# International Cooperation Following the Economic Crisis: Where Next?

Keith Boyfield*

This paper examines initiatives to oversee a coordinated response to the recent worldwide economic crisis. The paper highlights the manner in which the regulation of the global financial system was dangerously fragmented, triggering the collapse of leading banks such as Lehman Brothers and the Royal Bank of Scotland (RBS). In order to address the disintegration in international confidence, world leaders were obliged to act – overtly through the G20, but more covertly via the US government's willingness to act as the lender of last resort. Turning to the role played by key institutions established by the Bretton Woods Agreement, the paper assesses the responses of the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and the World Bank. Focusing on future challenges, this paper highlights the way in which the Eurozone has continued to suffer from spasmodic growth, with many EU members recording erratic progress and high levels of unemployment. The Euro has been a casualty, reflecting a fault line in strategy between France and Germany, clearly demonstrated in the ongoing crisis surrounding Greece. By contrast, other regions of the world have achieved impressive levels of economic growth. This has been helped by regional development banks, such as the African Development Bank (AfDB) and the Islamic Development Bank (IDB). Meanwhile, China has opted to create a brand new Asian Infrastructure Investment Bank (AIIB) with the support of a cluster of OECD partners. The article concludes by noting that the world's response to the financial crisis has illustrated the shifting epicenter of global economic power. The US is losing its pre-eminence to China and a more self-confident Islamic world. The EU remains inward-looking, and the IMF's support for continued Greek membership of the Euro has raised questions about the Fund's future direction and leadership.

* Keith Boyfield is a research fellow at the Centre for Policy Studies, London, United Kingdom.

*Introduction*

This paper examines initiatives to launch and maintain a co-ordinated response to the recent worldwide economic crisis. The crisis in confidence which gripped international financial markets in 2008 exposed the fault lines in the global governance of economies, both large and small, where investors struggled to find attractive financial returns in an era characterized by low interest rates. The paper moves on to highlight the manner in which the regulation of the global financial system was dangerously fragmented, triggering the collapse of leading banks such as Lehman and RBS. In order to address the disintegration in international confidence, world leaders were obliged to act – overtly through the G20, but more covertly in the shape of the US government's willingness to act as the lender of last resort. Turning to the role played by other key institutions established by the Bretton Woods Agreement, the paper assesses the responses of the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and the World Bank.

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Focusing on future challenges this paper highlights the need to move away from debt and improve productivity as the crucial lever to enhance GDP growth. The Eurozone has continued to suffer from spasmodic growth with a number of EU members recording erratic progress and high levels of unemployment. The Euro has proved to be one of the main casualties, illustrated by the ongoing crisis surrounding Greece's place in the currency union. By contrast, other regions of the world have achieved impressive levels of economic growth, notably sub Saharan Africa, the Gulf region and Far East Asia. This has been helped by regional development banks, such as the African Development Bank (AfDB) and the Islamic Development Bank (IDB). The latter has made imaginative use of *Sukuk* debt instruments to channel investment into trade finance, infrastructure and small to medium sized enterprises (SMEs). Meanwhile, China has opted to create a brand new Asian Infrastructure Investment Bank (AIIB) with the support of a cluster of OECD partners, but facing US opposition.

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The article concludes by noting that the world's response to the financial crisis has illustrated the shifting epicenter of global economic power. The US is losing its pre-eminence to China and a more self-confident Islamic world. The EU remains inward-looking and the IMF's support for continued Greek membership of the Euro has raised questions about the Fund's managing director and her personal commitment to the preservation of the Euro at all costs, in preference to long-established IMF rules for debt relief. Looking ahead, this may trigger an overhaul of global financial institutions established to maintain financial stability and economic growth.

*The World is Struck by the Worst Financial Crisis in Eighty Years*

The economic crunch that had such a devastating impact on global capital markets was first signaled by the collapse of Bear Stearns, a Wall Street investment bank which ran into serious difficulties as a result of its heavy involvement in complex mortgage-backed securities, notably collateralized debt obligations often known by the acronym CDOs. The fundamental flaw in the bank's business model - it was by no means the exception - was that these securities were built on feet of clay: the assets underpinning these complex instruments – CDOs, CDO squared or even CDOs cubed[1] – were unable to justify the values ascribed to them. In the years before the crisis hit, there was a flood of irresponsible mortgage lending in the US. Loans were freely doled out to "subprime" borrowers with poor credit histories who then struggled to repay them. The risks were exacerbated by financial engineers at the major investment banks – sometimes referred to as "rocket scientists" – who transformed them into supposedly low-risk securities by aggregating large numbers of them in pools: the CDO time bomb.

