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# ECONOMIC CRISIS IMPACT ON CHANGES IN INTERNATIONAL FINANCIAL INSTITUTIONS OPERATING

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## **Abstract:**

The emergence and deepening global economic crisis is in large part reflected in the operation of international financial institutions and their current structure. Long-term financial crisis has increased demands for decisive reform moves in operating and structure of the IMF, World Bank Group and other global and regional financial institutions. This means that so far the results of their policies are inadequate and that their role is subject to critical observation. The crisis has imposed the need to reform international financial institutions and new global financial architecture. Changes in their structure and operation should lead to global economic stability. Members of the Euro zone are faced with a new attitude towards the international financial institutions, particularly the International Monetary Fund. Proclaimed missions of International Monetary Fund and World Bank clearly differ in theory, but with the passage of time their activities have become increasingly intertwined.

*Keywords:* The Economic crisis, impact, changes, structure, functioning, financial institutions.

*Jel Classification:* G01, G2

## **INTRODUCTION**

International financial institutions have come a long way over the last sixty years from a stability guarantor of the global financial system, through a savior of creditor and debtor countries in the world debt crisis (the eighties of the twentieth century) and finally to the role of adviser and financier of the transition process in post-socialist countries during the nineties. However, almost seventy years having passed since their foundation (the IMF and World Bank), it may be inferred that international public financial institutions have failed to fulfil the vision, mission and goal of their existence. The neoliberal project of international financial institutions operating has achieved a high degree of economic efficiency (till emergence of a new economic

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crisis), but at the high social cost reflected in the spread of poverty. Therefore, in current circumstances the long-term financial and general economic crisis has necessitated a radical reform of international financial institutions, especially revising voting rights at the IMF and World Bank, which represent the two major international financial institutions. Each IMF member country pays a certain quota into Fund<sup>1</sup>. Undoubtedly, the results of international financial institutions policies can be assessed as unsatisfactory, since the recent financial crisis is not the first one the international financial institutions have been confronted with, failing to respond adequately to it<sup>2</sup>. The foundations the international financial institutions policy has been based on heretofore, especially the IMF's ones, represent a recipe applied everywhere, regardless of time, place or economic system distinctiveness consisting of constant rigor, rapid privatization and wild liberalization. Results of international financial institutions policy may be characterised as devastating<sup>3</sup>. However, in order to mitigate the negative effects of globalization sustaining beneficial ones, it is necessary to reform the international financial institutions managing this process, globalization itself presenting no problem. The need for reformed international financial institutions poses numerous questions, such as: where are decisions to be made in the future, where is the taxation centre to be located and where the legislative power one? Dependent on the extent to which legislative, tax, and even judicial power shift towards the international stage, what is the international institution management going to look like in the future? What will represent the balance between developed and developing countries, especially with the change over time in population and economic balance in favor of countries developing now? These are only some questions answers should be provided to in the process of changing international financial institutions structure and their manner of operating. In this sense, this contribution also has no pretensions to offer ready-made solutions, but to indicate possible directions of reform through analysis of certain aspects and criticism of heretofore operation.

## **ORIGIN AND CAUSES OF CURRENT GLOBAL ECONOMIC CRISIS**

The current economic crisis has spread over all the world's national economies. It broke out so abruptly that many experts in international financial institutions had not been able to predict it. However, many believe that the current economic crisis has resulted from poor previous crisis management. In 2008, all steps were taken to save the banking system, though the crisis lasting until 2009 is considered to be less serious, not therefore requiring the subsequent government intervention and international financial institutions engagement. Now the key issue is the solvency of countries. Thus, the two crises had completely different origins. The first one spread from bottom to top.

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<sup>1</sup> The payment itself is made by subscribing 25% in special drawing rights or hard currencies and 75% in national currencies.

<sup>2</sup> Either due to the replacement of IMF's Keynesian orientation, placing great stress on market failures and Government's role by making absolute the concept of free market promoted by Margaret Thatcher and Ronald Reagan throughout the 1980s, or due to double standards applied or due to some other, third, reason?

