



Economic Theory

Vitalina KURYLIAK

**CONFIDENCE IN INTEGRATED
WORLD ECONOMY:
THEORY AND PARADOXES**

Abstract

The present paper is concerned with confidence as a factor producing the essential effect on financial markets. Theoretical approaches are formulated to ensure confidence of market participants. Tendencies and regularities are substantiated of the confidence formation on Ukrainian and global financial markets.

Key words:

Confidence, non-confidence, paradox of credibility, world economic order, new financial civilization, world economic crisis, culture, cross-cultural aspect.

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*Trust is the only key to success
in human – oriented work.*

(From manager's notes)

Introduction – Problem Definition. The world economy provides a sophisticated integrated system. It is described by globalization and regionalization, international flow of capital and labor force, interstate multilateral economic relations, internationalization and trans-nationalization of production, authoritative systems of state and supra-state regulators, net communications, and scientifically developed management technologies. The world civilization processes took an important place and till recent time poorly investigated area in the development of economy. Among them the confidence problem comes to the fore, the effect of which is manifested against the backdrop of crises. In particular, this is realized in the process of actual global economic and financial crises, when the necessity became acute to keep confidence in economic, financial and state institutions concerning their capacity to perform their functions effectively, and to cooperate.

Application of traditional methods and development of new ones for establishment and keeping confidence is an urgent need for running business both, within the frames of national economy, and on the supra-national level. While in the past, confidence was an essential identifying feature of international political relations establishment, in modern conditions it becomes an essential feature of relations in economic area. Eventually, confidence serves the basis of the formation of a new global economic order. Underestimation of this civilization and cultural factor brings about different kinds of crisis phenomena, specifically when non-confidence acquires a total character. As Academician V. Heyets regards, just because of public confidence deficit in the government the Ukrainian state appeared to be unable to pull out at least UH 400 bln. (40% GDP) from shady circulating and attract about \$60 bln. of people's private investments [3].

The crises of the 20th-21st centuries demonstrated that the problems on the financial market occur because of loss of confidence in institutions performing monetary and credit transactions, secure securities circulating, and provide other financial services. John Keynes when estimated the consequences of the 30-s crisis in past century found the most destructive component in the crisis of confidence. He wrote: «Financial market is functioning stable till its all participants are in the state of confidence», that in its turn has a significant subjective component [5]. That requirement was completely corroborated in Ukraine during the latest world crisis. In particular, during 2006–2007, and the first half of 2008 under the average exchange rate of hryvnya to dollar of 5.05, the meltdown of hryvnya occurred in the second half of 2008. By the experts' estimates, the «psychological barrier» making its devaluation impossible made six hryvnyas to

dollar. Nevertheless, the National Bank of Ukraine was not able to keep the exchange rate within those limits. In October-December 2008 it depreciated by 58.4% and from the beginning of 2009 – by 52.5% [9; 11]. That shook confidence in state institutions responsible for monetary policy, and brought about the aggravation of the situation on the financial market. In October-December the total volume of deposits in national currency decreased by 13.7%, and in foreign currency (dollar equivalent) – by 8%.

Hryvnya devaluation has become the first and the main reason why Ukrainians lost their confidence in banking system and, respectively, why the crisis of the system deepened. However, even more essential reason for enhancing the atmosphere of non-confidence in banks was the wave of tightening liquidity of commercial banks, and designation of provisional administrations by the National Bank of Ukraine, alongside with introduction of moratorium on meeting the creditors' demands. In fact, the moratorium did not cover the liabilities according to the agreements on bank deposits, as well as the liabilities concerning money transfers within the limit, set by the provisional bank administrator and agreed with the National Bank of Ukraine. As for 1.05.2009 thirteen banks were functioning under provisional administrators. The authorities of the latter were appointed for a year-long term under introduction of the moratorium on meeting the creditors' demands for six months, which by some experts' estimates is groundless from juridical point of view and economically not justified.

Consequently, the problem topicality is conditioned by both, the development of global and national economies, their essential aggravations, and insufficient attention paid to this problem research. The latter was and still is something like «an invisible mouse» in economic thought. But the global and financial crises exacerbated it. Though we can not say today that the problem of confidence within the system of economic relations in the aspect of its research have found complete understanding.

For Ukraine the topicality of the confidence factor research is critical, since it is extremely low-rated. In that connection, it is worth citing the findings of the 1999 European survey on values. According to that survey, a number of those who agree with the idea that «the majority of people could be trusted» makes in Ukraine 27.2%, in Belarus that figure is 41.9%, and the similar average European index makes 30.7%. Actually, that figure in neighboring countries is even lower, making in Lithuania 24.9%, in Russia – 23.7%, in Poland -18.9% [21]. At any rate, the resource of confidence in Ukraine is low, and there are no grounds to expect it to grow recently. It is just on the contrary, there are more grounds to claim the adverse.

