The Future Development Tendency of the International Financial Law from the Perspective of Financial Crisis

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Abstract: The global financial crisis triggered by the subprime mortgage crisis in America made a severe impact on the economies of the whole world including China. The paper analyzes the causes of the crisis, pointing out the deficiencies and insufficiency of the international laws today and offering constructive suggestions to its future development. The analysis of the causes of the crisis and the review of the neglects of the international financial laws in the paper are aimed to offer some suggestions to the reform and improvement of the international financial system in the future.

Keywords: Financial crisis; international financial law; deficiency; tendency

Résumé: La crise financière mondiale déclenchée par la crise des subprimes aux Etats-Unis a eu un impact sévère sur les économies du monde entier y compris la Chine. L'article analyse les causes de la crise, en soulignant les déficits et les insuffisance de la législation internationale actuelle et offre des suggestions constructives pour son développement futur. L'analyse des causes de la crise et la révision du manquement d'intérêt des lois financières internationales dans cet article ont pour but d'offrir quelques suggestions pour la réforme et l'amélioration du système financier international dans l'avenir.

Mots-clés: crise financière; lois financières internationals; deficits; tendency

Since the second half of the year 2008, the global financial crisis triggered by the subprime mortgage crisis caused tremendous shocks on the world economy. The financial industry in many countries has encountered with unprecedented crisis. Some leading investment banks broke down overnight, and still some were dependent on the rescue from the government to survive. Although the governments started launching the financial rescue plan, the crisis did not cease but rather extend to the real economy, tending
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to evolve to be a financial crisis. To turn the tide, the congress of the United States signed the $700 billion rescue plan (later increased to $800 billion); the European Union launched a $2500 billion financial rescue plan; the Chinese government planned to spend RMB 4000 billion in the next two years and other countries all lowered their interest rates respectively to prevent the future global economic crisis. Then, how did the crisis happen? Does the international financial law regulate the crisis? How will the international financial law develop in the future after the crisis? The paper attempts to give brief answers to the questions above.

1. THE ANALYSIS OF THE FORMATION MECHANISM OF THE GLOBAL FINANCIAL CRISIS

The current global financial crisis was evolved from the American credit crisis caused by subprime mortgage crisis. Then how was the subprime mortgage crisis formed? As we all know, the banks usually make a careful review of the qualifications of the borrowers before granting a loan. Launching subprime loans to the borrowers with reduced repayment capability to purchase real estate will bring more risks to the banks. In recent years, however, to expand their services, the American banks opened its access to loans for the low-income earners. Subprime mortgage means the subprime real estate mortgage or loan given to the borrowers who only have 620 credit scores as opposed to the 660 credit scores of the middle and high income borrowers. The subprime borrowers have a high rate of default. There are various reasons why the banks provide loans to the low-income borrowers. First, it’s because the house price keeps increasing, and the borrowers can repay the loan by revolving the capital. This caused the housing bubble expansion, for the real estate can make profits and many speculators got involved. Second, the investment banks used a financial derivative package called Credit Default Sweep to increase their speculating profits. However, once the housing market declines, the default rate will increase, the credit bubble will explode and a lot of subprime loans will not be withdrawn. This was when the subprime mortgage crisis happens, consequently evolving to be a financial crisis.

Under the impact of the subprime mortgage crisis, the American stock market dropped and several leading investment banks shrank and even declined into a state of insolvency. At first, one of the five leading banks in American, Bear Stearns declared bankruptcy. Fannie Mae and Freddie Mac the mortgage giants were taken over by the government. Later on, the famous Lehman Brothers Holdings was encountered with the bankruptcy. The Merrill Lynch Securities with a history of 94 years was merged by the government. The Wall Street in America suffered the biggest financial crisis in the past century. Responding to the America crisis, the Asian market stocks declined dramatically. The stock index in China dropped from above 6000 point in the prime time in 2007 to above 1600 point, reaching a 70% decline. European stock market was also on a decline.

