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Role of World Bank and International Financial Regulation of Global Economy

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Abstract**—This Paper discusses the current Global Economic Crisis and with a focus on the specific financial area of International Financial Regulation. This Paper begins with a discussion of the role of World Bank and United Nations Initiatives on Global Economic Crisis. The Paper analysis the nature, effectiveness, practical contributions and challenges faced by international cooperation in International Financial Bank Regulation and also considers issues relating to systemic risk and financial stability with the attention to possible regulatory changes.**

Keywords**—Global Economy, World Bank, International Financial Regulation, International Financial Institutions , United Nations Initiatives, Vulnerability, Declining growth rates, International Bank for Reconstruction and Development, the International Development Association, Global Trade Finance Program, Global Equity, Microfinance, Macroeconomics, International Monetary Fund, Financial Market, European Union, Organization for Economic Co-operation and Development, Formal Country Financial Sector Assessment Programs, Reports on the Observance of Standards and Codes, Financial Soundness Indicators, Early Warning System, Multilateral Development Banks, Regulatory Controls, Enhanced Enforcement Cooperation, International Fund for Agricultural Development, UN Stolen Asset Recovery, Financial Infrastructure, Modern Corporate Governance, Risk Management System, Regulatory Systems.**

I. INTRODUCTION

Almost all developed and developing countries are suffering from the global economic crisis. While developed countries are experiencing some of the sharpest contractions, households in developing countries are much more vulnerable and likely to experience acute negative consequences in the short and long-term. Declining growth rates combined with high levels of initial poverty leave many households in developing countries highly exposed to the crisis. Vulnerability is heightened if governments are constrained in cushioning the impacts due limited institutional capacity and fiscal resources.

II. ROLE OF WORLD BANK

Background on Recent World Bank Group Initiatives: The World Bank Group has been stretching to offer expanded, innovative products and services to assist developing countries.

Substantially increasing lending by the International Bank for Reconstruction and Development (IBRD): IBRD could make new commitments of up to $100 billion over the next three years. This year, lending could almost triple to $35 billion.

Fast-tracking funds from the International Development Association (IDA): The facility now in place to speed $2 billion to help poorest countries deal with the crisis. Money to be used for safety nets, infrastructure, education and health which is part of the $42 billion IDA15 fund for the poorest people.

Food crisis response: Nearly US$900 million is approved or in the pipeline to help developing countries cope with the impact of high food prices through a US$1.2b food facility. The International Finance Corporation (IFC), an affiliate within the World Bank Group that focuses on the private sector, has launched new facilities to provide around $30 billion over the next 3 years.

Ensure trade flows: IFC plans to double its existing Global Trade Finance Program to $3 billion over a three year period and mobilize funds from other sources.

Bolster distressed banking systems: IFC is putting in place a global equity fund to recapitalize distressed banks. IFC expects to invest $1 billion over three years, and Japan plans to invest $2 billion. The $3 billion fund, managed by the IFC, is a global equity and subordinated debt fund which aims to help recapitalize banks in smaller emerging markets.

Keep infrastructure projects on track: IFC expects to invest at least $300 million over three years and mobilize at least $1.5 billion to provide rollover financing and recapitalize viable private infrastructure projects in financial distress. Germany has earmarked 100 million Euros for the facility. With additional funds from KfW Bank, the amount could grow to half a billion Euros.

Support Microfinance: IFC and Germany have launched a $500 million facility that will support microfinance institutions facing difficulties refinancing as a result of the global financial crisis. It will ensure that low-income borrowers in developing countries continue to have access to finance. Shift advisory support to help companies weather the crisis. IFC is refocusing advisory services programs to help clients cope with the crisis. It estimates a financing need of at least $40 million over three years. Exposed countries; those in the central shaded area are most exposed to poverty risks, as indicated in the Figure 1.