Furthermore, low interest rates maintained by the US Federal Reserve Bank created an incentive for banks, hedge funds and other investors to seek out riskier assets offering higher returns. This was dubbed the search for yield. Under pressure from their shareholders to in-

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1 Collateralized debt obligations cubed are a special purpose vehicle with securitization payments in the form of tranches. In turn, CDO-cubeds are backed by a pool of collateralized debt obligation squared (CDO-squared) tranches

crease returns, banks operated with minimal equity, which in turn left them vulnerable if things went wrong. Moreover, from the mid-1990s financial institutions were allowed greater scope to employ their own internal models to assess risk. In effect, this enabled them to set their own capital requirements.

This dangerous state of affairs was compounded by central bankers and other financial market regulators who bear some responsibility for mishandling the crisis and failing to identify the risks associated with economic imbalances. When warnings were given, for example by the Bank for International Settlements, they were ignored. In January 2008, Malcolm Knight, the chief executive of the Bank for International Settlements (BIS), the central bank for central bankers, highlighted "the Balkanization of regulation - fragmented across market segments, (and) across national jurisdictions as a major challenge" for regulators in what was meant to be a global financial system.[2]

*The Crisis Breaks*

This elaborate house of cards began to collapse when Bear Stearns was sold to JP Morgan Chase at the knockdown price of $10 per share in March 2008. This was a massive discount on the bank's pre-crisis 52-week peak of $133.20 per share. Yet Bear Stearns was just the first of a number of high profile casualties. The tale of woe continued for the next six months as other leading names on Wall Street ran into difficulties. The casualties included Lehman Brothers, a global bank with extensive investment banking interests and a major name in bond trading; one of the world's major insurers, AIG; and Merrill Lynch, a firm synonymous with stock broking whose brand was symbolized by a confident bull. However, over the course of the year, global capital markets were caught in a downward spiral, leading to the demise of many famous names. Merrill Lynch was one of them: the firm was acquired by Bank of America, another victim of the much misunderstood US mortgage-based CDO market.

The other side of the Atlantic also witnessed a wave of banking failures, notably the Royal Bank of Scotland (RBS) Group, which had over extended recklessly; the Halifax Bank of Scotland Group that could not muster one qualified banker to stand on

2 `BIS warns on fragmented regulation`. *Financial Times*, 26 January 2008.

its board; and two of Belgium's largest banks, Fortis and Dexia. None of these banks would have been able to continue trading were it not for taxpayer support in the form of government bail-outs.

The UK government effectively nationalized a clutch of major banks; seven years later the coalition government was still seeking to unravel some of these toxic assets and find buyers for its extensive shareholding stake, albeit acquired under unprecedented duress. Ironically, state ownership of banks was rejected by a Labour administration in the 1970s as too radical a step; yet only a generation later a moderate Labour government was obliged to nationalize a large share of the banking sector in order to prevent a calamitous slide into depression.

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In the case of Belgium, Fortis was split into two parts: the Dutch division was nationalized, while the Belgian business was sold to BNP Paribas. Dexia was disaggregated with the Belgian bank taken into state ownership.

These examples of banking incompetence in three separate jurisdictions illustrate just how close the world came to a collapse in global confidence - and one, moreover, that would have rivaled the Great Depression of the early 1930s in its reach. Politicians were determined to avert such a disaster and they responded immediately to President George W. Bush's invitation to meet in Washington DC to hammer out a response to the greatest threat to international capital markets since the end of the Second World War.

*The G20's Response to the Financial Crisis*

Thus, shortly after the implosion of Lehman Brothers in September 2008, President Bush invited the leaders of the G20 nations to Washington in order to co-ordinate a response to what was rapidly evolving into an economic meltdown. This summit, together with a massive stimulus package agreed at the London G20 summit five months later, was widely perceived as playing a pivotal role in rebuilding confidence in the global financial system. However, on closer scrutiny, this perception turns out to be significantly exaggerated.