We should say that American subprime mortgage had a good will in the beginning and had made great effects in the first 10 years. In 1994-2006, the house ownership rate has increased from 64% to 69%, over 9 million families owning a house. Many low-income earners purchased a house through the subprime mortgage. Those borrowers could not get a common mortgage loan because of their weak credit history or because they cannot afford the down payment. The subprime mortgage help the low-income borrowers have a new opportunity, but the risks for the bank are also increasing. The subprime mortgage rate can be as high as 10%-20%, and employ the adjustable-rate mortgage (ARM). As the Fed increased the rate several times, the repayment rate kept rising which led to the increasing delinquency and foreclosure. The crisis thus took place.

The world monetary system today plays an fundamental role in turning the subprime mortgage crisis in America into a global crisis. Since the early 1970s when the early world monetary system – Bretton Woods system collapsed, the free exchange between dollars and gold has been abolished, however, the American dollar is still playing the leading role in the world. What’s more, many countries still use dollars as their foreign exchange reserve currency to stabilize the value of their own currency. In this way, America actually assumes a role of World Central Band, and is free to issue currencies to the whole world. Although the Euros and Yens have the capacity to be against dollars, American dollars still holds
its leading role supported by the leading economy of America in the world. Therefore, the American dollars are indispensable and irreplaceable in the world monetary system, and influence the world economy directly.

In addition, as the world’s largest economic entity, America has a direct impact on the other countries in the financial activities. It is common for individual American people or the government to make loans to consume, consume today with the money for tomorrow. It is believed that Americans today have spent all of the money for the next few generations. This habit in America has been founded on the America’s role as the world leading financial country and American dollars as the hard currency acknowledged by the world. America admits that if America wishes, it will start the machines to print American dollars and circulate them around the globe. However, anyone with a basic knowledge of economics knows that when the amount of the currency issued is larger than the real value of the circulating commodities, the currency will be devalued and the inflation happens. Federal Reserve surely knows that the starting the machines to print American dollars will lead to Seigniorage for America and potential inflation. To withdraw the currency, the Federal Reserve had to raise the interest rate again and again, causing the explosion of the real estate credit bubble and the outburst of subprime mortgage crisis and financial crisis. The globalization of the world’s economy has connected all the countries around the world. The American financial crisis spread to the other countries in the globe, and a global financial crisis happened.

At last, the invalidation of supervision is another major cause of the global crisis. Since 2008 there appeared the sigh of the financial index exasperating, but American government and financial supervision bureau did not regulate to stop it become worse. The international law did not regulate the high risk behaviours of the financial industries because of its own deficiency, set it free leading to the global crisis.

2. THE ANALYSIS OF THE DEFICIENCY OF THE INTERNATIONAL FINANCIAL LAW

Based on studies of the financial crisis formation causes and the practices of the governments and international organizations’ crisis rescue plan, we could clearly see that the current development of the international financial law falls far behind the development of financial globalization and liberalization. It has many deficiencies and defects. Here we analyze the international financial law from two perspectives, namely, its performance and content.

The international financial law has a poor enforcement power. It is the result of the conflicts and coordination of the various international financial relations. And it is also a major cause of the inadequate performance of international financial law in regulating the financial crisis.

2.1 The amount of the financial articles with public law nature is limited and their contents are implicit.

However, these articles would play a key role in protecting the international financial system and security. The lack of these articles could not satisfy the needs to offer effective legal support to the financial crisis regulation. For example, although International Monetary Fund Agreement prescribes the purpose of the IMF to facilitate the stability of the international monetary and its function of supervising the international financial operation, there are no specific articles on how to facilitate the stability of the international monetary, to implement the financial supervision, and whether it has the rights to act upon the financial crisis and so on. Therefore, in the practice of dealing with the financial crisis, there are problems and disputes regarding to IMF, such as overreaching its authority, untimely rescue, insufficient rescue funds, improper rescue measures, and so on.
2.2 The enforcement power of the bilateral document that is closely related to the financial crisis regulation is limited.

The major form of the document titled “Memorandum of Understanding” does not have legal powers, and it’s only an announcement of the intentions signed by the financial authorities of the countries. Therefore, it lacks a strong legal guarantee during its implementation. Another document form is “Mutual legal Assistance Treaty”, which has some legal binding force but not a technical document for the international financial supervision. Also, the second form of documents is usually signed between the developed countries instead of between developing countries which could be the real victims in the financial crisis, from this perspective, its function in preventing and regulating the financial crisis cannot be fully realized.

