ASSESSMENTS AND CONTROVERSIES ON THE ROLE OF THE INTERNATIONAL FINANCIAL INSTITUTIONS – IFIS - WITHIN A GLOBALIZED MARKET

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The world economy registered within the last decades a series of transformations which had as a result astounding economic growth, yet also violent crises, a maturing of the international cooperation with positive effects, yet also negative aspects as a consequence of interconnections that allowed the external transfer of economic unbalances. Under the pressure of globalization, internationalization and increasing complexity of the markets, the future of the International Financial Institutions – IFIs and their role appear as a challenge to change, yet they also raise a series of questions on the reasons of their existence. We try to explain the present system of international financial institutions and debate upon several ideas regarding the future thereof. At the same time, the study emphasizes controversies on the manner said system managed to get involved and solve the problems of the world economy.

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Within a world economy of globalization, internationalization and increasing complexity of the markets, yet of periods marked by crises as the recent one, the future of the International Financial Institutions – IFIs and the role thereof appear as a challenge to change, yet they also raise a series of questions on the reasons of their existence. Said aspects represented points of interest for many economists and politicians. Some of them limited themselves to carrying out assessments on the achievements of said institutions, others went further trying to draw the lines of their evolution.

In Europe, the speed of European economic integration, the carrying out of the unique market by gradually eliminating intra-European barriers in performing financial services also raised a question on the role of the European credit institutions in the future and on the way they may generally bring added value.

Except for the European Bank for Reconstruction and Development, IFIs were created the moment there was a control on the international capital flows and when the financing of the les developed countries was limited. A characteristic of the last decades was the globalization and internationalization of the capital markets. At the beginning of the 1980s, an increase of the capital flows towards the emergent markets started to manifest, on the grounds of recycling the incomes from oil. Yet this presented a slowing down due to the crises of debts in 1982. After a period of macroeconomic stabilization, the private capital flows "exploded" at the beginning of the 1990s, when direct foreign investments portfolio investments and non-banking credits represented the main source of funds for developing the world countries. Given this evolution, after year 2000, the IFIs loans decreased as percentage on market to only a few percentages of the total capital flows, given almost 40% in 1990, thus resulting a reducing of the importance thereof. In this context we may say that the IFIs share becomes more and more subjective as crediting orientates itself more to the private sector and financial integration is larger. The logic of the IFIs interference and, in connection thereof, the role of said institutions are questioned by the economic globalization and the increase of private sector role as vehicle of the economic development.

The IFIs traditional operating way demonstrates that said institutions were the favorite creditors of the world governments, special intermediates of the capital flows, of saving from richer countries to the investors in the poor countries, the IFIs traditional model being that of attracting funds from the international capital markets such as to lend them to governments. The IFIs characteristic feature is given by their multilateral nature, that is the occurring errors have repercussions on any other stockholder states, this representing a bigger obstacle than the bilateral problems which may occur from a private relationship creditor-loaner. On the other hand, said institutions present the advantage that the credit risk generally manifests in extreme cases.

In *Christopher Hurst* and *Eric Peree's* opinion, both economists at the European Investment Bank, the international environment created a preferred creditor, IFIs, which cannot be duplicated by the private sector. For said creditor the cost of providing capital is low, as the probability of exerting the guarantees is reduced, that means that IFIs uses its credits on a non—discriminating basis, cost-plus. As the market has to take into consideration the political risk, this risk does not equally manifest in the case of IFIs. These institutions represent the preferred creditors and may offer loans at, or under the market interest, this being valid even in the case of a global capital market. If the international capital markets do not manifest a drop, the political risk premium correctly reflect the lack of certitude in crediting each country, lack of certitude that occurs due to the quality of the economic management. The risk that a govern might not be able to deal with the duty service is low in a country that is stable from the macroeconomic point of view, where the monetary and fiscal policies are adequate and the capital flows are wisely and correctly invested. Moreover, IFIs credits private projects, which is not the case of providing credit lines by private creditors. This also determines the use of funds in a clearly specified way, the Institutions' role manifesting from assessing the project file to offering technical assistance with projecting and implementing said project. The cheap financing from IFIs could divert public investments from said projects. More than that, the political feature of the packet that comes together with the credit changes the nature of investment, such that other countries may also benefit of credit (by international auctions for the necessary consumables for carrying out the project, by fulfilling minimal requirements regarding the environmental protection, etc.).

Hurst and *Peree* characterized IFIs as "*funds wholesalers that lack the retail trading network.*" That means that IFIs has in view large projects, the small ones being extremely expensive and ineffective for them. Even if large projects present a convenient return, there cannot be excluded small investments that may bring a major contribution to the economic development. The result is that IFIs may distort investments from the latter to large projects that require an intensive financing. A solution was financing sectorial projects, yet the problem that occurred is that IFIs personnel does not poses the local knowledge necessary to successfully implement small projects. In financing said activities, IFIS assigned the management of the project to the local parties or counselors. The expansion of credits to larger and larger projects does not simply mean providing credit lines to governments. If IFIs financing did not have an impact on the quality of investments and, therefore, on the economic growth, the crediting effect would be harmful.

