

Role of financial institutions in the global economy

[Economics](#)



Globalization has sparked a revolution in information and communication technology, resulting in the emergence of an era that boasts the arrival of new levels of global interconnectedness. As a result, globalization has also increased the significance of the many different roles that financial institutions play in the overall global economy. Financial institutions can play several roles, ranging from operating as a simple method of savings, to functioning as an important revitalization source in a low-income community.

This paper will explain the general role of financial institutions in the global economy, will touch on more significant individual roles, and discuss the overall role of international financial institutions. Research indicates that a financial institutions' role as an intermediary is clearest in the credit and deposit business (Kramer, 2002). The usual function involves clients bringing to the bank their savings, or money which the bank transfers to its credit clients in the form of loans.

In the loan instance, a borrower's credit rating may change during the life of a loan, thereby changing the value of the loan at that point in time, which reflects the interest and amortization payments expected in the future (Kramer, 2002). In some cases, credits may even become entirely worthless if borrowers become insolvent and bankrupt (Kramer, 2002). Another function which banks perform within an economy is rating and selecting the loans they finance.

Through their activities as an agent, another essential function performed by banks is to reduce risks overall (Kramer, 2002). In this way, the general role

of banks is to undertake and provide specific products or services. Financial institutions also play an additional role within an economy by granting loans, processing payments, accepting deposits, and carrying out investments. Through these activities, banks create added value for their clients, employees, service providers and shareholders.

As a result, there is a significant amount of potential damage were a bank to collapse. Thus, the economic benefits generated by a bank are basically no different from the economic benefits generated by a doctor, teacher or train driver: by exercising, to the best of their knowledge and abilities, their specialist function in competition with others, companies and their employees make their contribution to economic benefit (Krayner, 2002).

Research indicates that bankers act responsibly when they ensure that their house is in order and resist the temptation to pass off poor financial performance as a contribution to the economy (Krayner, 2002). Larger financial institutions play an additional role than just that of providing typical banking services. Financial institutions can form the core of economic development in a low-income community. For example, the World Bank's focus is on project lending and structural reforms that enhance long-run development and poverty alleviation (Stiglitz, 1998).

The role of the World Bank in the global economy is to address pressing issues such as weak financial sectors, lack of transparency and poor governance in the corporate sectors, and weaknesses in external liability management will help restore confidence among foreign and domestic investors (Stiglitz, 1998). In this way, the World Bank acts to reactivate poor

economies and thus to protect and extend social and economic achievements. In poorer countries, the World Bank appears to operate in coordination with the government as it steps in and fills the income-security gap that is left by companies closing and workers losing their jobs.

Over the longer term, the World Bank will be working with countries to help them design modern, durable social safety nets that complement their other structural reforms (Stiglitz, 1998). Finally, as illustrated above, the role of financial institutions is very diverse, as communities depend on them for basic transactions such as savings and loans. In the larger view, however, banks operate as the financial support of an economy, the stabilization of which the community depends on.