



Volume XXI 2018

ISSUE no.1

MBNA Publishing House Constanta 2018



## Scientific Bulletin of Naval Academy

SBNA PAPER • **OPEN ACCESS**

### **Revision of Functional Role of the International Financial Institutions on Global Economy Governance**

To cite this article: Catalin Popa, Marius Cucu, Imre Reczey and Ana Maria Monica Popa, Scientific Bulletin of Naval Academy, Vol. XXI 2018, pg. 173-179.

Available online at [www.anmb.ro](http://www.anmb.ro)

**ISSN: 2392-8956; ISSN-L: 1454-864X**

doi: 10.21279/1454-864X-18-I1-029

SBNA© 2018. This work is licensed under the CC BY-NC-SA 4.0 License

# Revision of Functional Role of the International Financial Institutions on Global Economy Governance

**Authors:** Catalin Popa<sup>1</sup>, Marius Cucu<sup>2</sup>, Imre Reczey<sup>3</sup> and Ana Maria Monica Popa<sup>4</sup>

<sup>1</sup> Naval and Port Engineering and Management Department, “Mircea cel Batran” Naval Academy, 1<sup>st</sup> Fulgerului Street, Constanta, Romania, [catalin.popa@anmb.ro](mailto:catalin.popa@anmb.ro)

<sup>2</sup> International Affairs Office, “Mircea cel Batran” Naval Academy, 1<sup>st</sup> Fulgerului Street, Constanta, Romania, [marius.cucu@anmb.ro](mailto:marius.cucu@anmb.ro)

<sup>3</sup> Business Department, Higher Colleges of Technology, Abu Dhabi, United Arab Emirates, [imre.reczey@hct.ac.ae](mailto:imre.reczey@hct.ac.ae)

<sup>4</sup> “Mircea cel Batran” Naval Academy, 1<sup>st</sup> Fulgerului Street, Constanta, Romania, [monica.popa@yahoo.com](mailto:monica.popa@yahoo.com)

**Abstract:** *The International Monetary Fund as global organization, beside World Bank, World Trade Organization and other relevant international entities with global soundness, has a major role and responsibility not only in promoting the monetary and financial equilibrium on international level, but also has significant impact and responsibility residing from it, regarding the poorness relief and balanced economic development. This article is proposing a brief radiography, reminding and explaining the major policies available as strategic options nowadays not only for IMF but for the entire system of global institutional governance system. Looking behind and recalling for the IMF operational and political failures when interfering with the national economic systems and regional or international markets, there were determined several options for improving the coherence of IMF strategic goals against the global governance stability variables.*

**Keywords:** *financial system, international monetary fund, financial policies*

## 1. Introduction. International Financial Institutions role and global responsibilities

The main actions of the International Monetary Fund (IMF) and of the World Bank Group (WB) related to the economic phenomena refers to all the techniques and instruments used in the governance of the international monetary and financial system, with implicit consequences on the economic dimension and monetary and financial policies, regarding the economic macro-stabilization, materialized through assistance programmes on sustainable development of emerging countries and reducing poverty in the world's poorest countries. The failure of international bodies is precisely because of the state of the world economy, highlighted by huge growing gaps, between the level of the most developed countries and the level of the poorest countries.

Starting from the main difficulties, depicted in the relational diagram of Figure 1, regarding the perspective of an efficient governance of the economic and financial relations, integrated and globalized, the delimitation of functional relations between the IMF and the WB should foresee the first concrete steps in redefining the world's institutional architecture. Overlapping institutional attributions, approaching different attitudes about the monetary-financial qualitative dynamics and about the world economy balance are just several realities likely to bring dilutions for these two institutions role and action image, as proving themselves sometimes too independent of any international political forum and caught in unilateral monologue as any other simple financing institution facing its clients.