In retrospect, it is more accurate to argue that the crucial aspect of the international financial management of the crisis was the willingness on the part of the United States to act as an international lender-of-last-resort (ILLR). It did so on an unprecedented scale. If US authorities had not provided liquidity in this way, the possibility of a collapse of the global economy would have been a far greater threat. The US opted to intervene on a unilateral basis through bilateral swaps, and offered to act as the ILLR. Significantly, these initiatives were taken prior to the first G20 leaders' summit. The subsequent meetings of the G20 largely endorsed and publicly ratified the strategy adopted by US policy makers and the Fed in collaboration with leading central banks worldwide.

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One of the principal coordinating instruments employed by the world's major economies in response to the crisis was the Basel Committee, previously an obscure body composed of central bank governors from the world's leading economies. The Basel Committee's primary role is to establish global standards for the prudential regulation of banks; it also provides a forum for cooperation on banking supervisory matters. Its key mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability – a role which it failed to effectively fulfill in the years before the crisis.

*Mea culpa* was long overdue and central banks and regulators needed to take responsibility for their shortcomings in the lead up to the financial crisis. Accordingly, the Basel Committee led the way with the announcement that it would seek to identify the weaknesses of the pre-crisis banking sector and implement a new set of global standards to address both firm-specific and broader, systemic risks. Central bankers clearly acknowledged that they needed to be seen to be taking concrete steps to ensure that a similar financial crisis would not threaten global capital markets in the foreseeable future. Having made such a mess of matters prior to the crisis, the onus was on central bankers to restore confidence.

In November 2008, Britain's Queen Elizabeth II memorably asked how the credit crunch could have taken so many economics experts by surprise. Her Majesty uttered this remark when

she quizzed some of the leading lights in the economics profession at the opening of a new academic building at the London School of Economics (LSE), midwife to many a Nobel Prize winner in economics. What caught the newspaper headlines was the fact that the economists present failed to come up with any compelling reply to her query. In this context, it is worth recalling that only six months earlier, the Governor of the Bank of England, Mervyn King, a former professor at the LSE, had opined: "It's quite possible that at some point we may get an odd quarter or two of negative growth. But recession is not the central projection at all".[3] His prediction proved to be spectacularly inaccurate.

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*Basel III*

In the wake of the collapse in confidence in global capital markets, the program of measures initiated by the Basel Committee has been termed "Basel III". The response features the following elements, which were agreed upon and issued by the Committee and its governing body between July 2009 and September 2010:

1. The adoption of new standards with respect to higher quality of capital, with a focus on common equity, and higher levels of capital to ensure banks are able to absorb the types of losses sustained in the 2008 financial crisis;

2. Improved coverage of risk, especially for capital market activities;

3. An internationally harmonized leverage ratio to constrain excessive risk taking and to serve as a backstop to the risk-based capital measure. In the technical jargon this is referred to as "migrating to a Pillar 1 treatment based on appropriate review and calibration"[4];

4. The adoption of capital buffers, which should be built up in good times so that they can be drawn down in periods of stress;

5. Minimum global liquidity standards to improve banks' resilience to acute short term stress and to improve lon-

3 Giles, C. (2008) `The economic forecasters` failing vision`. *Financial Times*, 25 November.

4 `Basel III leverage ratio framework and disclosure requirements; Press Release, *BIS*, January 2014, Available at: http://www.bis.org/publ/bcbs270.htm (Accessed: 30 May 2015).

ger term funding; and

6. Stronger standards for supervision, public disclosures and risk management.

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The Basel Committee is also contributing to the Financial Stability Board initiative to address the risks of globally systemic banking institutions. The Basel Committee's membership - 28 full members and three observers - is drawn from the leading central banks of the world.

*The Role Played by the IMF*

In addition to the G20 and Basel Committee, the other key players in the global initiative to restore confidence in international capital markets were the International Monetary Fund (IMF) and the World Bank, both of their institutions established by the Bretton Woods Agreement dating back to 1944. What became known as the Bretton Woods system was an attempt to establish a fully negotiated monetary order which would govern monetary relations between sovereign nations following the ravages of the Second World War.

