since the Mexican banking system was heavily regulated (I guess, since the U.S. and Mexican war that led to the ownership of Texas by the U.S., there was a certain level of distrust for investment activity by the “Yankees”).

The Mexican banking sector endured a series of struggles during the mid- and late 1990’s. The Mexican government’s program of bailing out the banking system partially prevented the collapse of a major banking system in Mexico. Even after a massive bailout by the Mexican government, Banco Serfin, one of the largest banks in Mexico at the time, had to embark on a major overhaul of its operation to become profitable. The Mexican banking crisis eventually led into a massive bailout by a consortium of foreign multinational banks that eventually brought stability to the Mexican economic system to the point that Mexico was able to pay back its loan. Today, Mexico’s economic and banking systems experience relative stability and Mexico is considered to be one of the advanced emerging market societies. For further information, please see Footnote #21.

Indonesia

When discussing the banking system in Indonesia, one cannot separate the political and corruptive influences in the banking system throughout Indonesia. The Indonesian banking system collapsed in the late 90’s, during the Asian Tigers (some of the Southeast Asian countries combined are titled so) banking crisis, and it went through a complete overhaul and reconstruction process. The collapse of the government of President Suharto exacerbated the deterioration of the financial market and the operation of the banking system.

The banking system in Indonesia is universal in nature with close and peculiar ties to various multinational corporations. The Central Bank of Indonesia is presently active in the restructuring process of the banking system. The Indonesian Bank Restructuring Agency (IBRA) was created to help the process of restructuring. Furthermore, steps were taken by the government of Indonesia to enhance public confidence in the banking system. For further information, please see Footnotes #22, #23 and #24.

India

The banking system in India used to be known to lack economies of scale and took many years to realize relative efficiency, due to the absence of available technology. Historically, the banking system in India was established and managed by the locals. Establishment of the first Indian commercial bank was a dream and aspiration of a banker that took pride in having an independent Indian bank devoid of foreign dominance.

The State Bank of India evolved administratively, benefiting from British bureaucratic discipline under Commonwealth status, but it was slow to realize the efficiencies of other banking systems in its counterparts. For further information, please see Footnotes #25, #26 and #27.
China

The Chinese banking system is diversified to accommodate many sectors of economic activity in the urban and rural areas of China.

Under socialist/communist ruling, China’s banking system functions as a government fiscal agent, rather than conducting western-style traditional banking. Though the old model of state banks was to channel capital to different industrial sectors of the country, this model is gradually being dismantled. The four commercial banks that were mentioned in reference #28 were established in the 80's, and a major overhaul of the banking operation was implemented in the mid 90’s. This overhaul is responsible for Chinese banks becoming more market driven and competitive with their foreign counterparts by replacing the old and antiquated banking system. Further changes in the banking orientation were implemented by the Industrial and Commercial Bank of China (ICBC) with consolidation of the core business activities and improvement of liquidity issues. The ICBC has developed a menu of services, such as project financing and investment banking, and continues to provide services required by the industrial sector of China’s expanding economy. With all the changes that have occurred within the Chinese banking system, their participation is limited when it comes to competing with foreign multinational banks, since the operations of the foreign banks are already restricted by Chinese banking regulations. Overall, the Chinese banking system offers limited financial services and it is not in line with the rest of the emerging market and OECD economies. New guidelines have been put in place with the emergence of the commercial banking system to enable them to provide financial services in line with those of the foreign banks.

Being a member of the World Trade Organization (WTO), China is forcing its banking system to become more competitive and improve their performance. The WTO required that China enact a liberal policy that allowed foreign banking systems to be able to compete with their domestic Chinese counterparts. China’s banking system is plagued with management incompetence that has resulted in massive risk taking when conducting banking transactions with customers, or conducting speculating activity in the financial market. There are few checks and balances within the Chinese banking bureaucracy to prevent risk taking activities by the bank managers, but steps are being taken to rectify the situation. The Chinese banking system is regulated by the Central Bank of China, known as the People’s Bank of China (PBOC). There have been continuous efforts by Chinese law makers to provide more latitude, in terms of banking operations and competitiveness, to the Central Bank of China that will trickle down to other banking systems, especially the other four large commercial banks that were referenced before.