<sup>3</sup> The impact of Transition Economic Advisory Boards. For example, in 1990, China's gross domestic product (GDP) amounted to 60% of the Russia's one, while at the end of the decade this picture turned upside down. To many developing countries globalisation has brought virtually no promised benefits, the difference in material wealth between the five richest and five poorest countries in 1913 being 11:1, in 1950 – 35:1, and in 2010 – 96:1;

It started among over-optimistic homebuyers, deepened through the Wall Street machine, with more than a little help from credit rating agencies and ended up infecting the global economy. It was the financial system's collapse that caused the recession. The ongoing difficulties, by contrast, have started from the top. Globally speaking, governments worldwide having been powerless to stimulate their economies and "*clean their homes*", gradually lost the confidence not only of corporations but also of investors.

Likewise, financial companies and households using cheap credits somehow endured till 2007–2008, whereupon a massive recession shock occurred. Now, the problem is opposite, the companies do not borrow which results in anaemic consumption and significantly impeded investment growth. Finally, the last difference is a direct consequence of the first two. Given the background, the financial disaster of 2008 had a simple but painful solution - the governments were supposed to step in to ensure liquidity by means of: low interest rates, bank guarantees and cash injections into the economy. However, they have not provided sufficient assistance so that today these countries are in a much more complex situation. At the time, the international financial system was not cleaned (banks did not have to change their habits having succeeded in escaping the fire they themselves caused). Banks have been rescued but the insolvent countries are to keep on managing banks and the entire economic system. The debt self-financing system has reached its "*breaking point*" so that the colossal debt level in the world has to be drastically reduced now. Consequently, market compression arises. The International Monetary Fund predicts that the eurozone is still going to be the epicenter of instability in the global economy in the next year as well and that there is a danger that the crisis may deteriorate further in that part of the world, especially if bad dynamics is coupled in the *vicious circle* of GDP growth, fiscal dimensions and the banking system.

## **CRISIS IN THE EUROZONE AND THE IMF**

The European Union and especially so called Eurozone seems to be have been struck by the global financial crisis harder and longer than other countries. For example, the unemployment rate in the first half of 2011 reached almost 11 percent, by which the record of April 1997 was equalled<sup>4</sup>. As evidence of the economic division between the north and south of Europe, the lowest unemployment rate in the eurozone was recorded in Austria (4%), the Netherlands (5%) and Luxembourg (5.2%).

The EU existential crisis precipitated by the Greece financial collapse, has imposed to the eurozone a new intermediary in negotiations - the International Monetary Fund. It engineered to approve "*mammoth bailout package*" to debt-stricken eurozone member states. Once sapped by IMF's engagement into the Greek economic adjustment programme, the EU was faced with a new relationship with this international financial institution. In mid 2012, the IMF estimated that the eurozone had entered a new and critical stage, that "financial markets in the parts of the region have remained under acute stress, sharpening a dilemma of the purposefulness of the EU Monetary Union while the eurozone seems more like a global economic recovery

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<sup>4</sup> Eurostat, The Statistical Office of the European Union, release of 03.06.2012 (displays that in May 2012, 18,14 million people sought employment, while Spain with its 24,6 % unemployment rate ranked first among the eurozone members).

ballast"<sup>5</sup>. The euro is overvalued, the risk of deflation is steadily growing, the monetary union is threatened with possible new shocks, including the collapse of a major bank, so that the IMF recommends a prompt intervention by both Brussels and the European Central Bank. As recommended by the IMF, the European Central Bank should urgently print more euros, reinstate the purchase of government bonds (from debt-burdened eurozone members) and introduce a new tidal wave of cheap credits. The European Union may, according to the IMF, restore its credibility if it quickly establishes the banking union and somehow manages to pool debts, which is adamantly opposed by Germany, the financially strongest eurozone member. The famed economist Joseph Stiglitz claims that the debt crisis in the eurozone definitely cannot be resolved by "belt-tightening", but that economic expansion should be enhanced instead by encouraging public consumption. According to the formula advocated by Joseph Stiglitz, countries facing the debt crisis should not follow the IMF's advice implying austerity budget adoption, but focus on economic growth and employment. The IMF considers that the solution lies, should the market allow, in using an expansionary fiscal policy, striking a balance between monetary and fiscal policy, providing support to the unemployed and other crisis-stricken social strata and establishing a coordinated response at the macroeconomic level.

