

Spaseska Kitanovic, Violeta; Kozuharov, Saso

Article

The International Monetary Fond as a creator of the global financial system

UTMS Journal of Economics

Provided in Cooperation with:

University of Tourism and Management, Skopje

Suggested Citation: Spaseska Kitanovic, Violeta; Kozuharov, Saso (2012) : The International Monetary Fond as a creator of the global financial system, UTMS Journal of Economics, ISSN 1857-6982, University of Tourism and Management, Skopje, Vol. 3, Iss. 1, pp. 83-90

This Version is available at:

<https://hdl.handle.net/10419/105281>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

THE INTERNATIONAL MONETARY FOND AS A CREATOR OF THE GLOBAL FINANCIAL SYSTEM

Violeta Spaseska Kitanovic¹
Saso Kozuharov

Abstract:

IMF and World Bank were created after the Second World War as a result of monetary and fiscal Conference of the United Nations (UN) in the Bretton Wood, New Hampshire in July 1944. This conference was part of the efforts to finance the construction of Europe which was destroyed in the Second World War, and to protect the world from further economic depressions. The decision that was reached at Breton Wood was influenced by the global economic depression which had affected the world in the yearly thirties. That was the biggest crisis that with with the capitalism confronted. The unemployment grew with tremendous speed and for a short time period almost one quarter quarter of the U.S. working-age population was unemployed. English economist John Maynard Keynes claimed that the cause of economic recession is insufficient demand.

Keywords: International Monetary Fond, World Bank, regulation, economic recession.

JEL classification: F33; F35

INTRODUCTION

In this section of the paper the IMF and World Bank are in the focus because these two institutions were the center of the main economic issues in the past two decades, including financial crises and the transition of former communist countries to market economies. IMF and World Bank were created after the Second World War as a result of monetary and fiscal Conference of the United Nations (UN) in Breton wood, New Hampshire in July 1944. This conference was part of the efforts to finance the construction of Europe that was destroyed in the Second World War, and to protect the world from further economic depressions. What was decided at Breton wood was influenced by the global economic depression which had affected the world in the early – 30`s. It was the biggest crisis that confront capitalism. Unemployment grew with tremendous speed for a short time nearly a quarter of U.S. working - age population was unemployed. English economist John Maynard Keynes, who would later be a major participant in the Breton wood in the formation of the IMF and World Bank,

¹ Violeta Spaseska Kitanovic, MA; Saso Kozuharov, Ph.D., Full Professor, University of Tourism and Management in Skopje, Macedonia.

gave a simple explanation of this phenomenon. Keynes argued that the cause of economic recession is insufficient demand and that the state may, through its economic policy, stimulate the demand. In cases where monetary policy is ineffective, the state can rely on fiscal policy, i.e. either raise taxes or cut spending. The IMF was set up with the money of taxpayers across the globe. The full Name of the World Bank-“International Bank for Reconstruction and Development” shows its original purpose. Complex task of ensuring global economic stability was presented to the IMF. It was obligated to prevent another global economic depression. It was supposed to do that by international pressure on those countries that do not contribute to the realization of plans for maintenance of total global demand. It was planned IMF occasionally to grant loans in order to improve liquidity to countries facing economic trouble to prevent them from lifting the demand with their own funds. In its original conception, the IMF was conceived on the notion that the market often is not perfect, resulting with increased employment. World Bank and IMF were formed on the belief that there is a need for collective action at global level to maintain economic stability. Control over the operations of the IMF is enabled through a specific voting system, which is made according to economic power in several countries. By the time of its establishment until now, the IMF experienced significant changes. Formed under the belief that the market is often imperfect, that there is a need for international pressure on countries to have a more expansionary economic policies-such as to increase spending to reduce taxes and interest rates to stimulate economy.

