Oesterreichische Nationalbank

Eurosystem

Workshops

Proceedings of OeNB Workshops

60 Years of Bretton Woods – The Governance of the International Financial System – Looking Ahead

June 20 to 22, 2004

No. 3

The World Bank's Contribution to Financial Stability

Kurt Bayer

Executive Director
The World Bank

1. Development and Financial Stability

The World Bank's mission is economic and social development and poverty reduction. The two major pillars of its activities are "Building a Climate for Investments, Jobs and Sustainable Growth" and "Investing in Poor People and Empowering Them". Since the beginning of the Millennium, the international community – and with it the World Bank - have resolved to pursue development assistance in a result-oriented way, *in concreto* by helping to achieve eight so-called Millennium Development Goals, mainly couched in quantitative targets to be reached by 2015. This was accompanied by the so-called Monterrey Consensus in which the joint responsibility of industrial and developing countries and international financial institutions for development was stipulated, whereby continued reforms in developing countries would be "rewarded" by higher and more client-oriented development assistance flows from industrial countries.

The World Bank Group provides loans and grants and insurance of around USD 24 billion annually and has an outstanding portfolio of more than USD 130 billion. This makes the World Bank one of the primary actors in monetary development assistance. Equally important, however, has the role of the Bank group as a "Knowledge Bank" become, transferring world-class know-how from all over the world to its clients.

There are a number of reasons which make *sound and efficient financial systems* in a country a priority element for sustainable growth and poverty reduction. They constitute the vehicle to mobilize savings to finance productive investment for growth; they provide the payments system for the smooth exchange of goods and services among economic actors; they provide major risk protection for households and firms; they promote the accumulation of savings and wealth in a society. And specifically, they can be designed to provide much-needed access to finance for the poor – a condition which is usually not available in emerging, and even less so in developing countries.

Weak financial systems discourage business initiative and development, increase countries' dependency on foreign financing and aid – with its concomitant volatilities – and make successful shock mitigation less likely. All these impact disproportionately more heavily on the poor who have fewer means to shield themselves against all types of crises. World Bank experts have estimated that during the last 25 years over 120 systemic banking crises have occurred in 95 countries. The costs of these crises have been estimated to average 16% of GDP, in some cases up to 50%. Aggregate losses to developing countries have been estimated to amount to around USD 1 trillion, which approximately equals the amount developing countries have received in foreign aid. But the impacts of these losses are not only temporary, as the above flow numbers might suggest. Experience with recent crises has shown that they frequently lead to heavy setbacks in social development, reduce school enrolment rates, increase poverty rates dramatically and damage human capital often in an irreversible manner – thus impeding growth and development prospects also for the next generation.

2. The World Bank Financial Sector Strategy

The above suggests that strong and resilient financial systems contribute to emerging or developing countries' growth prospects and thus to poverty reduction. It constitutes an important part of the Bank's strategy towards sustainable growth (normally contained in the 3–4 year Country Assistance Strategies) to increase the resilience of developing countries' financial systems to reduce the likelihood of crisis; to build the legal, regulatory and infrastructure framework for financial sector development and to broaden and deepen access to financial services for all levels of society.

For the last few years the Financial Sector Group in the Bank has undertaken more than 60 projects a year with an annual commitment volume of around USD 5 billion. In addition to its own activities, the Bank engages in a large number of partnership projects with major financial institutions around the world.

The World Bank has three types of instruments available for this task: knowledge products, lending and policy advice and technical assistance. The Bank develops cutting-edge analysis on financial topics in client countries and applies its world-wide knowledge in measured ways to clients. By means of Financial Sector Assessment Programs (together with IMF) and Economic and Sector Work key issues of concern in the individual countries are identified and solutions and options proposed. Loans/grants and technical assistance are used to help countries to import knowledge and pay for the creation or strengthening of regulatory systems, build institutions able to deliver better and more financial services, including asset and debt management.

In addition, the International Finance Corporation (IFC) helps finance financial sector acquisitions in emerging and developing countries, including their necessary investments into leasing, insurance, retail banking, housing finance, micro-credit to rural and urban poor, etc. the Multilateral Insurance Guarantee Agency (MIGA) has been very active in offering insurance against political risk for foreign direct investments of banks.