## RELATIONSHIP BETWEEN THE IMF AND THE US

After several years of the International Monetary Fund's stating the European debt crisis as the key global economy risk factor, the turn came for the main engine of the world economy - the United States. In a report released in late June 2012, International Monetary Fund experts pointed out that the United States, particularly its fiscal system, was threatened by the deepening crisis. The IMF has also revised downwards its previous forecasts of US economic growth: the latest GDP growth forecast is 2 per cent for 2013 and 2.25 per cent for 2013<sup>6</sup>. However, agencies and companies specialising in offering economic consulting are still cautious (predicting GDP growth of just 1.5 per cent). Then, the US Federal Reserve's (the equivalent to the Central Bank) predictions are less accurate, but equally reserved: its previous 2013 estimate, ranging from 2.4 to 2.9 per cent, have been revised down between 1.9 and 2.4 percentage points accompanied by an unemployment rate of 8.2% with an upward trend. The head of the IMF, Christine Lagarde, as a chief counsellor, warned American leaders to do their best to avoid the "*shock*" to arise from the expiry of tax cuts enacted in the nineties of the last century. Thus, automatic cuts of a large number of budget items would come into force<sup>7</sup>. The IMF states as the reasons for the slowdown in the US economy the decline in personal consumption as citizens save more trying first to pay off their old debts, slow job creation, high unemployment rate and the effects of

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<sup>5</sup> IMF Report, according to the Politika, Belgrade, 20.07.2012, p.2 ("Greece is short of 11,7 billion euros now. Spain's borrowing costs are increasing dramatically again. Ireland needs the European Central Bank's help once more to save its financial system"...).

<sup>6</sup> For example, these forecasts were a bit more optimistic in April 2012: 2.1 and 2.4 percent for these two years.

<sup>7</sup> The IMF predicts that such a pattern could repeat itself, which is not impossible, given that the US government, if the trend continues, is soon to hit the legal debt ceiling on the issuance of bonds to cover the budget deficit (40 cents is still being borrowed for every budget dollar spent), therefore necessitating a prompt increase in the new borrowing limit.

the crisis in Europe. The IMF also called upon the USA to reduce its medium-term debt and work at its fiscal consolidation<sup>8</sup>. Also, numerous international experts find that American economic condition is not satisfactory. And besides, Ben Bernanke<sup>9</sup>, the head of the American banking system, warned the legislators "not to play with it: not to drag out negotiations over deficit reduction measures too long or else the country will fall off the *"fiscal cliff"*: in December 2012 tax increases and government spending cuts would automatically come into force, which would send the economy toppling back into recession." Though the USA economy undoubtedly suffers from serious problems, the fact remains that almost all countries around the globe would gladly swap their economic troubles for its. With about 15 trillion (thousand billion) dollars gross national product, US is by far the world's largest economy. The next two, China and Japan, has annual production and services output making up just a third of the economic output achieved by America over the same period. It is important to ascertain since the impact of the international financial institutions on the American economy, and in the conditions of global economic crisis, is very small.

## INTERNATIONAL MONETARY FUND'S STRUCTURE AND OPERATIONS

The International Monetary Fund's guiding mission and vision is to define the framework and code of conduct to regulate a number of issues related not only to the international monetary system but also to the global economy and specific economies of individual countries, members to the Fund.

The prime objective of the International Monetary Fund was averting a global depression whose cause was seen by leading economists to lie in insufficient aggregate demand<sup>10</sup>. That objective was supposed to be attained by exerting pressure on the countries not contributing to sustaining global aggregate demand, while loans themselves were to be granted to the countries not able to stimulate the demand with their own resources. Thus, the IMF has over time grown from the institution advocating an increase in demand, tax cuts and lower interest rates as measures of stimulating demand, into an institution providing loans to certain countries only if they pursue policies such as deficit reduction, increasing interest rates, glorifying the idea of free market supremacy<sup>11</sup>.

Member countries having problems with balance of payments deficit may count on IMF loans under certain circumstances. Types of loans obtainable from the Fund have changed over time<sup>12</sup>. Of course, borrowers pay a commission, costs and interest to the Fund for all loans. On the other hand, obtaining a loan basically depends on the

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<sup>8</sup> Christine Lagarde says that she does not support "any each fiscal consolidation", but the one that is "sensible and not excessive". A small deficit reduction of about one percent of GDP in 2013, would be a perfect alternative, she believes.