MAIN PART

CREATOR OF THE IMF AS GLOBAL FINANCIAL SYSTEM AND TOURISM ROLE AND FUNCTIONS OF THE IMF

IMF in the early 80's, where the main objective was poverty reduction, began to approve loans for structural adjustment, i.e. only if the country had previously fulfilled the conditions required by the IMF. The fall of the Berlin Wall provided a new arena of action for the IMF. When crises have become bigger and when funds become insufficient to the IMF, the World Bank was called as well. It was supposed to provide money to support the country, but only under the previous guidelines of programs of the IMF. The IMF was expected to restrict the activities related to state budget deficits, monetary policy, inflation, trade deficit, the state debts, while the World Bank is oriented towards structural issues, i.e. how the state spends money, financial institutions, labor market , trade policy. However, the IMF usually had the answers to all questions and they were mostly the same for all countries. Half a century after the establishment of the IMF, it becomes clear that the IMF failed to accomplish its mission-to secure financial assistance for countries facing economic problems.

The programs of the IMF insisted that fast liberalization of capital markets and financial markets contributed to global economic instability. Once the country enters in crisis, IMF programs not only failed to stabilize the situation, but in many cases worsen things, especially the poor countries. IMF failed to accomplish its primary mission-establishment of a global economic stability, as it was unsuccessful in his new mission, to manage the transition of former countries to a market economy. Keynes's orientation of the IMF, which emphasized the Imperfection of the market and the state's role in creating new jobs, was replaced by the motto of a free economy 80 years, part of the

new “Washington consensus” between the IMF, the World Bank and the U.S. Federal Reserve. It meant "correct" policy towards developing countries, which was radically a different approach to economic development and stabilization. Much of the ideas within this consensus were developed in response to the events that occurred in Latin America, where governments allowed budgetary spending to get out of control, and poor monetary policy led to an increase in the rate of inflation (Kozuharov).

Adam Smith was much more aware of the limitations of the market, including threats that come from imperfect competition, than those now considered to be his followers. Smith was also more aware of social and political context in which all economies need to function. Social cohesion is very important for normal functioning of an economy. But as social cohesion may affect economic performance is possible and the reverse situation, economic situation or to create social unrest. The state should have a role that can recognize the limitations and failures of the market, but which can see that the government and market can work together with the precise roles of both partners, depending on the level of economic and political development of the country (Stiglic, 2003).

In the past thirty years, the economy has focused on the role of financial institutions, information, global competition. These new views have contributed to changing views about market efficiency and market economy, but also change the ways of an appropriate response to economic crises. IMF and World Bank overlooked these new insights and their impact on economic policies, just as they were neglected experiences of East Asia, which followed the policies of the Washington consensus and had higher economic growth compared with other regions in the world. Failure to learn the lessons of modern economic science have left these institutions to cope with economic crises that appeared unready to promote economic growth in the world. For those who believe in free markets, liberalization of capital markets was desirable and evidence that it contributes to economic growth was not required. Evidence that liberalization creates instability was anticipated and was treated as a cost adjustment, or as part of the pain that must be survived as part of the transition to a market economy.

REFORM OF IMF AND GLOBAL FINANCIAL SYSTEM

There are some things in common when it comes to reform of all international economic institutions, despite the fact that each institution faces special problems. Starting with the IMF as the institution to highlight specific problems that are more or less present in other economic institutions. How can an organization with such a skilled and highly paid government bureaucrats make so many mistakes? The suggestion is that some of their problems stem from differences between the goals for which the IMF was originally established to promote economic stability and newly purposes, such liberalization of capital markets, which increasingly served the interests of the financial community, rather than the global economy (Kozuharov, 2009b).

These differences contributed to the intellectual inconsistency, which were more differences than of academic interest. Economic science is often replaced by ideology, which always had clear directions and policies that must be followed. One of the fundamental differences between ideology and science is that science recognizes and acknowledges limitations of knowledge.

IMF never wants to discuss the uncertainty associated with the recommended policies, but always strives to project the image that they're perfect. Such placement of things and this way of thinking makes impossible to learn from past mistakes. How can the IMF learn from the mistakes of the past, when they did not even recognize them? The IMF refused to admit the mistakes of crises in East Asia, recognizing that restrictive fiscal policy spur economic crisis and the strategy for restructuring the financial systems in Indonesia led to a banking crisis. Economic science explain why and in what conditions the market is functioning well, and when it isn't. An explanation was got, why the market may lead to less production of certain products or to excessive supply of other products. Most dramatic failures of periodic market are the downturns, recessions and depressions that leave thousands of workers jobless, environmental pollution, asymmetric information. Governments can and must play a significant role in reducing these market failures, but also in ensuring social justice. Market processes can often leave many people without income. While there is sharp debate in the U.S. and other countries around the precise role the state should have, there is broad consensus about the fact that the state has a role to society and the economy to function more efficiently and more humane. There are strong disagreements about economic and social policies. Some of them are related to the core values.

