ABSTRACT

Cross Country Consequences of the Financial Crisis and Regulatory Reforms

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Global financial crisis that started in 2008 has severe impacts on national economies. The economies which are negatively affected are not only the developed but also the developing ones. Actually the current crises, originated in the financial sector of US, spread like wildfire as a result of high level of financial globalization and securization.

Therefore, the focus of my paper is to model the international depth of the financial crisis and discuss financial policies to EU countries resilence to potential financial market shocks and in the longer run develop necessary reforms to improve the quality of financial system. Moreover why the impact of the crisis differs across many countries is also investigated in my paper.

The international financial linkages among many financial indicators(i.e. fluctuations in stock market, credit riskness rate of the countries, changes in real GDP, exchange rates fluctuations) are investigated to understand whether they triggered the 2008 crisis.

I also analyze how developing countries which has holding American bonds are affected from the 2008 crises which cause a sharp decline in the value of these assets.

Given the harmful effects and increased frequency of financial crises in the emerging economies, it is now the exact time for policy makers throughout the world to shape agenda to fight against financial crises.

There are twelve basic areas of financial reform according to Mishkin: (a) prudental supervision, (b) accounting and disclosure requirements, (c) legal and judicial systems, (d) market-based discipline, (e) entryof foreign banks (f) capital controls, (g) reduction of the role of state-owned financial institutions, (h) restrictions on foreign-denominated debt, (i) elimination of too-big-to-fail policies in the corporate sector,(j) sequencing financial liberalization, (k) monetary policy and price stability, and (l) exchange rate regimes and foreign exchange reserves.

Banks play a particularly important role in financial systems of emerging market economies, and problems in the banking sector have been an important factor promoting financial crises in recent years.

Deterioration in bank’s balance sheets, increase asymmetric information problems. Here, I want to make additional observation. A stable financial environment is obviously important for the effective pricing and management of risk.

Competetion and market discipline are also important mechanisms for improving the effiency of financial systems. Encouraging the entry of foreign-owned financial institutions; privatization and the withdrawal of state intervention in the financial system and greater issue of subordinated debt. It is also important to emphasize the link between capital controls and capital account inconvertibility. There would be better quality intermediation if the banks could take deposits and lend in domestic and foreign currencies.

The presence of foreign financial institutions in emerging markets is good on grounds of ‘ diversification, risk sharing, and deep pockets’. Postliberalization crises are virtually inevitable, even desirable.

Huge changes are being demanded of developing countries, changes that we know from experience are typically made because of a crisis.

As the crisis unfolded, governments have been forced into the role of becoming new owners of distressed financial institutions, guarantors of loans, taking over the risk implicit in poor collateral, and making regulatory adjustments on the run. In this context, policies to improve European countries's resilence to potential market shocks, there are basic steps required to deal with a banking system solvency crisis.

Strengthening the transparency and credibility of fiscal institutions, continuing to improve the functioning of the automatic stabilisers by extending the new expenditure targets, prioritising the re-payment of foreign currency denominated public debts are urgent for consolidation in fiscal policy.

Important actions in monetary policy should include banks should begin calculating and publishing alternative measures of core inflation, such as a median masure and a trimmed mean.Making public a comprehensive road map for the re-establishment of disinflation. Banks likely response to risks should be clearly calculated.

Governments need to guarantee liabilities to stop bank runs. All deposits need to be covered to avoid gaps between covered and non-covered institutions. Seperating the good assets from the bad assets, and getting the bad assets off banks balance sheets is another approach. The asset- cleansed banks need to be recapitalised by finding new equity holders.

Minimizing the risk of situation worsening further is indispensable for fiscal consodilation plans. Significant policy efforts should be devoted both to reducing the risk of shocks, and to strengthening the resilience of the economy to cope with such shocks should they occur.

In the longer run, European rescue plans need to cover sustainable policies for the financial system. There are various areas that will need attention as emergency measures need to be relaxed and removed. In the first place, reforming the incentive systems that gave rise to the crisis, afterwards governments need to match the regulory influence on the cost of capital to the risks that institutions actually take.