2.3 The international financial supervision rules issued by the non-government organizations do not have sufficient legal binding force.

From an objective view, the non-government organizations with the Basel Committee on Banking Supervision, International Organization of Securities Regulators and International Organization of Insurance Supervisors as representatives, have issued a series of international financial supervision rules. These can be seen as the legal response to the financial crisis. Because of its explicit supervision standards, advanced supervision methods, strong market orientation, the rules could make practical effects on regulating different countries’ behaviors, improving the financial supervision performance of all countries, preventing and controlling the financial crisis. However, the rules have some problems in its effectiveness and implementation, thus weakening its expected capacity to prevent financial crisis. First, it is because the rules do not have legal binding force, and they are mainly recommended by the international non-government organizations to the inspection authorities of different countries, including financial supervision rules, standards, suggestions and methods. Second, these rules are more suitable to their banking inspection of the developed countries, so it is difficult to put them into practice simultaneously in different countries with different financial supervision systems and different levels of supervision capacities.

There are deficiencies in the content of the current international financial law system:
- Lacking explicit and authoritative international financial regulators.
- Lacking a set of related legal responses to the financial crisis.
- Lacking an effective coordinating mechanism of international financial policies and system.
- Lacking an effective supervision on the cross-border capital flows.
- Lacking a punitive system to maintain the international supervision cooperation.

To sum up, financial crisis and its legal regulations have become a major global concern. To improve crisis regulation performance, the innate deficiencies of the international financial system should be overcome; the systematic risks accumulated by the global financial system should be eliminated; the excess of credit in the financial and economic fields should be terminated fundamentally; the international cooperation on regulating the international financial capital flow should be enhanced systematically; the international organizations supervision power should be enhanced. These are the issues that international financial laws should solve in its future development.

3. THE FUTURE DEVELOPMENT TENDENCY OF INTERNATIONAL FINANCIAL LAWS

The international financial law is rooted in the international economic life and is a positive response to this economic life. The tendency of financial globalization is a remarkable characteristic of the
international economic life, influencing the international politics, economies, laws and cultures comprehensively and profoundly. In the context of financial globalization, the international financial law is developing fast and makes progress in many fields, but it has also led to the fast spread of the subprime mortgage crisis. Under the influence of the financial crisis, the development of the international financial law has a new tendency. Certainly, this development is more to respond to pressure or to meet the current needs. Mastering these pressures and needs of the international financial law, we could have a vision of the future tendency of the international financial law.

3.1 International financial supervision becomes a new tendency of the development of the international financial law.

Financial globalization has changed the traditional international finance profoundly: the appearance of the international finance leads to the abolishment or neglects of the financial supervision; the national financial crisis is open to the international investors; the national residents and non-residents enjoy the same rights of market entrance and management permission; international organizations implement the cross-border management strategies and so on. These activities provide convenience to the people. However, the new changes, such as the trade disputes between the developing countries and developed countries, the globalization of the financial market and capital circulation, and the cyber economy, also made the international financial risks globalized. In the context of the international financial globalization, it is not practical to depend on one country's financial supervision to deal with the financial security challenges to all of the involved countries caused by the global financial crisis. Every country has an urgent demand to enhance the global financial inspection. It is also necessary to ensure a healthy development of the financial globalization. The legislation for the international finance is core to strengthen the global inspection.

To realize the international financial inspection, it is necessary to make a general review of the current international legal system, on such basis, to integrate resources, and supply the deficiency. The key international financial organizations such as IMF, World Bank Corporation, Basel committee, etc, should make the best use of their resources to improve the resource utility, improve the legalization and standardization of the financial inspection through the mutual communications of financial and technological information, and build the powerful international security system including the international capital inspection system. For example, the World Fund Organization has such major advantages as its authority as the international organizations among the governments, the universality of its members, the constraints of the fund agreement, the sound organizational system, the general financial analysis, the easy accessibility to the financial inspection information, the convenience with the other international financial organizations, and so on. The Basel committee has such advantages of flexibility of the non-government organizations, easy accessibility to the financial inspection information and experience of the developed countries, the convenience of revising the bank inspection rules, market friendliness of the financial inspection standard, and so on.