The objective of the paper is to systematize materials concerning the role and place of confidence in the system of economic relations, its effect on the development of economy, and revealing of tendencies for confidence growing within the system of market relations, specifically in the financial and banking area.

The Problem substantiation. From the view of the confidence factor growing both, in the current results of economic activity, and in the fortune of national economies, as well as in the formation and functioning of integrated world economy, there is an urgent need in the development of relevant theoretical basis. Traditional economic theory did not operate the category of confidence. There could not be essential objections that it is connected with belief in the domain of spiritual life. Though from the view of formal logic that explanation can not be watertight, since political economy treated economy as the relations among people in the area of production, distribution, exchange, and consuming. That phenomenon might look more exact when it were explained by the fact, that the confidence factor in the past did not produce significant effect not only on the world and on national economies, but also on business economy.

However, as S. Yurii and Ye. Savelyev write, «a new financial civilization has a philosophy of confidence in its basis» [15]. Close to this point of view is A. Halchynskiy's position, who, proceeding from general historic foundations of global transformations, determines within the structure of economic relations the market and trans-market ones. « In appliance with that,- he writes,- global economy is defined not as an object-subjective, but as a subject-objective system of economic relations, where the weight of post-material values, principles of economic freedom significantly increases, when the area of individual choice, moral and psychological, and religious assessments expands, and at the same time, the function of rational economic determinants weakens» [2, 7].

Lack of the developed theory of confidence in the system of economic relations does not imply that this category was not researched by economic scientists. J. Keynes was the first who studied it from the view of searching the ways how to regenerate economy in the period of crisis surmounting. He considered confidence as a factor the lack of which makes the growth of real production impossible. Nevertheless, it should be preceded by the actions of public power in financial economic support. «The following speculations refer to the technique of the regeneration itself, the object of which is the increase of national product and employment of people, – wrote J. Keynes in his open letter to the USA President Franklin Delano Roosevelt. – In modern economic system all manufactured products are for sale; and the volume of production depends upon the purchasing capacity. The latter is included into initial value of product, that is expected to be entered the market. In general sense, the production can grow having at least one out of three factors functioning. That impulse could flow either from business, or from the increased confidence into future, or from low interest rate, that is, all that which creates marginal revenue of the employed workers, and that occurs when variable or durable capital grows. In addition, public authorities could be called for providing assistance in securing extra current income through spending borrowed funds, either through cash issue. In hard times one can not expect that the first factor will become somewhat essential. The second factor starts functioning as the second wave of attacking the crisis outcomes after the regeneration has begun on account of money expenditures of public power. That

is why we can expect the initial main impulse be made specifically by the third factor» [23].

Modern theories of social and economic sciences concern confidence as a key characteristic, which distinguish the developed society from other societies. It has the overall scales implying that it pertains to the relations not only on the level of certain individuals, but also in the area of public and governmental institutions. Eventually, the category of confidence is viewed as a specific organization of the society and its inter-state relations. After Fukuyama classification, societies with the highest confidence rates are exclusive ones. Their exclusiveness consists in the fact, that they had been formed, developed and are functioning on the basis of confidence. These societies include the states with liberal democracies, i. e. USA, Germany, and Japan. Other European countries, likewise traditionalist countries (China, India, Mexico) belong to the societies with lower indexes of confidence rates. «Easier production, invention of «Toyota» Corporation, that will illustrate the public innovation, enabling to occur specifically in the society with high confidence rate» [13, 14].

Confidence is a specific factor within the system of human capital formation. The majority of qualities connected with culture and science, the individual is able to develop by him/her self. To earn confidence, either to develop mutual confidence is possible exclusively within the system of social relations. According to Fukuyama, the terms for confidence establishment are the following: integrity, responsibility, ability to cooperation, call of duty before milieu.

Confidence scopes often determine distinguishes in economic regimes of different countries. In the societies with prevailed values of consanguinity and at the same time the distant relationships of low confidence rates, the businesses prevail in the forms of small family enterprises. The active non-state economic sector has been successfully developed in the countries with the developed nets of educational institutions, hospitals, churches, benevolent associations. However, that sector is created on non- families principle. From that view, it is fairly easy to explain arise of big modern corporations with effective systems of organizations and management in the USA, Japan, and Germany. It is just in these countries with different bases of spiritual life where rather high level of confidence existed out of family relations. As a result, these countries gained significant growth of human capital.