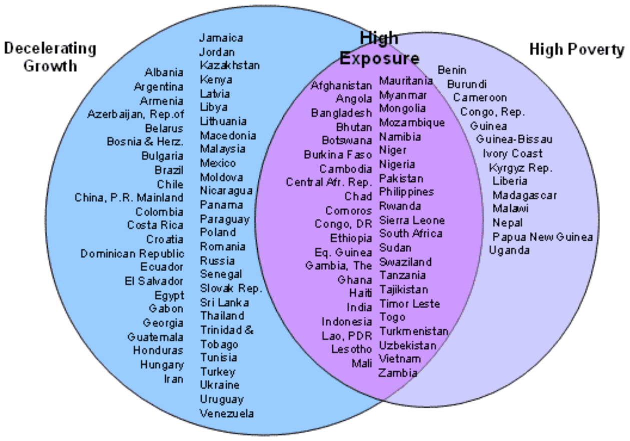

Fig. 1 Global Economy – Countries with Decelerating Growth, High Exposure and High Poverty

The Economic growth prospects for both high-income and developing countries have deteriorated substantially, and the possibility of a very deep global recession cannot be ruled out. The Global Export opportunities for developing countries could decrease quickly because of the recession in high-income countries and because export credits are drying up and export insurance has become more expensive.

III. World Bank Forecasts

The World Bank forecasts World Economic growth in 2009, a 0.9 percent, the weakest since comparable data became available in 1970, revising its projection downward from the 1.0 percent growth estimated in November 2008 as the global financial crisis has worsened since September 2008. The United States forecasts to post a 0.5 percent economic contraction in 2009 and the European economy at 0.6 percent shrinkage. The Japanese economy is predicted to shrink 0.1 percent in 2009 before growing 1.5 percent in 2010. High-income countries as a whole are expected to suffer a 0.1 percent economic contraction next year. The World Bank forecast developing economies to grow 4.5 percent in 2009 against 6.3 percent in 2008. The Global Economic growth is predicted to decelerate to 7.5 percent in 2009 from 9.4 percent in 2008 for China, to 5.8 percent from 6.3 percent for India and to 2.8 percent from 5.2 percent for Brazil. The Global export volumes are projected to fall 2.1 percent in 2009 after expanding 6.2 percent in 2008, curbing world economic growth. Japan's jobless rate has been rising every month since January's 4.1 percent figure, while manufacturers, hard-hit by the global economic crisis, have been drastically trimming their workforces. The World Banks cuts China’s economic growth forecast as it is likely to be further hit by the global economic slowdown during 2010. China's economic prospects have been hit hard by the global economic slump sparked by the credit crunch in the United States. The credit crunch was caused by loose monetary policy and the ensuing financial bubble. The slump in demand abroad for Chinese-made goods has particularly hit the China’s economy, which relies on exports for about 40 percent of its gross domestic product. China will still achieve a healthy growth rate next year and that the government is well placed in terms of cash and reserves to implement measures to boost the economy. The International Monetary Fund has decided to increase its lending to poor countries affected by the Global Economic Crisis by up to $17 billion through 2014. This is an unprecedented scaling up of IMF support for the poorest countries, in sub-Saharan Africa and all over the world.

IV. Financial Market and the World Economy

During global growth, growing capital flows, and prolonged stability, market participants required higher yields without a sufficient appreciation of the risks and failed to exercise proper Due-Diligence.

A. Causes of the Current Global Economic Crisis

The weak underwriting standards, unsound risk management systems, increasingly complex and obscure financial products, and consequential excessive leverage combined to create vulnerabilities in the financial system. Policy makers and regulators (in some advanced countries) did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic implications of domestic regulatory actions. Major underlying factors to the current situation were inconsistent and inadequately coordinated macroeconomic policies, insufficient structural reforms, which led to unsustainable global macroeconomic results.

B. International Financial Institutions

On the International level, there are formal multilateral institutions such as the International Monetary Fund (IMF), the World Bank Group and the Organization for Economic Co-operation and Development (OECD). On a Regional basis, there are treaty-based regional economic community, the European Union (EU), which has a sophisticated institutions structure including the European Commission and the European Central Bank. The IMF and OECD have become themselves International standard setters on firm matters and serving other Global Financial Regulatory purposes. There are intervention of the IMF, World Bank Group, and regional development banks in getting into the Business of financial sector development and related law reform through conditionality and technical assistance. The World Bank on Corporate insolvency becomes relevant to International Standards in the financial sector. Its standards and codes have continues to be revised on the base of experiences and expectations of Countries.