As part of the G20 response to the economic crisis, the IMF saw its funding substantially increased through the quota subscriptions paid by its 188 member countries. It also negotiated larger borrowing agreements from certain member countries. This was done with the aim of creating a 'crisis firewall'.[5]

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In turn, the IMF was able to step up its lending to countries which had run into difficulties. As part of this program, it has so far committed over $600 billion in loans to its members. The IMF has focused in particular on the poorest countries worldwide and has quadrupled resources devoted to concessional lending.

Renewed efforts have been made to improve the Fund's monitoring, risk analysis and policy functions. Moves have also been made to reform the IMF's governance structure, although it is important to note that the Fourteenth General Review of Quotas, approved in principle in December 2010, remains to be implemented because of the inability to gain support from certain key

5 `IMF Response to the Global Economic Crisis`, *IMF*, 27 March 2015, Available at: https://www.imf.org/external/np/exr/facts/changing.htm (Accessed: 30 May 2015).

members, notably the US. This has curbed the planned increases in the financial resources available to the Fund and has denied certain countries, China, India, Brazil and South Korea for example, a greater say in how the Fund operates. This impasse is worrying since it does not recognize the shifts that have been seen in world economic power in the last couple of decades.

*The Role Played by the World Bank*

The other key global institution established by the Bretton Woods Accord is the World Bank. In the aftermath of the economic crisis of 2008-9, the World Bank and its affiliates (notably the International Finance Corporation [IFC]) responded with unprecedented expansion of financial support to member countries, centering on low income countries that had suffered a high level of stress. It is striking to note that the World Bank points out that average Gross Domestic Product (GDP) growth among its client countries declined from 6 percent in 2005 –0.7 to 1 percent in 2009.[6]

In its response to the credit crunch, the Bank sought to protect the world's poorest by stabilizing member countries' financial and private sectors, as well as helping governments manage fiscal challenges, while underpinning long term development expenditures, notably for infrastructure. As part of this program, the World Bank announced in 2009 that it intended to triple lending through the International Bank for Reconstruction and Development (IBRD), with new commitments totaling $100 billion over three years. The World Bank's response was unparalleled. Average new commitments by the Bank and IFC together amounted to USD 63.7 billion a year in fiscal 2009–10, compared with less than half that amount each year during the pre-crisis period, 2005–07.

The World Bank made a determined effort made to improve the evaluation of financial support and accelerate the disbursement of funding. However, the World Bank's own evaluation of its response to the economic crisis reveals that, "Although the Bank provided substantial support in social protection to a number of countries, it was hampered by limited country capacity to target those who

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6 World Bank (2011) `The World Bank Group`s Response to the Global Economic Crisis`, *Phase II report*, Available at http://ieg.worldbankgroup.org/Data/reports/chapters/crisis2_overview.pdf (Accessed: 30 May 2015).

were made poor by the crisis, and, as a result, the bulk of support went to the chronically poor."[7]

*Future Challenges*

While it is to be hoped that these measures by the Basel Committee and its members, along with initiatives adopted by the IMF and World Bank, will rectify the problems of the past, there are still worrying signs that financial instability might once again grip international capital markets. In its 2014 annual report, the BIS expressed concerns that the present low-interest rate regime, initiated in a move to overcome the effects of the 2008 crash, has pushed financial markets to new highs while lowering the rate premium for many risky loans. The BIS notes that markets had been "exuberant over the past year", particularly in advanced economies, but warned that they were "dancing mainly to the tune of central bank decisions", with volatility reaching historical lows and "market participants ... hardly pricing in any risks." The Bank added, "Overall, it is hard to avoid the sense of a puzzling disconnect between the markets' buoyancy and underlying economic developments globally." Yet, as the BIS points out, "The only source of lasting prosperity is a stronger supply side." Accordingly, the Bank concluded, "It is essential to move away from debt as the main engine of growth."[8]

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Nonetheless, despite a huge monetary and fiscal stimulus, including a considerable injection of liquidity through quantitative easing coupled with exceptionally low interest rates, the global recovery has remained erratic; the Eurozone, in particular, has shown only spluttering signs of a revival. Indeed, several Euro members, notably Ireland, Spain, Portugal and Greece have experienced exceptionally difficult unemployment and a sizeable downturn in GDP. This has led, in turn, to damaging public protests and serious social tensions – nowhere more so than in Greece.