As represented in Figure 1, the main directions of political and strategic action of the IMF and WB, related to the economic dimension, refers to **macroeconomic stabilization mechanisms** and to the

**direct involvement in international economic issues**, generated by capital, goods and services flows liberalization, in relation to the essential dilemmas of globalization (Fingerald K.M., 2001).

**Macroeconomic stabilization mechanisms** refers to the entire ensemble of statutory instruments, assigned to the monetary and financial bodies, regarding the macroeconomic balance, structure and evolution of the balance of payments, exchange rates evolution, the level of economic growth, fiscal discipline, inflation rate, unemployment rate or social policies. Macroeconomic stabilization is essential at least from the bottom up perspective from the component to the whole system, involving macroeconomic balance and being able to bring local, regional and international benefits.

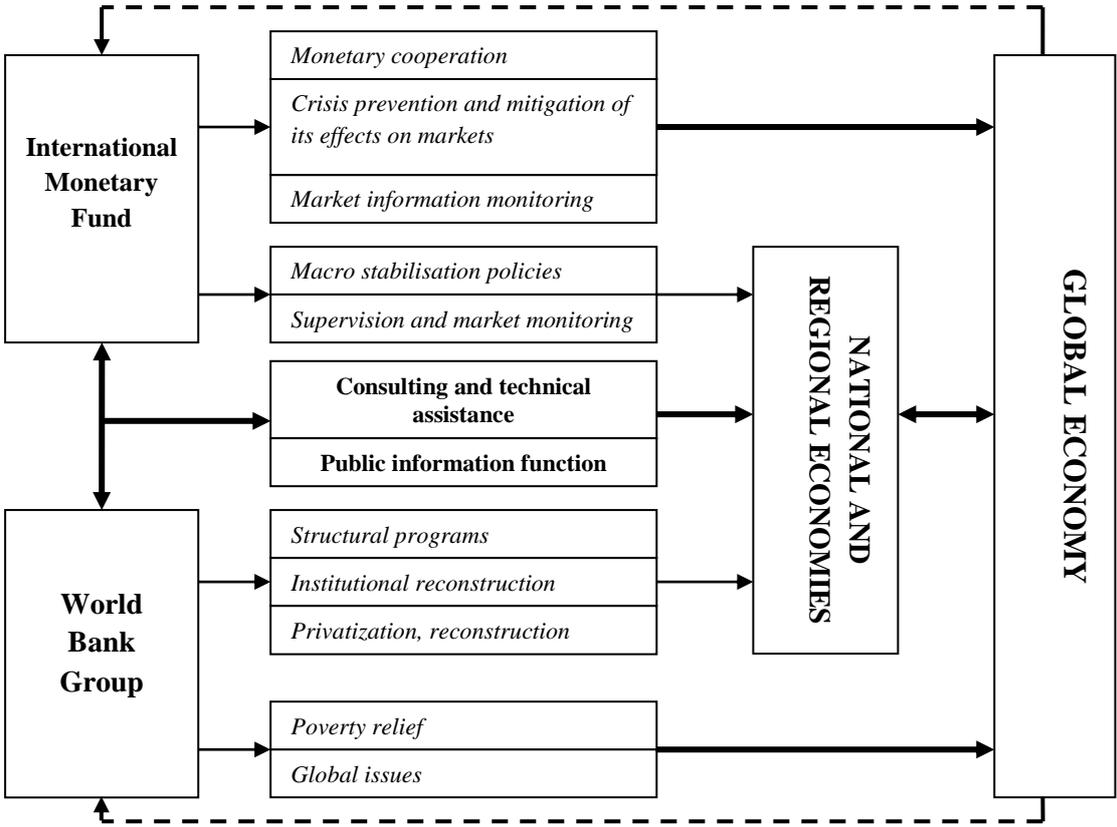


Figure 1: The place and role of the IMF and the BM in relation to the global economy system

**2. IMF’s learned lessons from past on applied policies and its options for the future**

At macroeconomic level, macro stabilization and support policies of the IMF and WB have suffered, as we have presented before, doctrine changes, especially in terms of preponderance of monetary formulas and ignoring the g relations with the social and economic dimensions of the applied restructuring programs to the assisted countries. History proved that monetary formulas focused on reducing the inflation, supporting the currency exchange rates or the external creditors’ clearance, mainly to support the banking system functionality did not have the foreseen effect nor expected relevance in terms of sustainable development (i.e. as the case of developing countries).