The growth of confidence role in the system of economic relations is not random. Its roots are in civilization processes. The humanity switched into a new type of civilization development, when the innermost objective was «to live in abundance». At the moment, another objective is added, that is «to live in culture». The term to denote theoretical grounding of a new type has not been yet finally developed, though the most commonly used are the following: post-capitalist, post-industrial, post-economic. The essential thing is that the economic matrix alongside with traditional components, like market, investments, and profit intervenes with the civilization ones, like moral norms, partner confidence, and social justice. It is not accidental, that in the category of «economy»

the definitions appeared related to information and knowledge, since its development is impossible today without mass media, Internet, international cooperation, creative work, and self-actualization.

The researches of social and economic sciences show that the interest horizons on every level of business relations are limited. In addition, they often oppose each other, and manifest themselves in more or less confrontation form. As a result of that kind of interactions development, «society happens to be split by private and corporate interests, mutual non-confidence, when the state does not trust in business, and the latter in its turn, does not trust in the state, while the citizens do not trust in both» [12, 5–6].

That situation is often taken indifferently, especially when general results of the activity are positive. Nevertheless, in case of certain problems arising, especially the crisis that kind of psychological bubble is immediately bursting. It enhances crisis phenomena and is able to cause the economic meltdown, firms' bankruptcies, governments' resignations, etc. Then not only significance of common interests, moral foundations and traditions is understandable, but also necessity to continuously support and keep to them. Proceeding from that, the economic and political elite should realize the most important rule, saying that production and social relations should be built on the culture of confidence in partners, clients, and average citizens. The western experts, who study the organization of information flows in Internet, began to refer more often to the problem of confidence in research literature. In general, they proceed from the notion that the word of «confidence» is usually understood as the synonym of «truth» or «truthiness». Also the western experts draw attention to the fact that the notion of «confidence» is juggled with disinformation through spreading rumors or information designed to cheat others. Proceeding from that, the need arises in assessment, control and selection of net information [16].

General theoretical searches oriented at the information organization requirements in Internet system, are also critical in economy. It is worth accentuating such aspects of confidence as comprehensive and timely information [17]. Moreover, Internet and economy have such features in common as global scales and need in communication nets. What is implied here is that only these decisions are worth trusting which are developed and taken on the basis of sufficient and timely received data.

Among the factors enabling to assess information and believe it, a significant role belongs to intermediates. Their task under the condition of intensive and ramified structure of information flows consists in competence to select the qualitative implying the true and essential information. It means that the intermediates should be not only the means of information transmission, but also they should be able to transfer to the consumers its necessity and usefulness. In this respect, we can refer to the role of the known international sources of intermediate information like CNN or BBC, having the highest confidence rate throughout the world.

The confidence should be viewed as one of the most important resources of economy. The development of economy in the conditions of confidence in the government and belief in sustainability of national, and moreover, global economic system significantly decreases the need in circulating funds required for business-processes. Availability of confidence is a basis for optimization of the costs for insurance of risks and costs of crisis-proof measures. On the contrary, «in the conditions of confidence decrease in the state, mass unemployment, increase of wage debts, detention of pensions and scholarships, so called bank collector practices with respect to their borrowers could rapidly bring about negative consolidation of the lest protected strata of society» [1, 59].

Theoretical analysis of the confidence problem in the development of economy from the position of classical and neo-classical schools can not produce the essential result, since economic theory does not include it into its categories. Value, price, demand, profit, and other economic categories traditionally are viewed narrow (rather one-sidedly) within the frames of the economy of supply that is a self-regulated, specifically market-wise system with a sovereign consumer. However, in the conditions when the development of production depends upon big corporations with complicated management systems embodying economic power; when the necessity in economic order based on the ideas of conformity to plan grows not from ideological, but from pragmatic positions; when the economic development is regulated by the state, trade-unions and when it is effected by different phenomena of legal, moral and ethic, and psychological character, that approach to understanding the essential features of modern economic development is obviously scarce. In the 1960-s J. Galbraith wrote, that the industrial system is mostly characterized with the scope of modern corporate entrepreneurship [4, 117]. Alongside with that, the increased role of T. Webler «cumulative causal principle» according to which the progress is determined by causal interaction of different phenomena (both, economic and non-economic) which enhance each other.

Consequently, the present results and outcomes of the activity of Adam Smith homo economics can not be put within the frames of economic analysis. At that, a specific place belongs to autonomous variables covering culture, science, and politics, and which reflect the activity of a «live wire» against so called «economic» and «rational» individual. It should be taken into account that power in matured corporations gradually deputed from the owners to technical structures. Within the frames of the latter a new social class is being formed, that consists of scientists, constructors, technologists, managers, and financiers, and which step by step owns the first positions in economy due to its right to participate in taking strategic decisions and control over property [18, 412].