Internationalization and globalization of the financial system cannot but have effects on IFIs activity and role. While the financial system globalization would reduce the imperfections of the market, the present financial crisis has demonstrated that the gregarious spirit of said international financial markets continue to determine an increased volatility of the capital flows.

The financial markets did not manage to anticipate financial crises and, therefore, the flexible foreign crediting helped the support of the ineffective management in different countries. Another consequence of the gregarious spirit is that the countries may stand negative consequences, with no connection to their economy.

Other economists, such as *Jannik Lindbaek*, former Executive Vice President at the International Financial Corporation and former President of the Northern Investment Bank and

Neil Gregory from UK Overseas Development Administration consider that, except for the traditional action model of IFIs as preferential creditor, IFIs also plays an important part under the conditions of an increased volatility: *the international crisis management and allotting resources under uncertain conditions*. Said part strongly manifested during the present world economic crisis period and gave a new reason for founding such institutions.

In general, the information on the macroeconomic conditions are collected and analyzed by independent rating agencies. The practice demonstrated that the resulted information thereof may be altered, imperfect, and in this context IFIs vision on the economic policies plays an important part for future prosecutions (especially in case of IMF). When having in view a financing, IMF bases on said prospections and uses them in establishing the conditioning policy applied to the debtor. If IMF does not have enough resources such as to set credit lines into action, the task is divided between regional IFIs even if said collaboration is different from the financing model of the long term development – the classical IFIs role. The macroeconomic conditioning imposed by IFIs under these circumstances have an important role, being adopted by other institutions and represent the grounds that provide the use of funds for carrying out adequate reforms, and not an ineffective management.

Another role that IFIs may further on assume results from *increasing loans towards the private sector*. Many activities considered until now as the natural domain of the state may be more effectively carried out by the private sector. Moreover, there appeared as natural within the last few years that governs sell on a larger scale the state companies such as to ameliorate the level of public debt. Said evolution also hints at a more closely implication of the private sector in developing the new infrastructure by partnerships between public and private sectors. If the implication of the private sector in the development process appeared recently, its crediting by IFIs started long ago. The International Financial Corporation and BIRD started even from 1960's to function in this regard and, the other regional institutions also started to support the private sector. Certainly, the private sector crediting implies assuming political, commercial risks and specific regulating risks for this sector.

Another aspect of IFIs activity that we would like to emphasize refers to the evolution of the role that they have in *developing regional capital markets* seen both in the sense of obtaining the necessary resources for crediting and, by the intermediating services delivered or requested within regional markets.

It is well known the fact that the existence of several powerful national financial and banking markets represents another key factor in the process of economic development. Numerous studies demonstrated that financial development goes hand in hand with economic development, that is IFIs treasury and capital market operations may play a role in development, on condition that their actions stimulates the market and lead to a know how transfer to local national institutions. IFIs participates into the development of the capital markets first of all by collecting funds within larger and larger bond issuing on said markets. Nevertheless, taking into consideration the entire development of the capital markets, the share of the issues carried out by IFIs given total Issues tends to diminish.

If we take into account the structure of said bond issues, we may consider that in a world of free capital moves and increase of the appetite of investors for investments in a less used currency, IFIs also enlarged the set of currencies in which they borrow. There were cases as the case of the Hungarian forint, wherein IFIs initiated the first issuing programs of international markets for certain currencies, being the only issuers in that currency. Such pioneering operations created or contributed at the consolidation of the developing states markets, with a direct effect on the trust in their national currency. Later on, going in the same direction, governs and the private sector managed to obtain resources necessary to funding the deficits or development projects.

We consider that this tendency *of taking a loan in the currency of the emergent states* could give to IFIs a new role and a new reason for existing for the next few years. A first observation in this