<sup>9</sup> The Chairman of the Federal Reserve System, appointed by the US President (the US Central Bank, which plays its "dual role" pursuant to the Founding Act (the Federal Reserve Act) enacted as far back as 1913: to maximize employment and stabilize prices, and the third one, monetary policy, was added subsequently).

<sup>10</sup> Besides the aforementioned objectives, with the fall of the Berlin wall the IMF is faced with one more challenge which comes down to transition management;

<sup>11</sup> These changes mainly ensued in the 1980s, when "supply-side economics" ushered in by Ronald Reagan and Margaret Thatcher.

<sup>12</sup> This practice was particularly pronounced during the 1960s and 1970s of the last century.

specific country size along with prior arrangement with the Fund on the adjustment program. However, the adjustment program, that is conditions imposed by the IMF on the loan beneficiary countries are often the reason why governments seek assistance from these institutions. This is because governments are using the Fund as a "*whipping boy*" over possible betrayed voters' expectations arising out of the painful economic reforms implemented, thus seeking to preserve their political ratings. The International Monetary Fund should have paid more attention to its basic principle relating to providing resources to boost aggregate demand in countries facing recession. Along with that, it should have dealt more thoroughly with aspects of poverty and unemployment, as this would round off the Fund's corpus of interests and would greatly contribute to easing up on the unconditional insistence on macroeconomic stability, that is inflation control, enabling it to see the big picture of the developing countries' problem. Furthermore, the IMF kept laying emphasis on inflation while neglecting economic growth and unemployment, although equally important. Given the scope and duration of the current global financial crisis, the IMF Board in Washington has decided to change the rules of its regular annual financial policies monitoring of all 188 Fund members. Under the new regulations, the Fund has undertaken to assess the impact of each member country's internal decisions on global financial stability. It is beyond dispute that the IMF is facing a great challenge posed by the current economic crisis. In the years prior to the crisis, the situation looked like this - the process of globalization lead to removing economic barriers and intensive cooperation among the member countries. Developed countries were expected to achieve greater savings than investment, and put them into direct investments in developing countries. This scenario did not happen, with the developed countries also investing their surplus funds in other developed countries. Therefore, the financial sphere crisis spilt into the real sector of economy. The financial crisis has made bank loans more expansive, which further leads to increases in companies' operating costs. On the other hand, a decrease in loan volumes results in lower solvency levels. In consequence of falling demand, companies are forced to reduce their production, while a drop in sales and income leads to layoffs aimed at reducing costs arising from an increase in financing costs.

## **WORLD BANK GROUP**

The International Bank for Reconstruction and Development (IBRD) along with the IMF is the second global financial institutions set up as a direct result of an international conference. Later, three more financial institutions were formed under its auspices<sup>13</sup>: (1) the International Finance Corporation - IFC; (2) the International Development Association - IDA; (3) the Multilateral Investment Guarantee Agency – MIGA.

The main objective of the World Bank is funding projects important for the national economy but insufficiently profitable to attract private sources of capital implying larger sums of money and hence higher risks. Loans are principally intended for infrastructure projects, power, transport, education, industry, agriculture and rural

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<sup>13</sup> The term World Bank is frequently used to refer to the IBRD and IDA. All the four institutions: IBRD, IFC, IDA and MIGA make up the World Bank Group.

development projects, and the like. In the eighties of the last century, loans for structural adjustment were introduced designed to address balance-of-payment problems via changes in the economic structure, of course, with the IMF approval and conditions that beneficiary countries have to fulfill. These loans account for about 30% of the total loans approved<sup>14</sup>.

Besides a certain degree of overlap, there are fundamental differences among these institutions. First of all, the IMF is a monetary institution aimed at stabilizing the monetary system and financing temporary balance of payments deficits. By contrast, the World Bank is a development institution, with the aim of promoting and funding economic development. Also, they differ in the source of financing and credit approval. The IMF loan is granted to all members from official reserves, while the World Bank lends money exclusively to developing countries, with a repayment period of 15 to 20 years. The main differences are summarized in the Table below.