In retrospect, it can be seen that the creation of the Euro triggered a major expansion of the financial sector both within the Eurozone and in adjacent banking hubs such as London and Switzer-

7 Ibid.

8 `84th BIS Annual Report, 2013/2014`, Press Release, *BIS*, 29 June 2014, Available at: http://www.bis.org/publ/arpdf/ar2014e.htm (Accessed: 30 May 2015).

land. Recent detailed research by Professor Hyun Song Shin,[9] a Korean economist previously at Princeton University currently, the Economic Adviser and Head of Research at the BIS, has demonstrated that this boom in global banking – illustrated by the excessive expansion of the RBS Group – exerted a significant influence on the loose credit conditions that characterized the US economy before the credit crunch.

The crisis which engulfed the world's capital markets in 2008 exposed important weaknesses in the governance of the Euro, ironically the currency that many analysts thought had the best chance of challenging the dollar's global role at the time of the outbreak of the crisis. This proved to be a chimera.

Southern European economies racked up massive current-account deficits during the first decade of the Euro, while countries in northern Europe ran significant offsetting surpluses. The imbalances were financed by credit flows from the Eurozone core to the overheated housing markets of countries like Spain and Ireland. That proved to be an immense problem when the economic crisis struck in 2008. Peripheral Euro economies began to implode and emergency measures were required to shore up several EU economies. However, market analysts have continued to be concerned about the balance sheets of many European banks, which are characterized by bad debts as a result of imprudent investments in residential, commercial and retail property.

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Ten years earlier, Professor Martin Feldstein of Harvard University had with great foresight predicted problems with the determined move to establish a single currency for the EU. In an article in the journal *Foreign Affairs,* Professor Feldstein predicted the risks associated with this political move to establish a common currency so long as sovereign member states retained power over fiscal policy. He observed: "… the attempt to manage a monetary union and the subsequent development of a political union are more likely to have the opposite effect. Instead of increasing intra-European harmony and global peace, the shift to EMU and the political integration that would follow it would be

9 Hyun Song Shin, a Korean economist, was educated at Magdalen College, Oxford, where he obtained his DPhil. In his distinguished academic career he has also held posts at the London School of Economics and Princeton University.

more likely to lead to increased conflicts within Europe."[10]

Furthermore, as Professor Feldstein predicted, "if countries discover that the shift to a single currency is hurting their economies and that the new political arrangements also are not to their liking, some of them will want to leave".

In the last year, Greece, which was admitted into Euro membership despite Eurostat statistics indicating it was unable to meet the qualifying criteria,[11] has exemplified the tensions surrounding the maintenance of the current Eurozone. The country's two main political parties, PASOK and New Democracy, hemorrhaged popular support and a new coalition government, led by Prime Minister Alexis Tsipras, was elected in January 2015. Tsipras's party was highly critical of the economic constraints laid down by creditor nations, notably Germany.

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Negotiations over economic reform and the repayment of an emergency EU-IMF bailout totaling €240 billion have proved particularly fraught. In April 2015, IMF managing director Christine Lagarde observed that talks between Greece and its creditors had been "difficult on almost a daily basis."[12] Relations were not improved when the Greek government announced in the same month that Germany owed it nearly €279 billion in war reparations, from the Nazi occupation during World War Two.[13] This led Sigmar Gabriel, Germany's Economic Minister, to claim that it was foolish to link Greece's bailout by the Eurozone with the question of war reparations. "To be honest I think it's dumb," said Gabriel. "I think that it doesn't move us forward one millimeter on the question of stabilizing Greece." In July 2015, after a marathon 17-hour negotiation session running through the

10 Feldstein, M. (1997) `EMU and International Conflict`. *Foreign Affairs*, 76(6), November/December.

11 It was revealed in 2010 that a number of leading investment banks, notably Goldman Sachs and JPMorgan Chase had devised financial products which enabled the Greek government – along with other euro members such as Italy - to disguise their real level of borrowing which would have disqualified them from membership of the single currency, see , for example, Blodget, H. (2010) `Greece Paid Goldman $300 Million To Help It Hide Its Ballooning Debts`. *Business Insider*, Available at: http://www.businessinsider.com/henry-blodget-greece-paid-goldman-300-million-to-help-it-hide-its-ballooning-debts-2010-2 (Accessed: 30 May 2015).