Major areas of World Bank involvement in Financial Sector Strengthening are improvement of the Banking Systems (including the working out of non-performing loans, creating modern financial instruments, strengthening supervision, adherence to capital adequacy principles), capital markets, insurance and contractual savings, rural finance, SME finance, micro-finance models, improvement of payment systems, natural disaster and weather insurance schemes, commodity price fluctuation insurance, and recently active efforts to help countries combat money laundering and terrorism financing.

3. The World Bank as a Partner in the Global Financial Architecture

In its statutory role of helping less developed countries to improve the standards of living of their populations, to combat poverty and to put economic growth and social development on a sustainable footing, the World Bank is part of the International Financial Architecture institutions that have grown over the past 60 years. This is not the place to discuss whether Global Economic Governance in its entirety is adequate or appropriate. The World Bank as part of the Bretton Woods institutions has come a long way. It has disbursed around USD 550 billion in credits and grants to its now over 100 client countries. Its role in stabilizing the International Financial Architecture has increased, together with the recognition of the importance of stable financial systems for sustainable growth and social development. Its commitment to help stabilize countries by introducing them to modern institutions and processes, among these very importantly a stable financial system, is part of the global effort to improve world stability, mitigate national and social tensions and improve relationships of its 184 member countries with each other.

This commitment to a better world manifests itself in a number of *partnership arrangements* where the World Bank cooperates concretely with other institutions.

Foremost among these efforts are the joint programs by World Bank and IMF to do Financial Sector Assessments (FSAPs). These serve to identify strengths and weaknesses in the financial sectors of member countries by means of thorough analysis, and to bring policy advice for improvements to these countries. The Bank has developed the Financial Reform and Strengthening Initiative (funded with USD 54 million) to be able to do provide the technical assistance necessary for FSAP and ROSC (Review of Observance of Standards and Codes) follow-ups. During 2000–2004 more than 70 FSAPs (full FSAPS and updates) have been undertaken.

The Bank participates in a number of Regulatory Bodies: it makes contributions to the revised Capital Accord (Basle 2) and to the revised Core Principles on Bank Supervision, provides guidance notes for assessors of compliance of IOSCO standards, contributes to the revision of the core principles for insurance supervision (IAIS) and has developed a template for FSAP insurance audits; it participates in the meetings of the Financial Stability Forum, has contributed to developing good practices for the regulation of pension fund managers and participates in the Financial Action Task Force (FATF) and has recently accepted the mandate to cooperate in AML/CFT; it has participated in a number of Bank Standard exercises, e.g. the Bank Insolvency Principles and Corporate Insolvency Principles, as well as in the joint conference on migrant labor remittances.

This list shows that the Bank is not only heavily engaged in its "own" activities to strengthen the financial systems of its client countries, but is also willing to share its know-how in this large number of very important global initiatives.

The activities of the World Bank experts in the financial sector field are very varied. They do not remain in the lofty realm of analysis proclamation, but attempt to develop *country-specific and context-specific solutions* "on the ground", frequently under very difficult circumstances. In all these solutions, the unique know-how World Bank experts have acquired through their work throughout the world is continually being adapted to the country in question. Lessons learned from previous experiences are incorporated into the work and conditions outlined under which circumstances and conditions which options for solutions are more likely to be effective in a given country.

A partial list of recent analyses and policy notes by the World Bank for specific regions or countries give a brief glimpse of the variety of this work:

- Islamic finance
- Health insurance design
- Agricultural risk toolkit
- Annuity products
- Housing Finance
- Corporate Governance
- Corporate Debt Restructuring
- Improving public bank governance
- Good practices for bank insolvency
- Access to micro-insurance services
- Catastrophe risk management
- Depository services
- Credit reporting and information systems
- Regulations for debt markets
- Distributional impacts of crises
- Risks of dollarized financial systems
- Solvency for developing markets

References

Finance for Growth. Policy Choices in a Volatile World. The World Bank. Oxford University Press. Washington, D.C. 2001.

Financial Sector Assessment Program – Review, Lessons and Issues Going Forward. IMF. World Bank. February 2003.
Global Development Finance. Harnessing Cyclical Gains for Development.. 2 Volumes. The World Bank 2004.
Oral remarks by Cesare Calari. VP Financial Sector. World Bank. ED Induction. December. 2002.
Stiglitz, Joseph. The Role of the State in Financial Markets. Proceedings of the World Bank ABCDE Conference 1993. Washington, D.C. 1994.
Strategy for the Financial Sector. The World Bank Group. March 2001.
The World Bank Annual Report 2003. Volumes 1 and 2. Washington, D.C. 2003.