**Table 1.** Key Features of the IMF and World Bank

Features	IMF	World Bank
Type	Monetary institution	Development institution
Function	Stabilising the monetary system and financing temporary balance of payments deficits	Promoting and financing economic growth
Length of the loan/loans	Short-term	Long-term
Source of financing	Official reserves of the member country's national currency	Loans in international credit markets
Approval of credits	To all member countries	To developing countries
Repayment period	3 to 5 years (sometimes up to 10)	15 to 20 years (40 years for International Development Association)
Staff members	Employs 2300 staff members	Employs 6400 staff members

The IBRD grants loans to finance specific projects, rarely being a general development lender. The project must contribute to the specific country's development but also ensure regular repayment of borrowed funds. Loans are primarily intended to provide funding to those at a higher development level amongst the developing countries. However, loans are more favorable compared to their counterparts available to individual countries in the market. The IBRD deems by means of a graduation process whether to exclude countries having already reached a certain level of development from the group eligible for lending (GNP - \$ 5,445 / per capita). Projects funded by IBRD go through the following seven phases: (1) identification, (2) project preparation, (3) project evaluation, (4) negotiations (5) adoption (6) execution and supervision, (7) the subsequent evaluation.

The International Development Association (IDA) was established in 1960 in order to provide loans to the least developed countries on favorable terms<sup>15</sup>. The International

<sup>14</sup> In case of Argentina, a real conflict broke out when the World Bank approved a large loan, failing to previously consult the IMF while the IMF was negotiating the conditions under which to approve the loan. Since then, the coordination between IMF and World Bank has greatly improved and their respective spheres of responsibility are more clearly defined.

<sup>15</sup> Countries with GNP/per capita below 865 \$ are eligible to receive IDA loans repayable over the period of 40 years with a 10-year grace period. Furthermore, except for the 0.75% service charge, an IDA loan is interest-free.

Finance Corporation (IFC) was founded in 1965. It offers loans due for repayment within 7-15 years, though its catalyst role in bringing together private companies in need of capital and interested investors in an international corporation is more significant.

The Multilateral Investment Guarantee Agency (MIGA) was formed in 1985 with the intent of providing guarantees against non-commercial risk to enhance private capital flow to developing countries.

Each institution plays a special role. Thus, for example, the IDA lends to governments of the poorest developing countries on favorable terms<sup>16</sup>; the MIGA provides guarantees to investors from non-commercial risks, the IBRD offers loans to middle-income countries<sup>17</sup>. Unlike IDA loans, IBRD loans, known as the World Bank's loans, are intended to finance high-quality programs and programs contributing to economic development that would not otherwise be financed on favourable terms. The World Bank operates as an investment bank, but with more lenient criteria and debt-deferment policy, having a wider range of options than commercial banks. Thus, in the 80s of the 20th century, with the industrial countries combating the Great Recession, and developing countries in dire straits struggling with debts, there were two lending programmes introduced: (1) Structural Adjustment Lending, (2) Sectoral Adjustment Lending.

In sectoral adjustment lending, general-purpose loans are approved to strengthen the economy and export sector. Quite often sectoral adjustment loans are approved together with IMF loans, and are designed for countries with high balance of payments structural deficit. Sectoral adjustment loans are intended for prompt provision of funding for a particular economic sector reform.

The World Bank publishes its annual World Development Report, giving a special tone to the problems of development and generating new ideas<sup>18</sup>. The Bank implements technical assistance projects funded by the UN Development Programme. There are two types of assistance:

- infrastructure assistance (feasibility studies) and
- institutional assistance (institutional and management skills development, defining macroeconomic policies).

The need to reform the World Bank is reflected in the fact that it must more take into account the integrated approach to development and the manner in which aid itself is delivered.