12 Kollewe, J. (2015) `Greece defends bailout tactics as latest deadline looms`. *The Guardian*, 13 April.

13 See `Greece Nazi occupation: Athens asks Germany for €279bn`, 7 April 2015, Available at: http://www.bbc.com/news/world-europe-32202768 (Accessed: 30 May 2015).

night, a deal appeared to have been struck between Greece and its creditors. But the conditions for the bailout were humiliating for Mr. Tsipras's government, overturning many of the key points he had personally fought for in a referendum only a week before.

Some commentators think that Greece is just playing for time. According to Brian Sturgess, Managing Editor of *World Economics*, "After a decade of deceit in relation to the near fraudulent economic statistics presented to Eurostat, successive Greek governments continue to play kick-the-can down the road promising reforms and economies and delivering little until the next deadline approaches. This game can only end in tears. Sensible plans have to be put in place for Greece to leave the Eurozone with a smooth transition."

*The Emerging Role of Regional Development Banks: Underpinning the Global Economy*

Sustainable economic growth remains an unfulfilled goal in many EU economies, and in recent years the low level of economic growth has contrasted sharply with other regions of the world, most notably Asia and many sub Saharan African economies, albeit develop from a relatively low base. In fact, Africa's economy has grown fourfold since the turn of the millennium. Seven of the world's ten fastest-growing economies are in Africa.

*Economic growth on the African continent has been greatly helped by foreign direct investment, notably from China, but also from other investors looking for attractive yields.*

The roles played by the World Bank and IMF are reasonably well known. What is less well-understood is the increasing role played by some of the regional development banks. Their success is confirmed by the decision to launch a new infrastructure development bank, the Asian Infrastructure Investment Bank (AIIB), with its headquarters in Beijing.

Economic growth on the African continent has been greatly helped by foreign direct investment, notably from China, but also from other investors looking for attractive yields. With an emerging middle class in Africa, there have been renewed calls for improvements in desperately needed infrastructure, education and training. In this context, it is worth highlighting the role played by regional development banks in attracting and leveraging private capital to fund such initiatives. The African Development Bank (AfDB) committed USD 6.7 billion to projects and

programs to its 54 continental member countries in 2013 with a further substantial sum invested by its sister organization, the African Development Fund, mainly funded by the Bank's non-African member states.

The AfDB is making good progress on its Ten-Year Strategy, particularly with respect to mobilizing resources within the continent and elsewhere to finance infrastructure projects in Africa. What is more, all four major rating agencies have awarded the AfDB their top AAA credit rating with respect to the Bank's senior debt, with a stable outlook. As Dr. Donald Kaberuka, the Bank's President notes, "This confirms the Bank's capital adequacy, prudent financial and risk management, solid shareholder support, and preferred creditor status."[14]

Another important development bank that is making a real impact is the Islamic Development Bank (IDB), first established over 40 years ago. The IDB is very much a 'South-South' institution whose member countries are virtually all developing nations. As with the AfDB, the IDB boasts an AAA credit rating from the major international credit rating agencies, enabling it to mobilize resources from international capital markets to finance development activities in member countries. One of the IDB's main tasks has been to foster and encourage a range of industries across member countries so that they can diversify their economies and improve their independence from unexpected fluctuations in global commodity markets.

*The record to date has shown that the IDB's Sukuk bond program has proved highly sought after by Islamic investors, not least because of the Bank's AAA credit rating.*

The IDB Group has rapidly expanded over the last six years. Over this period, the Group has benefited in three ways: firstly, from a substantial increases in its capital base; secondly, from the addition of a tier of debt finance on its balance sheet through the sale of *Sukuk* debt instruments; and thirdly, through a sharp increase in income which reached a historic peak in 2009 (1429H).