With the expansion of economic activity in China, and their involvement into world financial and capital markets, China’s banking system is bound to take the necessary steps to educate the workforce, replace antiquated regulations, and solve liquidity problems within the four largest commercial banks, eliminating the Chinese government’s subsidization of the banking system. And lastly, the Chinese banking system needs to equip itself with modern technology to be able to compete in the world of e-commerce and internet banking. For further information, please see Footnotes #28, #29 and #30.
South Africa

The South African Reserve Bank plays an important role similar to the central banking of some of the industrial nations. Monetary policies (expansionary/contractionary) are devised and implemented by the said bank. They maintain the gold reserve and oversee the foreign exchange reserve. One of the functions of the South African Reserve Bank is to issue currency, and they are the fiscal agent of the government. The South African Reserve Bank’s macro-orientation is to help customers (savers and investors), government agencies, and other banking systems. Additionally, since they also play the role of “lender of last resort,” they help the banking system to avoid liquidity problems that could be harmful to economic activity and the financial market in South Africa.

The major challenge that faces economic activity and monetary control for the Reserve Bank is to control recessionary and inflationary forces that have been haunting this nation, with massive social deviations and issues such as racial tensions, political dynamism, and tribalism. The orientation of the banking system in South Africa evolved from the 1950’s to the present time.

A major overhaul of the banking system in South Africa took place in 1991, unifying the banking system with the financial market. As a result, the South African banking system provided more services to the underprivileged and satisfied the requirements for capital adequacy.

The South African banking system is enjoying a certain level of sophistication, due to the utilization of the most advanced technology from which the banking system can benefit. The South African banking system’s main orientation is similar to many other advanced industrial nations, such as traditional banking activities (deposit taking and loan packaging) plus portfolio management and financial market speculative activity. As the apartheid system gradually gave way to more inclusion of everyone in the society, the country benefited from this process by removal of the economic sanctions that had been imposed on the South African nation by a large majority of the nations around the globe. This removal of economic sanctions further improved South Africa’s global identity and consequently created economic vitality for the nation.

The ultimate banking authority in South Africa is the Registrar of Banks that oversees and regulates the South African Reserve Bank’s operation. For further information, please see Footnotes #31 and #32.

Russia

With the collapse of the Soviet Union, the Russian banking system faced major challenges such as going through the transition from a government controlled economy to a market controlled economy. Just to deviate briefly from the subject of the banking system, I would like to give my humble opinion, as far as the collapse of communism and eventual disintegration of the Soviet Union is concerned. Many believe that Ronald Reagan had something to do with the collapse of the Soviet Union. However, for every political and economic ideology, there is a birth and there is a death. The birth occurs as a result of necessity, since the masses believe that the existing system is corrupted and antiquated, and through either peaceful or violent resolution, the system changes through the process of action/reaction, thesis/antithesis, and cause/effect. Political and
economic history is a testimony to the fact that reactionary forces revolting against the existing ruling sector caused political and economical changes within the society where the process occurred. The collapse of the Soviet Union was the result of the failure of a doctrine that promised and promoted economic and political freedom to the masses, but was unable to bring it into reality.

The administration and orientation of the financial system, hence banking operations, were controlled by the state. Therefore, the central bank was under the control of the State of the Soviet Union, which managed all banking operations, including credit requirements, currency, and checks and balances.

After the collapse of the Soviet Union, Russia made advances in the operation of the financial market and the banking system in conjunction with the assimilation of the market economy into Russian society.

In the old Soviet banking system, state banks allocated credit throughout the economy under political pressure, and played the role of the state’s fiscal agent. After the collapse of the Soviet Union, the Russia’s economic system shifted from a centrally-planned economy to a market-oriented economy. This inevitably meant that the banking system needed to provide services that the new system embraced.

The Russian banking system is still going through a necessary transition in order to meet the challenges brought by globalization, but the path of this transition has been relatively difficult and often plagued with repetitive crises. The Russian banking system is universal banking in nature. As we mentioned before, since the collapse of the Soviet Union, the Russian financial sector and banking system made major advances while transitioning from the centrally controlled economic system to a market economy.

The Central Bank of Russia oversees and regulates the banking system and is the lender of last resort. The Russian banking system has gone through a tumultuous period from the time they embraced a market oriented economy. The transition has been hard, since a market economy brought a certain level of transparency and economic greed, coupled with incompetent bank managers and regulators. Russia was invited to join the then G7 industrial nations as a guest, since they still maintain a certain level of political, economical and military influence. (With all that, you have to be very careful how you treat Russia, since they have roughly 20,000 nuclear warheads, and you know sometimes anything goes). For further information, please see Footnotes #33 and #34.