## **NEW RELATIONS BETWEEN THE EUROZONE AND THE IMF**

Many countries of the European Union, first of all Greece, then Portugal and Spain, and Ireland and Italy, must pass through a difficult process of adjusting the government finances to external competitiveness, in order to make the position of their

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<sup>16</sup><http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/IDA/0,,contentMDK:21206704~menuPK:83991~pagePK:51236175~piPK:437394~theSitePK:73154,00.html>

<sup>17</sup><http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/EXTIBRD/0,,menuPK:3046081~pagePK:64168427~piPK:64168435~thesitePK:3046012,00.html>

<sup>18</sup> For further information on numerous World Bank's reports, please see at <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/0,,contentMDK:20227703~pagePK:478093~piPK:477627~theSitePK:477624,00.html>



public debt sustainable again. However, considering intensive pressure of financial markets, in some cases it seems there is little probability that adjusting the fiscal program would be enough to avoid “emergency braking” of necessary external financing of public sector.

It is considered that when it happens, the European Union will not be in condition to avoid if (and in what shape) it could secure public financial support to one of its member states. Stabilization mechanism and new measures of the European Central Bank prove the determination of the European Union to protect financial stability in the Euro area and minimize short-term worry for solvency of some eurozone members, whose fiscal position and debt dynamics have worsened.

With the appearance of financial crisis in the eurozone, new relations between the EU and the IMF came up. According to the new recipe of the IMF, proposed system of budget coordination would represent a step towards common, centralized economic management within the eurozone. However, better internal monetary-fiscal control, respectively increased coordination on the plan of fiscal and economic policy is necessary<sup>19</sup>.

The contemporary situation raises a question as to which institution would be in a better position to design and monitor the strict program of adjustment to justify financial support: the EU or the IMF. The difference comes down to the following: the IMF has money, professionalism and a small number of political restrictions. On the other hand, EU institutions do have money and professionalism, but the EU, that is European Commission is confronted with serious political limitations in designing adjustment program.<sup>20</sup> However, it is not the question whether the EU would be “softer” than the IMF, but the key question is which institution would possess stronger enforcement mechanism, in case that some countries (like, for example, Greece) simply do not implement adjustment program. There is little IMF can do if the country in question simply does not keep its promises, except to stop further financing.

Contrary to that, the European Union possesses several other instruments: it can forbid financing from structural (and other) resources. Besides that, European Central Bank could exert enormous pressure by disqualifying the public debt of a member country (or generally its resources) from using within operations of its monetary policy. Therefore, the European Union could design a mechanism or an institution capable of bearing with failure to fulfill financial obligations. Hence, many experts and statesmen consider that the dilemma could be avoided by creating the “European Monetary Fund” (EMF), which would be in state to organize and implement regular performance of obligations, as a last possible measure. Thereby, the difference is that the European match to the IMF would act in case some of the eurozone member states needs financial aid, because it had been shown that European financial field lacks similar institution to aid the countries that got into a serious financial crisis. However, the European Commission thinks it can utilize its rights in domain of economic competition, which would understand strengthening the cooperation with other actors on international scene (such as G-20), but also exercising pressure, because world

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<sup>19</sup> The idea of a “European Monetary Fund” was presented to the public for the first time on March 6, 2010, in an interview with German finance minister Wolfgang Schauble, in which he stated that Europe needs an institution similar to the IMF to tackle situations such as the Greek debt crisis.

<sup>20</sup> This, depends to a large degree on the position of Germany, whose financing power is the largest in the eurozone.

financial markets are considered variable and endless<sup>21</sup>. The idea of European Monetary Fund, based on model of the International Monetary Fund, encounters wide support in the eurozone countries. Namely, as the IMF does the world scene, so would the European Fund be the last instrumentality for the eurozone members that get into financial crisis. Therefore, the EMF would, first of all, be a monetary stabilizer, primarily by establishing financial discipline, and afterwards it would allow short-term loans. More skeptical commentators say that the problem has been deferred, but not solved, because there is no clear answer to the question, how would weak and over-indebted economies cope with debts and loans for their repair.

### **EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)**

European Bank for Reconstruction and Development is the first international institution founded in the post-cold war period as a response to great economic and political changes that happened in the central and east Europe countries. Founded few years after the downfall of the Berlin wall, the bank's aim was to aid countries of well as promotion of private and entrepreneurial initiative, in accord with the principles of democracy, political pluralism and market economy<sup>22</sup>.