IMF has exactly a role in the flow of international aid. The Fund is tasked to review the macroeconomic situation in the country if it should get help and to see whether the country can live with their own money. The IMF is particularly interested in inflation. Countries whose governments spend more than they can collect tax and foreign assistance are often faced with inflation, particularly if the deficit in the budget to cover the printing of new money. Of course the good macroeconomic policy has other aspects.

The term macro refers to the aggregate indicators like economic growth, unemployment, inflation. Earth, according to the logic of IMF should have low inflation and no economic growth and is facing high unemployment. Many economists would appreciate that that country is desperately poor macroeconomic framework. For most economists inflation is not an end in itself but an instrument for achieving the ultimate goal.

RELATIONSHIP BETWEEN IMF AND DEVELOPING COUNTRIES AND DEVELOPMENT STRATEGIES

While developed countries are pushing to open markets in developing countries, their markets continue to be closed for textiles, agricultural and other products coming from developing countries. Other changes that would be desirable are to force the IMF in their programs to include the impact of poverty and unemployment. States should know the consequences of what the IMF recommended. If, for example, the increase in poverty is greater than predicted, the program should be rejected. You have publicly questioned whether there are systematic errors in models of the IMF.

Although the new directives were not always quite clear, and intellectual foundations not very strong, the World Bank began to take seriously the criticisms that was directed toward her. The reforms include changes in three areas: economic development, World Bank assistance is given and the relations between the Bank and

developing countries. In a review of its activity, the World Bank began to analyze countries that have achieved successful economic development. Some of the lessons that emerged from this review were the same as the World Bank had long recognized: the importance of living within a budget tightening, education and macroeconomic stability. But some new themes emerged as well. Success comes not only with the promotion of primary education, but by placing strong technological bases, which include more advanced training. Support for trade and greater openness of markets is important, but if the increased trade open up more jobs, not if increased imports creates a reduction of jobs (Kozuharov, 2010).

It is clear that international financial institutions can not be held responsible for this transformation, but they can play a significant role. At a minimum, they should not pose obstacles to successful transformations. The way these international financial institutions provide financial assistance may accurately represent an obstacle to successful transformation. Conditionality for aid didn't help in creating better policies, rapid economic growth and better results. Countries who think that reforms are imposed, do not feel included, nor are they committed to reform. Their role and serious commitment is crucial to successful reforms occur. What is worst, conditionality undermines the democratic process. There is public recognition, even in part of IMF conditionality that went too far, that huge number of conditions actually prevents developing countries to focus on real priorities. Some believe that conditionality should be replaced with selectivity, i.e. to assist countries to prove they are committed to development, allowing themselves to choose their own strategies for development. The assistance being set selectively can be a lot bigger effect, such as promoting growth and reducing poverty. Developing countries need financial aid to be granted in a way that will help their development. And certainly need more help. Corrected for inflation, real development aid is shrinking, even more if considered as a percentage of revenue of the country. When the IMF established the international money, the issue was allowed to create special rights for traction, as one type of these special drawing rights can help to sustain the global economy while at the same time to help the poorest countries. More recently attention has focused on writing off debts. Without writing off debts many developing countries simply could not be developed. Much of their revenue from exports goes to repayment of loans to developing countries.

IMF protect the interests of foreign creditors

When analyzing the policies of the IMF, one can conclude that their emphasis is increasingly placed on payments to foreign creditors, rather than using the national economies. The fact that lack of consistency led to a multiplication of problems is not surprising. The question is why there is a lack of consistency? Why the IMF continues to be persistent for some issues and when it is pointed and determined that they lead to problems. Part of the explanation is that the problems that the IMF has an obligation to resolve are complicated and complex. IMF economists are practical people who are trying to make difficult decisions in a short time. But I think there is one crucial reason. IMF is persistent not only to achieve the initial goals of the Fund, to provide global stability and financial resources to countries facing recession. But the IMF also represents the interests of the financial community. This means that the IMF often has goals that are conflicting with each other. The tension is even greater, because this

conflict can be revealed in public. If the new role of the IMF is publicly recognized, that would certainly weaken the support of the Fund. The new role of the Fund should be “packed” and seems consistent with his original role. The ideology of free market is the curtain behind which you can freely run the new role of the Fund. Changing the mandate and objectives of the IMF, although it seems quiet, is actually very dramatic.