The G-7/8 encouraged the IMF and World Bank to undertake Formal Country Financial Sector Assessment Programs (FSAP) and the IMF to increase the use of its voluntary Article IV member consultation process for member country evaluation purposes. To contain the differing institutional missions of the IMF and the World Bank, the FSAP initiative has been communicated in terms of diverged objectives: (i) financial crisis prevention and stability, (ii) economic development and poverty reduction. The FSAP is a data gathering and assessment process that probably can be improved and used in evaluating, revising, and prioritizing its financial sector reform policy objectives and associated technical assistance. The FSAP mechanism has potential in serving as a detection and assessment tool of the fragilities of country financial systems.

The joint IMF/World Bank FSAP program and the IMF's Reports on the Observance of Standards and Codes (ROSC) initiative are started to promote long term financial reform than to crisis anticipation. The IMF relies on bilateral country consultations and surveillance, a range of Financial Soundness Indicators (FSI included as part of FSAP program), multilateral surveillance involving analysis of global and regional trends, multilateral consultations on global imbalances, various Early Warning System (EWS) models and dissemination frameworks. While the IMF has capacities in providing surveillance and EWS models, the efficiency of these remain problematic. The World Bank pursues financial sector reform initiatives in the Development World, with a new focus on issues of admittance and justice.

C. Action Items on Global Economy

The actions to stimulate economies are to provide liquidity, strengthen the capital of financial institutions, protect savings and deposits, address regulatory deficiencies, unfreeze credit markets, and ensure International Financial Institutions (IFIs) can provide support for the global economy. Economic momentum is slowing substantially in major economies and the global outlook has weakened. The needed action items are to (i) identify the importance of monetary policy support (ii) utilize fiscal measures to stimulate domestic demand, while maintaining a policy framework favorable to fiscal sustainability, (iii) aid emerging and developing economies gain access to finance in difficult financial conditions, including liquidity facilities (iv) support the World Bank and other multilateral development banks (MDBs) to use full capacity in support of development agenda, (v) introduction of new facilities by the World Bank in its infrastructure and trade finance, (vi) make sure that the IMF, World Bank and other MDBs have sufficient resources to continue playing their role in overcoming the crisis.

D. Principles for Reform of Financial Markets by New Regulatory Controls and Enhanced Enforcement Cooperation

For the futuristic initiatives, the G-20 Summit on Financial Markets and World Economy sets stage for New Regulatory Controls and Enhanced Enforcement Cooperation. The financial markets and the world economy resulted in a declaration and broad commitments to strengthen transparency, governance, reform financial systems, and enhance enforcement cooperation and thereby response to the international financial crisis. The new declaration contains an action plan for medium-term actions to solve Global Economic Crisis by implementing the actionable items like Reinforcing International Cooperation, Reforming International Financial Institutions Strengthening Transparency and Accountability, Promoting Integrity in Financial Markets and also Enhancing Sound Regulation.

The new declaration recognizes that regulation is responsibility of national regulators, as the financial markets are global in scope, intensified international cooperation among regulators, and strengthening of international standards. The implementation of regulation is needed to protect against adverse international, regional, and global developments affecting international financial stability. Regulators need to make sure that their actions support market discipline, avoid adverse impacts on other countries, including regulatory arbitrage, and support competition, dynamism, and innovation in the marketplace. The Financial market reformation is to reinforce the international cooperation, as the declaration calls on national and regional regulators to formulate their regulations and other measures consistently. As a priority matter regulators and other relevant authorities should strengthen cooperation on crisis prevention and management.

The actions being taken by the World Bank and other Multilateral Development Banks (MDBs) need to be appreciated, which highlight their important counter-cyclical role in responding to the global crisis. To consider additional financing needs, after comprehensively reviewing World Bank's capital positions, including a thorough Resource Demand Analysis based on agreed medium to long-term strategies. Additional elements to be considered include a division of labor and collaboration among institutions, balance sheet flexibility, superior governance, healthier risk management, effectual use of aid, progress on promoting innovation, and focus on the worlds poorest. There are possible discussion in joint initiatives by the World Bank, the African Development Bank and IFAD (International Fund for Agricultural Development).