From the view of impossibility to solve new problems of economic development on the basis of the categories pertaining to economic theory in its classic and neo-classic interpretations, the institutionalism theory started developing since the beginning of the 20th century, having the expansion of economic analysis scopes through the application of allied sciences achievements as its objective. That direction of scientific researches was formed in a deductive way,

moving from «the principles of neo-classic economic theory towards the explanation of concrete phenomena of social life» [10]. At that, the notion of «institutionalism» implies, on the one hand, norms and customs of people's behavior in the society, and on the other – «institutions», or consolidation of human values in certain laws and organizational formations. From those positions confidence has in its basis cultural roots, which develop in early period of a man's life in the form of cross-personal trust. That early socialization grows with time into the capacity of homo economics to create and keep up confidence in the system of production and business relations. Eventually, confidence appears to be a component of human capital. If we take confidence for an element of human capital, its accumulation requires certain time, and as a rule, it is a long-term period. It can not be one-time investment. Confidence needs constant corroboration of loyalty to achieved agreements, following those agreements, in particular, in extreme situations connected with risks manifestations and economic entering the phase of crisis. Instead of that, to lose confidence in the system of economic relations one can instantly, and for a long time, or even for ever. Proceeding from the fact that economic crisis is of a wave-like character, on its new stage, according to S. Bukovynskiy, T. Unkovska and O. Yaremenko, « the most destructive effect is produced by loss of confidence caused by the disorder of currency flows of systemic economic agents. On the one hand, the reverse relations become stronger, exacerbate crisis processes and enhance general ambiguity, and on the other – their matter and character differ from the initial crisis impulse. Some actual crisis events occur in other plane; therefore the measures developed and aimed at the initial stage of crisis are not succeeding» [1, 58].

In cultural sense confidence can be viewed depending on the level of research, i.e. micro-, mezzo or macro-economic. It is probable, that in the system of economic relations the personified confidence manifested in the form of interpersonal integrity takes an exclusive place. It can grow into the confidence in these or those economic agents, in particular, in industrial enterprises, banks, insurance companies, and economic associations. At the same time, in authoritarian economic associations pertained to Central and Eastern Europe, including Ukraine, the confidence in the institutions of economic power is very low as western analysts note [21].

In cross-cultural aspect it is worth pointing out the so called sphere of confidence that determines the sphere of interpersonal confidence and the effect of its expansion on micro- mezo, and macro-levels. In any society it begins with the initial cell, implying family or clan, out of which everything is either impersonal, unmeaning, deprived of individuality, or hostile. In that confidence range there dominates corruption, avoidance of taxation and other civil duties, and bellicose incompetence. With the increased level of civilization in the country, the confidence range transforms from close family relations to moral and ethic ones in the direction of essential increase of the role and place of the latter. It promotes the consolidation of both, decentralized and centralized structures. Then there is no need in creation of many mechanisms for controlling the activity of employed workers and managers.

Expansion of confidence range is an important factor for increasing the international trade effects. For its measurement traditionally L. Guiso method is applied. The author uses genetic closeness and religious relationship, as well as military history as the basis of measurement. The results are impressive, since 1% of increased confidence ensures one third of exports growth [19]. Other researches also demonstrate the effects of trade liberalization and economic integration [23].

Today there are a great many of publications which analyze the reasons of recent global crisis. Among them the mechanism of creation of financial bubble on mortgage market takes an important place. We can not help agreeing the point of view of I. Kravchenko and H. Bahratyan that, by the way, is dominant with respect to the fact, that in the USA «mortgage credits grew immensely. When at the beginning of George Bush administration only 1.5 mln. of Americans annually used the system of mortgage crediting, in early 2007 they were 8 mln. It is not surprising, that for eight years of that administration, when the rates of economic growth sharply fall (comparatively with eight year term of Bill Clinton administration) the budget deficit again arose, external debt began to grow, the USA were involved into two wars (Iraq and Afghanistan). At the same time, while taking mortgage credits Americans instead of renting at last gained their «own houses» [7].