**Islamic Banking**

A quote of Islamic Law dictates that interest cannot be collected nor paid by lenders and borrowers, respectively. Borrowers are obliged to share a percentage of the profit realized from the borrowed funds with the lenders. With the modern banking system and globalization, this law is becoming a major challenge for the IB operation in strict Islamic societies that enforce the usury law. Like any other financial market and banking system, the Islamic society has gone
through major changes/challenges and evolved from the 19th century to the present time, enduring the colonialist rule dictating economic activity and trade.

Unlike all the western banking systems whose operation and survival are based upon collecting interest – the sole motivator for the creation of banks – as mentioned above, the Islamic banking system follows a religious edict and belief that dictates prohibition of usury in the process of banking operation. In the western banking style, when a loan is given, the borrower must pay interest when borrowing money and must compensate the lender within an agreeable period of time. This process of the western style banking activity is forbidden. Instead, the borrower pays to the lender a certain percentage of the profits that he gained from the borrowed assets in the form of compensation to the lender.

Full implementation of the Islamic banking code requires Islamic countries to take a major step in the area of eliminating the economic business cycle and instituting legal and institutional reform. Although it is difficult for many multinational banks to change their operation and orientation to compliment the Islamic banking codes, there are a few multinational banks, such as Citibank, that are successfully operating in some Islamic societies. The operation of the banking system in Islamic society is not only achieving profit, they are also expected to be in the forefront of the social responsibility for the less privileged. The most prominent Islamic bank is the Islamic Development Bank.

With the rapid advancement in the financial, economic and international trade activity brought about by globalization and the invention of the Internet, Islamic societies are compelled to make necessary adjustments in the areas mentioned above. These adjustments must be made in order to attract a higher level of foreign investment to stimulate domestic economic activity, which will increase employment and the standard of living. For further information, please see Footnotes #35 and #36.

**Conclusion**

During this module, you gained knowledge of the development of different banking systems throughout the world. With that in mind, you should also be able to examine the cultural and political parameters that were contributing factors to their distinctiveness.
FOOTNOTES

(1) What is an Emerging Market Economy?
http://www.investopedia.com/articles/03/073003.asp

(2) Universal Banking

(3) Organisation for Economic Co-operation and Development
http://www.oecd.org/home/0,2987,en_2649_201185_1_1_1_1_1,00.html

(4) Financial Supermarket
http://www.investopedia.com/terms/f/financialsupermarket.asp

(5) Federal Reserve
http://www.federalreserve.gov/pf/pf.htm

(6) What Was the Glass-Steagall Act?
http://www.investopedia.com/articles/03/071603.asp

(7) United States Securities and Exchange Commission
http://www.sec.gov/

(8) Office of the Comptroller of the Currency
http://www.occ.treas.gov/

(9) Japanocentrism
http://www.newworldencyclopedia.org/entry/Ethnocentrism#Japanocentrism

(10) Japanese banking collapse threatens IT sector
http://online.wsj.com/article/SB10001424052970204313604574327783590022854.html

(11) The Bank of Japan Law
http://www.zenginkyo.or.jp/en/banks/banking_regulation/

(12) Statement by the Governor concerning the temporary nationalization of the Nippon Credit Bank
http://www.investopedia.com/terms/f/financial-services-agency-fsa.asp#axzz1s8BMAfvh

(13) European Financial Regulation
http://www.riskglossary.com/articles/european_financial_regulation.htm

(14) Law & Policy – Banking guidelines to highlight impact of EU ecommerce laws
http://en.wikipedia.org/wiki/European_Banking_Authority

(15) Financial Services Authority
(31) South Africa – Banking  
http://countrystudies.us/south-africa/70.htm

(32) South Africa’s financial sector  
http://www.southafrica.info/doing_business/economy/key_sectors/financial.htm

(33) Russia – Banking and Finance  
http://countrystudies.us/russia/62.htm

(34) Russia – Reform of the Banking System  

(35) Islamic Banking  
http://users.bart.nl/~abdul/chap4.html

(36) Islam, Globalization, and Economic Performance in the Middle East  
http://www.policyinnovations.org/ideas/policy_library/data/01326/_res/id=sa_File1/