The examples offered by Joseph Stiglitz in his research and studies, demonstrates precisely this: Argentina has not recovered after nearly \$40 billion injected through assistance programs (1986-1987), there was no major change in Russia after the nearly \$30 billion received (1998) and the Asian

countries despite the massive collective effort of over \$70 billion (1997-1998), in the short term their critical situation has not been improved (Stiglitz J., 2002).

Prevalence of the last borrowing authority mentality and the force of dictating instead of carrying consultations and active cooperation, deliberate omitting the real needs of assisted countries and exaggerating the monetary policy priorities, have led to the transformation of the international financial institutions, for a long time, in simple financing entities, which are involved in regulating the budget deficit or balancing the payments of some states, who managed to fulfill, at least scriptically, the qualifications criterion imposed by priority formulated and not adapted recipes (Stiglitz J., 2009).

Obviously, in most situations (especially in the case of the Latin American countries), the mirage of monetary and financial stability in short term, at the next moment disappear, the problems of deficit increased, due to the worsening of the internal business environment and deteriorating the image of these countries on international markets. Loans granted have mostly reinforced the investor's conviction that something is happening in the assisted country.

As a late echo of the proposals formulated by Joseph Stiglitz in 1999, the implementation of "Policy Support Instruments" took place only in October 2005, through which the IMF has awarded market ratings to the assisted countries in order to stimulate the investments from capital markets, in exchange of costly and sometimes useful interventions for the market reaction. So, regarding the macro stabilization area, "goodwill letters" appear to be more effective than loans under stand-by arrangements, at least from the perspective of sustainable development of developing countries. (Stiglitz J., 2006).

In addition to this, transparent publication of statistical forecasts resulting from the field study results and the rational and objective assessment of the level of risk related to the macroeconomic or corporate level may face the issues arose by the international rating institutions, accused of impartiality, subjectivity or even corruption. Taking into account the recent events, and accumulated expertise, the IMF has the right and even the obligation to change and modify entirely the methodologies of assessing the macroeconomic and corporate ratings, in order to restore the credibility for institutional auditing system of the quality of global economy and financial balance.

In order to proper inform the data analyzers and market analysts we suggest in this context, in the form of a future approach, that IMF can further promote the need of adopting the point of view of the evaluated state itself that is being after being established the rating and substantiation report of the risk analysis of the assessment institution, as a measure to improve the lack of objectivity in the evaluation processes at international level, by promoting symmetrical information with a bivalent source.

Macro-stabilization of developing countries brings a major plus of stability, whether we are referring to the budget deficit, current account deficit, exchange rate evolution, inflation level, or economic growth. But as we could see in the late 90's, as result of system crisis and how it was reiterated from the point of the sub-prime credit crisis effects chain, the image, the prospects and expected anticipations, often brings the most significant changes of the international monetary and financial markets' behavior. As Aglietta M. remarks, „...it is hard to believe that a country like Mexico is reaching to be worth in real terms, 40% less than last week [...]” (Aglietta M., 2001). The crisis was based less on economic realities and more on speculative behavior of investors in the financial sector, which may at any time to abuse of the disadvantages arisen from the free movement of capital. Successful and effective demonstration of some Asian countries (respectively South Korea and Malaysia) who had the courage to impose restrictions on the capital flows movements had marked „... the consistency of the restriction of financial freedoms in certain situations [...]”, with the monetary-financial institutions' agreement and the consent, forced to judge at the time the macro stabilization priority in relation with the national interests, beyond the proclaimed principles of freedom of the market. (Teunissen J., 2000)