3.2 The financial crisis promotes the systematic innovation of the international financial law

Financial innovation is a key to the financial development. For example, with the popularity of the internet, financial innovation tools and the currency substitutes such as electronic currencies are applied in different countries, challenging the host nation’s authority to permit the admission to foreign currency. To protect their own interest, it needs to hedge the risks by financial innovation. For example, Australia launched “Electronic Transaction Act” in 1999.

Certainly, there are high risks in the process of the financial innovation. When the financial innovation has become the theme tune today, the international financial law which is most responsible for the stable operation of the financial system is encountered with great challenges. The financial crisis triggered by the subprime mortgage crisis is the consequence of the financial innovation, and a sign of the malfunction of the current international financial law and international financial system. IT is the core
value and purpose of the international financial law to build a financial system order and secure the financial system safety to maintain the stability of the financial system. Therefore, the globe is seeking the international unification of financial inspection standard. For example, Basel Committee has made and launched a set of documentary rules and suggestions, becoming increasingly important as the supervision principles in many countries. The unified international supervision standard enables the international society to supervise the high-risk fields such as financial derivatives.

Conducting relative system plans based on the main characteristics of the financial crisis is also the most important mission of the international financial law. For example, enhance the construction of the coordination of the international financial law including the internal coordination among the international monetary legal system, international bank supervision legal system, international security supervision legal system and the external coordination with the international trade law, international investment law, and international criminal law. World Trade organization, Monetary Fund Organization, and European union should complement one another, rather than conflict one another; to deal with the regional characteristic of the current financial crisis, the regional mechanism of the financial supervision should be built and developed; the legal cooperation in the regional risk prevention should be explored and improved such as currency exchange and exchange rate coordination; Considering the characteristic of the outburst of the contemporary financial crisis, all countries’ supervision bureaus and international organizations can learn lessons from one another, build a sensitive risk warning and emergency system, reform and complete the loaning conditions of IMF, and open the green access to the risk rescue. Considering the characteristic of the crisis being systemic, the rescue function of the international legal system should be developed and explored, endowing the IMF with rescue function and enhancing its punitive ability; the responsibilities of the developed countries in the crisis should be legalized; the international disciplines and procedures should be strengthened and completed; the deposit insurance system and national debt reconstruction in response to the crisis should be studied and developed. These measures can effectively prevent the extension and upgrading of the crisis.

From the a more general view, in some international financial fields during the spread of the financial crisis, there is no international law order recognized by many countries and good for the general developments of both developed countries and developing countries. Some international relations are still off the track of the international financial law system. There are still problems in creating international financial law regulations. Therefore, we cannot have a high expectation on the international financial legalization led by the developed countries, while without the substantial changes of the developing countries regarding to the improvement of their national power and international finance.

4. CONCLUSION

The explosion of the global financial crisis was evolved from the subprime mortgage crisis initiated in America. However, there are so many issues that deserve further studies. The future development tendency of the international financial laws is one of the issues. The instability and the innate inconsistency of the current global economy further drive the improvement and perfection of the international financial laws. After the crisis, the governments take lots of measures to rescue the market, and the timely rescue and the powerful measures have release the crisis to some degree. However, it still needs time to see whether the rescue plan could completely prevent the global financial crisis becoming a global economic crisis. Preparing beforehand is the best to prevent crisis. The new international financial law system should be built at a faster speed to complement the efforts in decreasing the influence of the crisis, thus preparing for adequate response to the next crisis.

In addition, this financial crisis brings opportunities for China to further participate into the world economy. This opportunity should be seized. We have no choice but to make a positive response to the development of the international finance and its legal system, and merge into the globalization. In fact, with the extension of the financial crisis and the rapid development of the international financial laws, the financial law building in China will enter a fast tract, making tremendous progress in the near future.
REFERENCES