However, the available researches are not concerned with the confidence factor, which essentially was put into the basis of so called sub-prime mortgage loans; the mechanism of the latter was developed by Wall Street «creative financiers». The sub-prime mortgages imply the loans issued to the clients with the problem credit history, low incomes or absence of funds for initial payment. The method of risk averting consists in risk distribution of insolvent loan debtors among great and very great number of them. In fact, the first wave covered certain banks, first of all Citygroup and UBS, the second one – mortgage agencies, among which the first happened to be IndyMac and Bancorp Inc. The regulators are blamed for recent crisis because of ignoring the crediting fundamental principles, i.e. orientation at the incomes and assets of borrowers. The peculiarity of sub-prime mortgage loans became the assumption that in case of default the cost of house will always exceed the loan value. Finally, the chain within the system of sub-prime mortgage loans is rating agencies, who worked with sub-prime models of rating assessment of complex structured sub-prime debts. In addition, investors (like pension funds) did not spend their funds for their own systems of risk rates, but completely relied on rating agencies.

As we see, the principal chain in the system of sub-prime mortgage loans, the client, has been over suspicion. The ECB Governing Council member and the Governor of Central Bank of Finland Erkki Liikanen describe that business model in the following way: «Clients were issued loans without any additional requirements. They were believed, accordingly they received credits and paid them, and the interest rate was low. The sub-prime borrowers implying these with low payment capacity had to be doubted either they would be able to pay

back the credits. Nevertheless, since prices for realty grew the situation with involvement of sub-prime borrowers was viewed acceptable [8, 46].

Proceeding from that, we can consider that the sub-prime mortgage was based on absolute confidence in the client. In its pattern it is something like relations in the detention facility for the under-aged, and like Anton Makarenko idea of bringing up «a new man». But it was only the pattern that was similar against its matter, since in Makarenko's facility the control was made by means of the rouble, since in fact Makarenko created the commercialized structure where the commune members produced electric appliances and photographic technique in Austrian technology and gained rather big profits. In case of sub-prime loaning one should account for the confidence in the agreed facilities that its developers managed to have. However, the agreed facilities appeared to be unprotected.

From the situation with the sub-prime mortgages proceeds the single conclusion of general character, i.e. with the increased confidence on the market its participants' activity grows, and economy begins to grow; the lower confidence on the market is, the more rational and reserved its participants are, even at a time when they should act vigorously, which eventually brings about the reduction of economic growth rates, and in case of increased scale of confidence causes crisis.

The innovation synergy theories for the analysis of critical state of economic system could serve as theoretic grounding for digesting the factor of confidence in the development of economic processes. These theories provide interdisciplinary area for researching the systems of non-linear dynamics, immoral behavior, effects of self-organization, availability of chaotic regimes, and bifurcation. The essence of them could be explained to some extent by the facts that became the impetus for serious scientific generalizations. In 1963 meteorologist E. Lorenz tested the model of air conditioning, which he had developed using the system of differential equations. At first the computations were made accurate to the thousandth. Then the results were checked through computer using six digital figures. The compared results revealed significant divergence between the first and the second computation. The scientist could not assume that the insignificant change of information basis could bring about great divergence. The made analysis led him to formulate the phenomenon as a dynamic chaos [15, 11].

From the view of the chaos theory ideas there are many reasons to assume that the behavior of the agents of economic processes is rather prognosticated. Having taken their state through certain time as an initial point, we can detect what would happen to them in future. However, the minor inaccuracy in determination of the initial system state in the course of time will increase unpredictability to lose the prognosticated capacity, specifically respectively determination of time when the critical state occurs.

Today the theories of critical state are developed under different titles. Thus, in Germany it is called synergy, in French-speaking countries – dissipative structures, in the USA – theory of dynamic chaos. For the economic science that theory's results are very important concerning nature of crises and the ways of

their surmounting. These researches in socio-economic aspects are on the initial stage. Nevertheless, they are proceeding so intensively, that there are good grounds to expect soon significant results. It is worth paying attention to the theory of crashes investigating the self-organizing systems in terms of «bifurcation», «attractor», «instability», as well as the theory of changes with its notions of «jump», «phase transfer», and «crash».

While relating the innovation synergy theories to the problems of confidence within the development of economic processes, we should note that the confidence is persistent up to the time when certain doubts and suspicions arise concerning the reliability of actual relations, available partners, taken decisions, etc. These phenomena are taking place when certain grounds come to the fore to doubt the available matter of things. In recent years these situations are observed, for example, in trade and economic relations between Ukraine and its strategic partner the Russian Federation. Some doubts have recently arose concerning dollar reliability as the currency of international reserves, and the currency exchange policy of National Bank of Ukraine. The citizens of Ukraine feel great suspicions regarding the earnestness of politicians' intentions to implement their declared reformation programs. That chain can be prolonged. And in case of not keeping to the given promises, when the facts of cheating occur, the doubts turn into disbelief. The latter is followed by the stage of crashing the system of relations, which could take form of chain reaction. The industrially developed countries are known to conclude many agreements orally and in large sums of money. A word of honesty here serves for the best seal. However, breaking the word given at least to one partner could make the violator bankrupt, since other partners would not believe him, and they would try to stop business with him.