More recently, as noted above, the Bank has explored methods of borrowing money in the rapidly expanding international market for Islamic debt instruments, notably *Sukuk.* The IDB Group now issues Islamic bonds in London, Kuala Lumpur and, most

14 African Development Bank Annual Report 2013, p ix, Available at: http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Annual_Report_2013.pdf (Accessed: 1 June 2015).

recently, through the Nasdaq Dubai Exchange. The record to date has shown that the IDB's *Sukuk* bond program has proved highly sought after by Islamic investors, not least because of the Bank's AAA credit rating. Furthermore, the recent launch of the Bank's issuance initiative in Dubai has been a welcome boost to trading volumes in this Gulf finance center.

During the course of this decade, and following the financial crisis that gripped capital markets on both sides of the Atlantic in 2008-9, there has been considerable interest in learning more about Islamic banking and finance. The principles integral to *Shari'ah* have also proved the driving engine for new and innovative forms of providing project finance in the Muslim world. This has served as a catalyst for the remarkably rapid development of the Islamic finance industry worldwide and a strong interest from other Multinational Development Banks (MDBs) in the use of *Shari'ah*-compliant instruments to fund development. In turn, this has acted as a spur for ingenuity and well-tailored financial products that address the key needs of their market. Since it is fundamentally against the principles of *Shari'ah* to market and sell interest-bearing bonds, international debt plays no part in the Group's operations. But it is for this reason that the IDB – along with other Islamic banks – was spared the complications and problems caused by the turmoil in international capital markets from 2008.

Islamic banks have emerged as a major force in the trade finance arena. The IDB Group, for example, has placed considerable emphasis on the importance of trade financing operations. Indeed, since its inception, the Group has consistently channeled resources and management time into this area of activity via its subsidiary, the International Islamic Trade Finance Corporation (ITFC), which was specifically set up to advance trade. Today, it is one of the leading players within this market. In 2014 (1434H), the ITFC accounted for nearly half the IDB Group's net investment approvals by value.

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The main IDB member country in the Caucasus region is Azerbaijan, where the bank has been active. According to Brian Sturgess of *World Economics*, "The amount of IDB Group financing for Azerbaijan has so far reached USD 1.7 billion for major in-

frastructural development projects in the sectors of roads, energy, agriculture, water supplies, as well as financing private sector and foreign trade operations."

*A new Chinese Player on the Asian stage*

Although some economic commentators anticipated that China might try to challenge US dominance during the crisis, Chinese policymakers ended up playing a relatively low profile role. For various domestic political reasons, Chinese policymakers were for the most part unwilling to divert from their traditional export–oriented development strategy. However, the crisis gave the Chinese a nasty shock, not least because of their extensive portfolio of US Treasury bonds. As a result, China began to diversify its investment portfolio worldwide, and the world's second largest economy also opted to develop a more prominent and independent role in global monetary and financial affairs.

A good example of this revised strategy is the move to establish an Asian infrastructure bank, the AIIB, which will be launched in 2015 with a planned $100 billion in shareholder capital. Significantly, a number of OECD member countries, including the United Kingdom, Germany, France, Italy and Switzerland have along with India and Pakistan decided to join this Chinese initiative as founder partners, despite strong US opposition. Their motivation for doing so is the recognition that Asia offers some of the best economic prospects in the world – in contrast to the prospect offered by a stultified Europe. Britain is just one of the countries that is looking to find and win infrastructure contracts for its national companies. Confirming this trend, Australia has opted to join them, too, although the US put considerable pressure on the country to stay out.

David Marsh, the Managing Director of the Official Monetary and Financial Institutions Forum (OMFIF) believes,[15] "China will do its best to scotch American and other western concerns over the AIIB's governance by recruiting top-notch international management and policing a firm line on environmental and social standards for the bank's lending."[16]

15 OMFIF provides a useful forum to link central banks, sovereign funds and private sector financial groups and leading experts in the economic and banking fields internationally.