situation is that a loan from IFIs in a particular currency does not automatically mean a *know how* transfer towards that country and a development of the national capital market. The crediting of the public sector on international markets is usually carried out in major currencies. The loans in new currency are usually changed by swap operations with non-resident investors. International investors may find the titles issued by international financial institutions in the currency of the attractive emergent states that are not submitted to a credit risk.
Another economist, *Pasquale Lucio Scandizzo* professor at the Rome University and former President of the Italian Institute of Studies in Economic Planning, approaches another aspect of IFIs role. On his opinion, *the increase of crediting the private sector brings IFIs in competition with commercial financial institutions*. When IFIs credits the private sector offering a large range of associated financial services, the competition with the commercial banks becomes obvious. Besides the facilities that come out of an official framework, IFIs have a number of other advantages including tax exemption, large capitalization and relatively low return required by shareholders. The capital payment in IFIs has a cost. At the same time, the more or les non-profit character thereof does not imply the lack of return of their own capital. The normal approach for IFIs is to asses credits as if they were 100 % financed by loan. The return of the own capital is linked to the governmental interest rate of the reference countries. This return is lower than the return of a private bank. If IFIs are cheaper than other financing sources, it is normal that the investors from the private sector look first for IFIs. For the public sector, the total project packet and the loan conditioning clearly differentiate IFIs credits from those of the private creditors. The project assessment in case of the private sector loans is similar to the analysis of risk assessment in commercial banks.
Professor Scandizzo establishes two extreme variants of the role of crediting the private sector by IFIs. Said variants are:
- IFIs should focus on one or two products – in comparison with commercial banks that offer a large range of products and the competition will manifest only on a reduced market segment;
- IFIs should base on the market at the maximum and intervene only when there is no doubt on the need of complementarities of the offered services, meaning a development of the interventions in support of the commercial banks sector (guarantee schemes, A / B credits, support in credit union trades).
We think that there are several sensible points in the two proposals. In the first variant it is possible that IFIs act in sectors where to present competitive advantages, given commercial banks and substitute them, and in the second variant it is not very clearly solved the complementarity problem. On the market it is ascertained that, together with the increase of the capital markets and holding of bank assets, the banks look for future profits especially in the area of consulting. In fact, everything that IFIs do with a project of the private sector, including the political risk insurance, can be carried out by a private bank as well, yet at a different cost. Then, where could we appreciate that the domains that make that IFIs and commercial banks differentiate mutually trouble themselves and therefore require a compelmentarity in action? The extreme whereat IFIs would situate depends on the local factors and the consensus of the shareholders on the role of public banks in general.
An interesting approach of the IFIs role in the future comes from another banker. In his opinion, *Jean-Francois Rischard*, not so long before Prime Vice President for Eurpe at the World Bank, considers IFIs multilateral institutions that might play a *leading part in the global public policy*, defined as policy whereat participation and the effects of its being applied have an international and multidisciplinary character. He considers that the role of the international financial institutions might re-orientate towards being charged with supporting the participation of developing countries to the global public policy networks. This includes the focus on constructing the institutions, promoting adequate governance, spreading information and establishing a knowledge basis allowing all interested parties to contribute at debating a public

policy problem. Rischard ascertains that, taking into account the position they have at present, IFIs are in an ideal position for initiating such a policy. Irrespective from states, private jobbers and NGOs, said institutions do not represent private interests. Their mandate is that of promoting the integration of world economy in sustainable terms from the social and environmental point of view. IFIs could also lead to identifying said problems of public policy that require a global engagement and could provide an institutional umbrella for the mediation between different involved parties. At last, they could assist in monitoring the applying of the global public policy. Based on these two roles, IFIs could act besides their original role in the future. IFIs should be thought as part of the global public policy network of the future. Within said role, they could provide not only financing, yet other categories of services, such as global know how services by stressing the informal character able to facilitate the operative access to information or partnership global services.

Far from these considerations, we consider that the traditional model for IFIs remains that of institutions structured to finance large infrastructure public projects. It is not questionable whether said model lost its validity, yet the political and economic world registered some changes. Crediting stressed upon project financing and IFIs progressively delegated projecting and implementing projects to third parties. It is important to notice the consolidation of the private sector as development agent and IFIs desire to participate into this process. Whereas small steps may be made in this direction, a direct consequence of crediting the private sector and competition with commercial banks is that the commercial approach must also be applied to IFIs. Conducting this logic to the extreme, some say that IFIs will return back to the traditional model and, others sustain that they could orientate towards the private sector. A midline for said institutions would be their action as agents or subvention donors (grants) that they should provide together with the credits. The crisis demonstrated that, even in developed countries, there might exist market drops to justify the intervention of the public sector this way.

IFIs role is that of financing the official development as important part of the external resources flows necessary to developing countries. IFIs should support the policy, institutions, necessary infrastructure for promoting the economic growth, should protect the environment and encourage the private sector. As countries reach success in their development, their request for IFIs services will decrease, due to the fact that said countries will have an easy access to international capital market. Except for the last two years, the flows realized by official financial institutions halved as share in the long term resources of the developing countries, reflecting the larger access to the capital markets of said states and as a smaller request for official assistance in financing public sector investments. Yet, private flows are focused to a restricted range of countries, sectors and borrowers: 75% of the capital net private flows go to a dozen of countries including the largest developing countries, leaving over 100 developing countries with a reduced access to financing. Even in that countries receiving a private capital, crediting is limited to certain sectors such as extractive industry, infrastructure and the financial sector. The private flows will not go to education, health, etc, characterized by long gestation periods and low return. Therefore, although many traditional destinations for the resources of IFIs have access to private financing, there remain a large number of companies, sectors and countries that continue to need IFIs implication for financing.

We consider that IFIs will continue to exist, as financing alternative. Yet, to fulfill their mandate, IFIs should continue to offers services in a selective way and become more capable to respond to an integrated world, in a continuous change.

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