The ability of a state to preserve its image of a solvable entity on international markets, may be indirectly affected through the aid granted by financial institutions, which is why interventions needs to be adjusted, to the strict level of states' request, in the form of last resort lender or rather of a **strategic investor**, against the designation of these entities as responsible with the elaboration of

macroeconomic strategies. Market worries can be diminished only through correct information and can even be effectively countered by carrying direct investments (through his own specialized structures, developed on the model of the International Financial Corporation). It can be theoretically suggested, as a strategy for rebuilding its own image, as in regulating the market behavior, including the establishment of a classic pool, to act on the monetary and financial markets in the pre-crisis periods, once a depreciating frame is evolving in the region. If it were to compare the effects felt by the international monetary and financial markets in these two strategic situations of action, respectively from the position of last resort lender and the position of strategic investor, we tend to give more chances to the direct investments strategies in remaking the market perceptions, in response to those intensive reactions applied, deliberately described by an excessive involvement in the assisted states' problems. (Stiglitz J., 2006)

On the background of liberalization of capital flows, uncontrolled income was allowed to come on speculative flows to supply an already fragile and insufficiently well adapted markets of the developing countries, but ignoring that the initial positive effect of receiving investment capital on short run can be reversed at the first negative market signal. The phenomenon of crediting, revived on the same process of free movement of capital has allowed diversification of economic agents' resources, but also the weakening of the banking sector, forced in a competitive way, to lower interest rates, to underestimate the risks and to become imprudent, in specific market actions, as could be noticed on the occasion of the sub-prime crisis. In these conditions, banks have also placed themselves in the position of market investors, acting in a dangerous manner, by diversifying portfolios on speculative titles or by unjustified wide-ranging their market interactions, issuing derivate instruments on markets (i.e. term contracts or insurance). Following the pattern of the 1998-1999 period, crisis are spreading the effect chain from the financial plan to the economic one by a simple mechanism, starting from the financing function of the monetary-financial system. To the extent that there is a financial crisis, starting either from insufficient liquidity, either because of the unjustified assessment of the real value/market value ratio, the first reaction of the banking system is to raise interest rates to recover losses from inflation, or to due to this attitude the risk margins suddenly had increased, only by changing variables (i.e. the case of the sub-prime crisis).

Covering the bank risks by widening interest rates produces serious disturbances in production function of borrowed enterprises, unable to cover the investment cycle with self-financing resources making it impossible for the economic agents to pay in time overdue rates and increased interest rates. In the case of the 2007 mortgage crisis, on the basis of the market values fall on the real estate sector, the banking system was forced to correct its assets value on invariable liabilities, recording huge losses only from revaluation (the case of the Japanese banking system whose correction of the balance sheet reached \$10 billion at the end of 2008).

In the case of the Asian crisis (Thailand, 1997), the consistent support of the IMF, has done nothing but „... *to pay indirectly the creditor's payment notes and to ensure in this way the net profit of their speculative nature*” (Stiglitz J., 2006). The IMF did not take into account the economic realities of the states concerned and the need to provide liquidity support for the market. From an unfair perspective, the creditors (investors of banking institutions), were placed before debtors, no matter if the debts were recorded due to speculative market game.

Comparison between Thailand's behavior, which followed all IMF indications without any blink and Malaysia, who assumed responsibility for possible sanctions, acting against the requested measures, could led to the idea that the government knows in most cases what is the best for its citizens and its actions to protect national interest will be far more effective than universal prescriptions, recommended by international institutions. Therefore, it was noted that, surprisingly, although it did not have access to the same amount of financial assistance, Malaysia managed to rehabilitate itself in a much shorter time compared to other Asian countries subordinated technically to the IMF monetary recipes.