From the institution which serves the global economic interests, the IMF has developed into an institution that serves the global financial interests. The liberalization of capital markets may not contribute to the stabilization of the global economy, but certainly contributed to the opening of vast new markets for Wall Street. The IMF has never publicly changed its term, nor ever has put the interests of the financial community over the interest of stability of the global economy or aid to poor countries which should be provided. Because it can not talk about the real reasons for this change. Maybe there is a gap between what they say and the real motivations for what they do. The behavior of the IMF clearly shows that the problems are approached by ideology and interests of the financial community. IMF or better said much of executives and economists, believed that the liberalization of capital markets will lead to faster economic growth in developing countries.

The IMF has never wanted to hurt poor countries and believed that the policies they advocate will help them. IMF may not have been an institution that cared for the collection of loans of the Group of Seven industrialized countries G-7, but obviously worked hard, though not always successful, creditors of the G-7 to be paid. Billions of dollars that the IMF provided in the form of loans used for short-term maintenance of the exchange rates of unsustainable level, a period in which foreign creditors and the rich can pull their money out of the country under the most favorable conditions, i.e. through open capital markets, that the IMF insists on. Billions of dollars that the IMF grants to States in the form of loans, are often used to pay foreign creditors, even when those debts are private.

IMF AND FINANCIAL MARKETS

IMF takes into account the corporate and financial problems that are actually caused by its stabilization policies, including high interest rates. If many companies fail to repay taken loans, it can happen that the banks suffer collapse. Even the collapse of one large bank can have devastating consequences. Financial institutions are the ones who determine the creditworthiness of companies. This information is very specific, can not simply be made public, they are always hidden in the files of the bank. When a bank fails, most of the information on the creditworthiness of its customers is destroyed and re-collection of that information is very expensive. Even in many developed countries, usually small or medium enterprise can get a loan of up to two or three banks.

When a bank goes out of business, many of her clients have difficulty finding another bank which will provide loans to bridge the daily liquidity. In developing countries, where funding sources are still limited, if a bank fails, the firm that financed the bank will be very difficult to find another source of funding, especially during recession. The fear of this vicious circle prompted governments worldwide to strengthen their financial systems by cautious and transparent regulation.

LOW INFLATION AND BAD PRICE OF LOANS IN THE AGENDA FOR THE IMF

Financial institutions may be satisfied with low rates of inflation, but workers and poor people are not happy with low economic growth and high unemployment. From all the wrong policies of the IMF, most are poor. Reforms in one sector without reforms in other sectors can only cause deterioration of the situation in the economy. The ideology ignores these things. The ideology says to go as quickly as possible to a market economy. Economic theory and history show how it can be disastrous.

There are more fundamental criticism of the IMF and the Washington consensus. It is important to see not only what is on the agenda of the IMF, but what is not as well. Stabilization is on the agenda, the opening of new jobs is not. Taxation and its effects are on the agenda, the reform of the land is not. There is money to provide banks and creditors, but no money to improve education and health services to workers laid off from work as a result of wrong macroeconomic programs of the IMF. Many of the items that are not contained in the Washington consensus can lead to higher growth and greater equality. For example, agrarian reform which was made in a proper and legal way would enable those without work, not only to obtain land, but access to credit, as well as knowledge of new types of seeds and techniques for processing of land, which will lead to higher productivity growth.

Excessive focus on IMF inflation resulting in high interest rates and high exchange rates creates unemployment, but not economic growth. Financial institutions may be satisfied with low rates of inflation, but workers and poor people are not happy with low economic growth and high unemployment. All side effects of the Washington consensus can not be predicted, but the present aspect can be clarified. Trade liberalization accompanied by high interest rates is almost a sure recipe for layoffs and rising unemployment. The liberalization of financial markets without appropriate structure for regulation is also a reliable recipe for economic instability and may lead to higher, not lower interest rates.