Consequently, the effects of non-confidence could be explained in the following way. A minor reason disturbs the system equilibrium and brings about the chain of outcomes, each of which is more substantial than the preceding one, i.e. backtracking – partner's disbelief- partners infringe of agreement- disbelief of market participants-loss of partners – unwillingness of market participants to keep economic relations with a backtracker – oust from the market, etc. A businessman's backtracking became in this tentative case a fluctuation that has led to certain system instability. Raising a non-confidence in the backtracker is a bifurcation point, from which the critical moment started for the system development, and the latter provides a choice of a new way for building economic relations. For the breaker of a business word the bifurcation point is the initial point for diversification of the variants of development, or in other words, it is the point where a crash occurs. In the concepts of self-organization the term of «a crash» implies qualitative, abrupt changes, jumps in development. In this phase the development is rather unpredictable. It is extremely destructive when the system is effected not only by endogenous fluctuations, the force and direction of which is easy to be forecast, but also exogenous ones, which are too complicated, and sometimes impossible for prediction.

Algorithm of confidence formation is demonstrated in fig. 1, and is related to currency market. In the conditions of sustained economic development currency exchange rate agrees with the situation of market equilibrium. The market relations entities have confidence in national currency unit and build their relations from the view of its stability. Under the first bifurcations causing minor changes of currency exchange rate the suspicions arise regarding the national currency reliability. The market participants (household entities and corporate clients) carefully observe the events from the positions of probable losses. The government also tries to act in a way of settling down the market. In order to hold the exchange rate on currency market the central bank is making direct investments. But the reserves are gradually diminishing. At that time far from all the market participants realize the threatening danger. Overall worry begins when the currency market regulator is not able to ensure stability, and carries out devaluation or revaluation of a currency unit. Accordingly, doubts turn into non-confidence. Alongside with significant reserve diminishing (but long prior to its full exhaustion) there comes a speculative attack absorbing the remainders of reserves. Non-confidence acquires such a great size that the avalanche-like crisis comes on, which N. Yankovskiy, Yu. Makohon and A. Ryabchyn called «psychological» [15, 137]. Everybody hurries to use his deposits or other savings, to exchange them into hard currency not enabling to have his savings in national currency completely devalue.

The probable algorithm of further actions of the state consists in transferring of its activity abroad and attraction of foreign exchange loans.

Feverish demand for foreign exchange could be met now on account for the credits of international financial organizations, in particular, IMF or other foreign governments. When there are no new speculative attacks on the currency market enabling the governments to apply to the rest of currency reserves, the crisis will be resolved and gradually confidence will be restored. But, how long this process will proceed usually it is difficult to prognosticate. As rightly been said by N. Yankovskiy, Yu. Makohon and A. Ryabchyn «succession of speculative attacks and investors' confidence restore looks natural because the market operators have no clear idea of potential amount of reserves which the state would use under the attack on national currency. That system existence is conditioned by the fact that the speculators in fact have no choice, since they lose nothing attacking national currency, even if threat of the government's refuse from fixed exchange rate is not applied in practice» [15, 136].

Investors' non-confidence in exchange rate policy produces great negative effects on economy. It makes the exchange rate security rather complicated and expensive. Its security algorithm (fig. 2) shows that holding the exchange rate in a fixed level needs significant costs from the view of the past devaluation expectations of market operators. Trying to precede the devaluation moment, creditors can request for higher interest rates, and that, in its turn, brings about the formation of that great debt amount, which is difficult to be served without certain measures in devaluation of national currency. At the same time the «blow» is expected to be made on the exchange rate on trade-unions side,

which increases the wage rates, and the latter could happen to be impossible for the agents of entrepreneurial activity. Eventually, the economic agents enter the noncompetitive stage.

Other situation with non-confidence in currency exchange policy arises in cases, when the devaluation expectations of market participants are oriented at future. Then the mechanism is applied of short-term interest rates that provide the temporal currency security. High interest rates could diminish state budget revenues and produce negative effect on labor market and production area.

Figure 1.