The economic importance of a reasonable rate of inflation, balancing the budget deficit and the payments account or preserving, or for a stable rate of the national currencies are obvious, but

international institutions should pay more attention to the particularities of the national economies at a certain time. Thus, thoughts on inflation should also take into account the real economy indicators, for obvious reasons, mainly related to the increasing consumption based on real income increments, increasing the price for the main energy resources or price evolution at international level for certain raw materials or materials, occurred in the economic circuit (e.g the case of substantial price increases to energy resources and food from the middle of 2008). For example, a high inflation rate may come not necessarily from exchange terms deterioration, but also from the consumption pressures occurred for short periods of time, having in the background some additional earnings for the population. Or, depreciation of the national currency can interfere in a bad moment provoking the reconsideration of market price for the main exported goods by certain states. (Soros, G., 2008) Also, the balance of payments may be deteriorated also as a result of increased investment effort and increment in the energy resources price causing not only inflation, but also the slowdown of the economic growth rate for some states or speeding up for others.

Therefore, IMF and WB are called to interfere in a complex economic climate, and the lack of consideration of all economic and social variables in the theoretical decisions on financial assistance, can lead to triggering some chain reactions with serious consequences for the assisted states. Macroeconomic stabilization implies more than the weighting of rate of inflation or adjustment of a country's balance of payments. Lack of an international authority responsible for the supervision of the economic environment and the proper functioning of the market relations, can bring, on specific situations: wrong procedures for financial and credit institutions supervision, indifference to small producers and their problems, indifferent perspective on the local business environment restructuring and bankruptcy, institutional corruption, ignoring social issues, failure to protect national interest and priorities. All these are just a few examples of attitudes which may affect economic macro stability, beyond the benefits of immediate actions applied through monetary policy instruments. The IMF information function, reviewed in the recent past years, now includes data on economic growth, social policies, the investment climate or the volume and structure of consumption, suggesting that economic failures found a receptor at least in this case. (Ritzer, G., 2011)

The focus has been shifted, correctly, on the importance of transparency and symmetrical information on the monetary, financial, economic, social and political perspectives of the states and on the anticipation of slippages instead of post-crisis or direct interventions in the market. However, market values as the corporate and capital policies are still neglected, recommendations made by the IMF under the terms of stand-by arrangements concluded the along the crisis time during 2008-2009 continuing to focus on fiscal and monetary policy elements (i.e. the case of Ukraine or Iceland) (Stiglitz J., 2009). Beyond the positive effects, acting in this way, there is a risk that the IMF, through the amounts it offers for stabilization of the payments balances, to actually resume to offer guarantees to investor's that the assisted economy will cope will all short and medium-term situations. We believe that the application of correct capital policies would have been more important under the circumstances of a crisis of "lack of confidence". Guaranteeing preventive lending and stimulating the access to various forms of external financing for the assisted state (i.e. as the conditional support for reforms to the banking system through the purchase of a medium and long-term governmental securities or by state intervention arbitration in the economy), could represent more consistent signals given to the international markets. (Soros, G., 2008)

Starting from the idea according to which, the losses recorded by a nation will always be found at the level of a third winning country (Appleyard F., Cobb. A., 2006), global economy, beyond a stable monetary and financial system, needs a promoter of a fair economic approach more close to the productive system and specific laws on the comparative economic yield and advantages (Hollander S., 1979). To find itself in the center of global economic problems, the IMF should give up on „ ... *old habits of a privileged bank of the rich*” and to engage actively in the improving of the macroeconomic conditions of the member states, by promoting adapted and customized advisory and assistance services, but considering the final goal of a **sustainable economic development** based on a healthy monetary-financial balance. (Coyle D., 2000)

Direct involvement in international economic issues aims another dimension of contemporary concerns, assigned to the international monetary and financial entities and refers to contemporary issues, generated by the processes of globalization and economic integration or with impact on the global economy. Out of these, the most important would refer to: promoting fair development in all parts of the world, poverty relief, eradicating the mass diseases, reducing illiteracy or promoting the fight against terrorism, considering afterwards the major global mutations (such as pollution, global warming, decreasing of global resources, global nutrition issues or the demographic phenomenon). (Rischar, J.F., 2002). If the IMF is called to watch mainly on the balance of the world economy from a monetary-financial perspective, its role resuming more to those aspects related to macro stabilization and sustainable economic growth, The World Group finds itself, from a statutory point of view, more in this direction, being responsible through all its institutions, about economic development issues, structural economic adjustments, poverty relief or global pollution effects mitigation.