16 Marsh, D. (2015) London`s Beijing links could herald fresh strains`. *OMFIF Briefing*, 16 March, 6 (12.1).

## Conclusion

The way in which international capital markets and official policy makers have responded to the tsunami that hit financial markets in 2008-2009 reflects a shift in the tectonic plates of world economic power. Whereas the US was the undisputed leader of the pack a decade ago, we are now witnessing the advent of other prominent world players, notably China, but also those in the Islamic world. Previous backwaters, such as the continent of Africa, are emerging as important economic markets, attracting investment from major corporations, private equity funds, and hedge funds.

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Whereas mainland Europe, with the exception of a few countries such as Germany and the Netherlands, continues to ossify and suffer from myriad supply side rigidities, companies and investment funds based in Europe are seeking to identify and invest in promising new export markets in Central Asia, the Middle East, Far East, and Africa. William Hague, who stepped down as Foreign Secretary in the UK coalition government, made the development of closer ties with rapidly expanding export markets worldwide one of his key goals while he was in office. This concerted export push is set to continue and develop.

Recognizing that economic recovery within the UK was dependent upon British businesses both expanding in existing international markets and winning in new ones, British Government policy focused on this challenge. As Angus Miller, a former special adviser to the Foreign & Commonwealth Office (FCO), comments: "Under the new coalition Government led by David Cameron no UK minister, or official, was to hold a conversation without an economic growth dimension being included – the Growth Agenda as it came to be known." He adds: "And no diplomat overseas was to enter into a conversation without there being a similar economic growth dimension." Not only was the UK Government talking about helping the recovery, through the FCO, it organized overseas support to British business to fulfill this objective. At the same time, state resources were mobilized and focused to provide front line support through the UKTI (UK Trade & Industry) agency to British embassies, especially in the

emerging economies of Central and Southern Asia and South America. This activity was paralleled by a concerted effort to attract new private and institutional investors from the growing economies of these same states, such as Kazakhstan, Azerbaijan and China, as well as from countries with traditional ties.

Looking ahead, we are likely to see fresh moves to adapt the world's financial institutions to this new reality. Already, there is a significant link between the AIIB and China's aim to become part of the Special Drawing Right (SDR), the International Monetary Fund's composite currency unit. A review of how this might be achieved is due to be concluded by the end of 2015. One of the crucial justifications behind China's bid is that the IMF's currency unit could be much strengthened by the inclusion of China's relatively strong currency, even though the renminbi is not fully convertible.

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It is important to note that enlarging the SDR to include an emerging market currency - the renminbi - could promote the idea that the AIIB should adopt the SDR as its own unit of account, thereby extending the use of SDR by a wide range of international organizations, such as the BIS and AfDB.

Any such steps will simply recognize the shifting status quo, as the US and European economies lose their share of world trade to rapidly developing economies such as China, Malaysia and India. At the same time, we are likely to witness greater pressure on the US and major European economies to implement the promised reforms to the IMF which were agreed back in 2010. The US Congress's reluctance to ratify even the modest reform agreed to by member countries in 2010 is likely to lead to mounting calls for concrete action by China and other rapidly developing economies. Since China is a major holder of US Treasury bonds, Congress may find it difficult to prevaricate for much longer.

Furthermore, the prolonged and discordant negotiations over Greece's membership of the Euro, and its ability to service a debt mountain totaling €320 billion, is likely to trigger a number of longer term consequences, hinging on the continued shape of the Euro currency area but also the wisdom of continuing to appoint a European as the head of the IMF. The strong support

for Greece's continued membership of the Eurozone shown by Christine Lagarde, a former French finance minister who has demonstrated many admirable talents in her career to date, has nonetheless raised questions about the IMF's independence and fairness in dealing with individual member countries. If no satisfactory answer is found to repaying the sum of €26 billion owed by Greece to the IMF, other countries far poorer than Greece will find it more difficult to access funding in future. Such an outcome would accelerate moves to reform the governance of the IMF and give non-Europeans a greater say in the direction of the Fund, beginning with the appointment of managing director, as this author highlighted in an article for *The Wall Street Journal Europe* at the time of Christine Lagarde's appointment.[17]

17 Boyfield, K. and Sturgess, B. (2011) `Jose de Gregorio Rebeco for IMF Chief`, *Wall Street Journal Europe*, 6 June, Available at: http://www.wsj.com/articles/SB10001424052702303745304576361332505734782 (Accessed: 30 May 2015).