Formation of Confidence on Currency Market

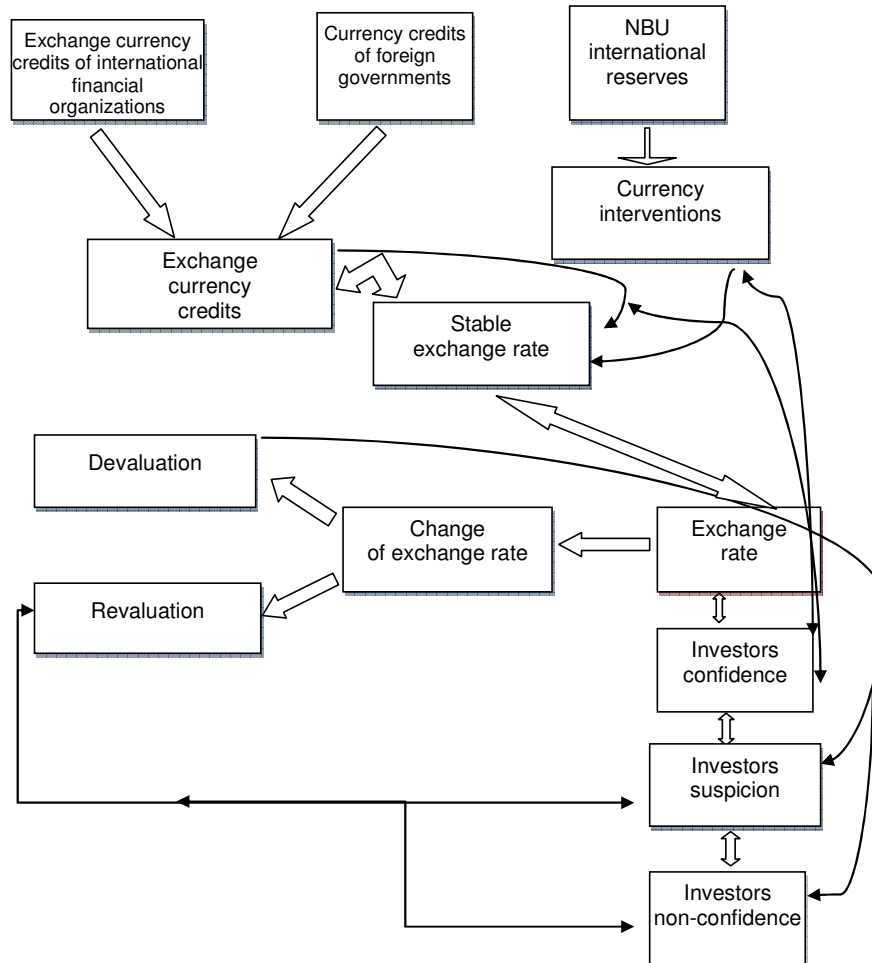
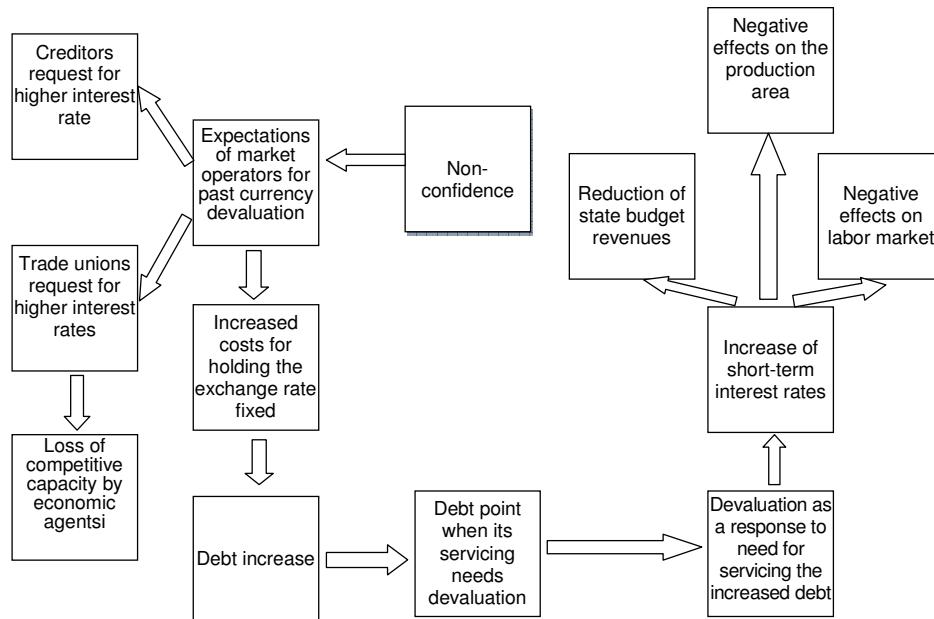


Figure 2.