### 3. Conclusions

In conclusion, no matter if we are talking about the monetary-financial phenomenon or the global economy issues, the relations of interdependence are so tight that approaching behavior or an action without interdisciplinary multi-dimensional perspective from international monetary and financial institutions, can lead to a major failure in political and strategic terms. System variables have greatly diversified the movement of the market elements has grown up significantly on social, cultural and political diversity, requiring new political standards with regard to the global consensus rebuilding. (Popa, C., Ionescu L.C., 2010)

In the contemporary context, lack of contact with the major problems of globalization, ignoring the answer to the high dilemmas raised by the interaction processes between global values and self-isolation from the international forum of political negotiations, can transform the institutions of the International Monetary Fund and the World Bank in simple „*lending offices*” or „*periodic publishing houses of international economic studies*” (Strange S., 2002). This can be avoided only to the extent that, the aspirations of the contemporary world will be found in policies and strategies proposed by these institutions with universal vocations, their usefulness or after case, their lack of performance, being the only rules of real adaption to the new global realities in which it cannot act alone neither independent, where the international cooperation process cannot be eluded on the basis of technical details, and moreover where major global issues cannot be forth ignored, but valued considering the complex influences in all dimensions of economic, social and cultural life.

### References

- [1] Appleyard F., Cobb. A., 2006. *International Economics* (5th ed.). McGraw-Hill Irwin.
- [2] Aglietta M., 2001. *Financial Macroeconomics*, vol. II, Bucharest: C.N.I. „Coresi” Publishing House.
- [3] Coyle D., 2000. *The World Economy Governance*. Bucharest: Antet Publishing House.
- [4] Fingerald K.M., 2001. *Trade, Finance and Financial Crisis*, Special Studies No.3, WTO.
- [5] Hollander S., 1979. *The Economics of David Ricardo*, Toronto: University of Toronto Press.
- [6] Popa, C., Ionescu L.C., 2010. *Financial Institutions' Policies within Globalization Framework*. Constanta, Romania: NAC Publishing House.
- [7] Rischar, J.F., 2002. *High Noon – 20 Global Problems, 20 Years to Solve Them*. New York, USA: Basic Books-Perseus Books Group.
- [8] Ritzer, G., 2011. *Globalization: The Essentials*. NY: John Wiley & Sons.
- [9] Savin-Baden, M., Major, C., 2013. *Qualitative Research: The Essential Guide to Theory and Practice*. London: Routledge.
- [10] Soros, G., 2004. *Political Voice and Become a Catalyst for Change*. Washington, USA: Inner Ocean Publishing.

- [11] Soros, G., 2008. *The new paradigm of the Financial Markets: The Credit Crisis of 2008 and What it Means*. New York. USA: Public Affairs-Perseus Book Group.
- [12] Stiglitz, J.E., 2002. *Globalization and its discontents*. London. UK: Penguin Books.
- [13] Stiglitz, J.E., 2003. *Globalization and the economic role of the state in the new millennium*. *Industrial and Corporate Change*, 12(1), 3-26.
- [14] Stiglitz, J.E., 2006, *Making Globalization Work*, Washington. USA: Penguin.
- [15] Strange S., 2002. *The State Withdrawn. The Diffusion of Power in Global Economy*, Bucharest: Trei Publishing House.
- [16] Teunissen J., 2000. *The Management of Global Financial Markets*, Hague: FONDAD.