Of all these wrong policies, most are poor. If the IMF in its development programs underestimates poverty and neglect, which means also underestimate the long-term political and social costs of policies that destroy the middle class, and to enrich a small number of people at the top. The middle class is traditionally composed of people who always push for law enforcement to improve public education and the creation of social protection. They are the basic elements of a healthy economy and the erosion of the middle class inevitably leads to erosion of support for these important reforms. While the IMF underestimated and ignored the costs of his programs simultaneously overestimate the benefits. Unemployment can be taken as an example. According to the IMF and others who think that demand is always equal to supply, unemployment is the result of obstacles that prevent the free functioning of the market.

While modern economic theories based on the existence of information asymmetry in the market, explain why in the high competitive markets as well there may be high unemployment. If the IMF has a very optimistic position on the market and it's functioning perfectly, his view of government is too pessimistic and should be careful when making decisions.

FINAL PART

From a public institution set up to resolve the market imperfections, the IMF has grown into an institution that stands for pure market economy without any government intervention. Not so successful efforts of the IMF during the 80s and 90s have raised questions about the position of the Fund for globalization, or how the IMF sees the goals of globalization and strives towards their realization, as part of its role and mission. IMF successfully perform the duties assigned to it, which means the establishment of global stability and helping countries in transition to achieve the required stability at the same time followed by growth.

Until recently it was discussed whether the IMF should deal with poverty, which in the past was the responsibility of the World Bank. There was a particular coherence in the idea of intellectual father of the IMF, Keynes, the concept of the Fund and its role. Keynes perceives a lack of market, which suggests that markets should not be left to themselves, but that they must be regulated. That problem could be solved by collective effort. He was concerned that the markets themselves may create long-term unemployment. He proved why it is necessary to require global collective intervention. Because the actions of individual states hurt the actions of other states. Imports of certain countries hurt the exports of others. Contingents and quotas on imports of certain countries intimidated economies of other countries.

There was yet another market failure, which was worried that the situation of a serious recession may occur that the monetary policy is no longer effective. It may come to a situation in which some countries will not be able to borrow in order to finance the growth of spending or to compensate for the shortening of the taxes necessary to stimulate the economy.

BIBLIOGRAPHY

- Balasubramanyam, Vudayagiri N., and David Sapsford, eds. 2004. *The Economics of International Investments*. Aldershot: Edward Elgar.
- Barfield, Claude E., ed. *International financial markets: Harmonization versus competition*: Washington D.C.: AEI Press, 2006
- Blanchard, Oliver J. 2008. *The Crisis: Basic Mechanisms, and Appropriate Policies*. MIT Department of Economics Working Paper No. 09-01. <http://dx.doi.org/10.2139/ssrn.1324280>
- Bordo, Michael D., Claudia Goldin, and Eugene N. White. 1998. *The defining moment: The great depression and the American Economy in the 20th century*. Chicago: University of Chicago press for the NBER.
- Burnell, Peter, and Oliver Morrissey, eds. 2004. *Foreign Aid in New Global Economy*. Cheltenham: Edward Elgar.
- Economist. 2002. After communism – Marx; Marx's intellectual legacy (The post-communist Karl Marx). *Economist*, December 21.
- Economist. *The future of capitalism*, 2003. *Economist*
- Kozuharov, Saso. 2010. *Strategijski menadzment*.
- . 2009a. *Biznis i pretpriemnistvo*.
- . 2009b. *Osnovi na ekonomija*.
- . 2009c. *Menadzerska ekonomija*.
- . 2006. *Revizija*.
- . 2005. *Platen promet*.
- . 2005. *Bankarski smetkovodstven system*.
- Lehmann, Alexander, Selin Sayek, and Hyung Goo Kang. 2004. *Multinational Affiliates and Local Financial Markets*. International Monetary Fund, IMF Working Paper no. 04/107, June.
- Malkiel, Burton G. 2005. *A Random Walk Down Wall Street: The Time-Tested Strategy for Successful Investing*. New York: W. W. Norton and Company.
- Stiglitz, Joseph E. 2003. *Globalization and its discontents*. New York: W. W. Norton and Company.