Algorithm of exchange rate security under conditions of lack of confidence in the state exchange-rate policy



For the latest years the category of «paradox of credibility» has been developed in the theory of international economy and finances. Its essence consists in the fact that under condition of credibility increase in the credit financial institution, its real liquidity increases and due to that the value of resources grows which could be channeled to crediting. Respectively, and the value of assets also grows. In addition, with confidence to financial and credit organs, primarily monetary ones, extra possibilities arise for regulating inflation processes and avoidance of financial instability. As V. Kozyuk showed, confidence in central bank enhances the meaning of fluctuations in the financial sector under conditions of moderate interest rates and low inflation even under expansion of liquidity. These processes are superimposed by the globalization that mitigates the dependence of national interest rates on national micro-processes, and forms cyclic-wise character of capital flow with respect to fluctuations of assets value.

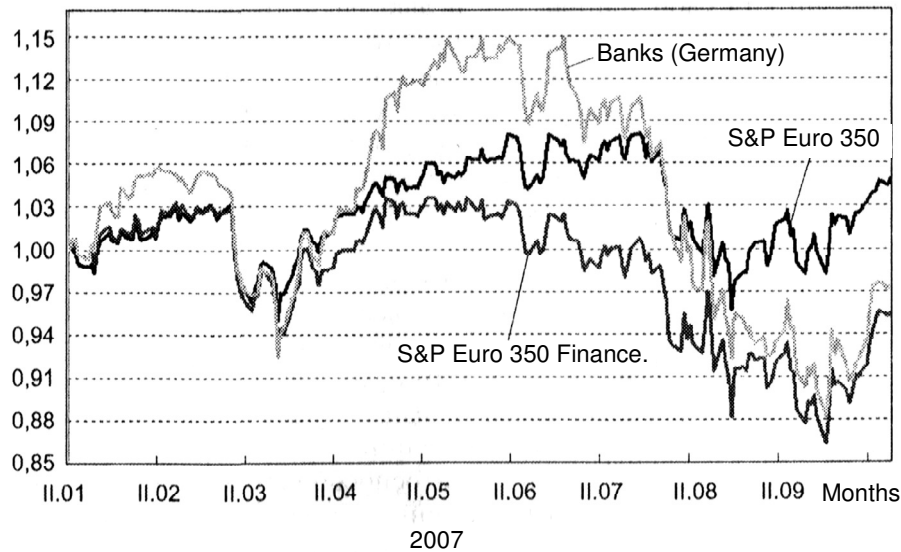
According to V.Kozyuk model, «flows of capital are heating the prices for assets at the stage of inflow and promote their rapid meltdown at the stage of their outflow. Alongside with the increased meaning of fluctuations in the financial sector, for the rest of economy the macro-financial instability can arise even

on the ground of price stability» [6, 284]. In addition, «paradox of credibility» is manifested in the expansion of speculative operations, which brings about the financial aggregates shaking-up. The opportunities for that have been created due to easy conditions of the market liquidity, which are formed on the basis of more flexible monetary policy under holding the price stability.

Paradoxes arising because of peculiarities of confidence formation in market relations are mostly connected with the psychology of information reception on the decisions taken by certain agents. In economic practice the cases cause misunderstanding and surprise when after the declared losses the price for assets increases, and vice versa. A typical case is demonstrated in fig. 3, where the assets value is figured of big European banks and industrial and financial organizations for the period of January through October 2007. As it is seen in fig. 3 in early October the assets value of 350 big European companies did not significantly decrease against May–June. On the contrary, the things in the banking sector look somehow different.

Figure 3.

Assets value of the European banks and 350 industrial and financial organizations from January through October 2007



Source: [8, 45].

The availability of opposite tendencies could be explained by the information that had been published by 2-3 big banks about their unprofitable activity. The outcome of the exposure of those data was the increase value of their shares and, in general of the bank shares. The situation is paradox, since while you declare that you suffer losses, your assets are raising in prices. Here is how E. Liikanen formulates its tendency: «If there is suspicion then the prices for assets drop because there is no confidence. Nevertheless, if some of the banks declare about their negative profits, that is, they admit their losses and write them off, and then investors begin to trust in these banks. Therefore, modern instruments of financial market are very sophisticated» [8, 46]. At first sight, that paradox situation arises because the market participants take the openness in the conditions of arising negative tendencies in the firm's activity conditioned by the exogenous factors as the manifestation of certainty for meeting the existing challenges. If so, then naturally the confidence in those banks' assets arises, and wish to purchase them at the time when prices so far «are not biting» It implies that the belief in future success of the firm breaks the negative tendency in spite of the fact, that so far there are no real grounds for purchasing those assets.

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