The G20 prioritizes the advancement of the reform so they can reflect changing economic weights in the world economy to increase legitimacy and effectiveness. Emerging and developing economies, including the poorest countries, should have greater voice and representation. The declaration calls for the Financial Stability Forum (FSF) to expand to a broader membership of emerging economies. The IMF, working together with the FSF and other bodies, work to identify vulnerabilities, anticipate stresses, and proceed promptly to play a key role in crisis response. The IMF must strengthen its collaboration, enhancing efforts to integrate regulatory and supervisory responses into the macro-prudential policy framework. The G-20 pledges to review the adequacy of the resources of the IMG, the World Bank Group and other multilateral development banks. The International Financial Institutions (IFI) continues to review and adapt their lending instruments to meet member's requirements and revise lending role during the current financial crisis. The IMF conducts surveillance reviews of all countries, as well as giving greater attention to their financial sectors and better integrating the reviews with the joint IMF/World Bank financial sector assessment programs.

The new declaration prioritizes strengthening financial market transparency, including by increased required disclose on complex financial products and ensuring complete and accurate disclosure by firms of their financial conditions. To promote financial stability, the governance of the international accounting standard setting body should be further enhanced, including by undertaking a review of its membership, especially in order to ensure transparency, accountability, and an appropriate relationship between this independent body and relevant authorities.

To enhance sound regulation, the declaration pledges to strengthen regulatory regimes, prudential oversight, and risk management, and ensure that all financial markets, products, and participants are regulated or subject to oversight, as appropriate to their circumstances. The G-20 members will exercise slip over credit rating agencies, consistent with the agreed and strengthened international code of conduct. The G-20 will make regulatory regimes over the economic cycle, while ensuring that regulation is efficient, and expanded trade in financial products and services. They commit to transparent assessments of their national regulatory systems. Medium-term actions require countries to review and report on the principles of regulatory system to ensure it is compatible with a modern globalize financial system. The appropriate bodies review the differentiated nature of regulation in the banking, securities, and insurance sectors and provide a report outlining the issue and making recommendations on needed improvements. The G-20 committed to a review the scope of financial regulation, with a importance on institutions, instruments, and markets that are currently unregulated.

To promote integrity in financial markets, the G-20 declaration commits to protect the integrity of the world's financial markets by strengthening investor and consumer protection, avoiding conflicts of interest, preventing illegal market manipulation, fraudulent activities and abuse, and protecting against illicit finance risks arising from non-cooperation jurisdictions. The G-20 promotes information sharing, including with respect to jurisdictions that are yet to commit to international standards with respect to bank secrecy and transparency. The national and regional authorities are to work together to enhance regulatory cooperation between jurisdictions on a regional and international level. National and regional authorities agree to review business conduct rules to protect markets and investors, particularly against market manipulation and fraud and strengthen their international cooperation to protect the international financial system from illicit actors. In the medium term national and regional authorities should implement national and international measures that protect the global financial system from uncooperative and non-transparent jurisdictions that pose risks of illicit financial activity. The Financial Action Task Force should continue its work against money laundering and terrorist financing, and support the efforts of the World Bank - U.N. Stolen Asset Recovery (StAR) Initiative.

V. Conclusions

The impact of the current Economic Crisis on developing countries is the most vulnerable. The Economic reforms will be flourishing if grounded in a commitment to free market principles, including the rule of law, respect for private property, open trade and investment, competitive markets, and efficient, effectively regulated financial systems. Recognizing the stipulation to improve financial sector regulation, avoid over-regulation that would hinder economic growth and worsen the contraction of capital flows, including to developing countries. Preventing and addressing systemic risk is the primary aspect of financial regulatory design. The design requires the following elements to be addressed: (1) strong financial infrastructure with payment and settlement, (2) managed financial institutions with efficient Modern Corporate Governance and Risk Management Systems, (3) disclosure requirements adequate to carry market discipline, (4) regulatory systems designed to reinforce management and market discipline as well as limiting and monitoring potential risks across all financial institutions, (5) provide liquidity to financial institutions on an appropriate basis, (6) mechanisms for resolving problem institutions. These principles are necessary to economic growth and affluence and have lifted millions out of poverty, and have appreciably raised the global standard of living.

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