Financial means of the Bank are directed to financing private or state-owned enterprises that are to be privatized, as well as creating new companies. Main objective of the Bank is to introduce investors in these countries, on what the Bank is working in partnership with other investors and moneylenders in order to secure equity, warranties and loans. Besides that, special attention is paid to development of transport, telecommunications, infrastructure and public sector projects, supposed to support private sector initiative. It also specially encourages regional cooperation, so Bank supported projects may be extended to more than one country.

The EBRD is co-financing certain projects and investments with commercial banks and multilateral institutions. Also, it encourages co-financing and foreign direct investment from both private and government sector, it secures technical cooperation in certain areas, and it helps mobilizing domestic capital.

All the countries of Balkan region are members of the EBRD and investment beneficiaries. In the words of the EBRD director in Serbia, Hildegard Gatzek, over the last 11 years the EBRD has invested in Serbia about 3 billion Euros in 180 projects in all sectors.

In the future period the EBRD is expected to support the infrastructure sector in Serbia (railway and works on corridor 10) as well as small and medium sized enterprises via banks and by direct financing of the corporate sector<sup>23</sup>. The EBRD is one of the largest investors in Bosnia and Herzegovina, and, from 1996 until today, via this bank it had been placed, in various projects, 1,4 billion Euros, through all the Bosnia and Herzegovina. In 2010 has been, within Croatian ministry of foreign affairs, brought a strategy defining basic objectives and directives for Croatian cooperation with EBRD. Among other matter, EBRD will aid development of economy, energetic

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<sup>21</sup> Pisani-Ferry and Sapir, "The best course for Greece is to call in the Fund".

<sup>22</sup> [www.ebrd.com/pages/about/history.shtml](http://www.ebrd.com/pages/about/history.shtml)

<sup>23</sup> Blic online "European Bank for Reconstruction and Development invests three billion Euros in Serbia". <http://www.blic.rs/Vesti/Ekonomija/315069/Evropska-banka-za-obnovu-i-razvoj-u-Srbiju-ulozila-tri-milijarde-evra>

sector, “to small and medium enterprises (SME) that still suffer consequences of limited liquidity, in financial system shall be eased access to means, with help of the loans, as well as equity and quasi equity investments, via financial intermediaries”<sup>24</sup>. From 1994 to 2010, the EBRD had invested in Croatia about 2,2 billion Euros for over 130 various projects. Similar investments are expected for other member countries, receiving investments.

## REGIONAL BANKS FOR DEVELOPMENT

Concurrently with developing activities of the World Bank, the need arose to form financial institutions of regional character. All the regional financial institutions aim at supplementing activities of the World Bank, promoting regional economic integration, and strengthening the weaker members’ economies.

The organizational and financial structure of regional banks is based on the World Bank’s organization chart. Like the World Bank, the main body is the Board of Governors, composed of member countries’ finance ministers. The Executive Board, headed by Chairman is in charge of day-to-day operation. The Articles of Association also provides for protection measures for regional countries participating in leadership, related to the region non-member states. As a rule, regional financial institutions should be led only by regional member states, although it happens in practice that even non-regional member states have a leadership position. Basic functions of the regional banks are:

- Allotment of long-term loans for development projects
- Promotion of investments
- Cooperation with international institutions.

The most important regional financial institutions are Inter-American Development Bank (founded in 1959), African Development Banks and Asian Development Banks, established several years later. Aside these three big development banks, there are a number of sub-regional banks, operating at a lower level. Some of the best known are the Central American Bank for Economic Integration, East African Development Bank, Caribbean Development Bank, and Islamic Development Bank. As a rule, these banks do not have any non-regional members, their efficiency varying dependent on the situation in the region.

The Nordic Investment Bank, which is owned by Finland, Denmark, Sweden, Norway, Iceland, Estonia, Latvia and Lithuania, enjoys a specific position<sup>25</sup>. This bank finances projects not only in Scandinavia, but in other regions as well<sup>26</sup>.

During the 1980s, regional banks have had certain difficulties in their work. Often, the banks had been under pressure from western donors and strong political pressure from the region. Western donors wish to have more responsibility and participation in regional banks. In the past dozen years, regional banks passed through the process of radical reforms and accommodation, which has been additionally strengthened by adoption of the Millennium Development Objectives. In relation to earlier periods,

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<sup>24</sup> <http://www.mfin.hr/hr/ebd>

<sup>25</sup> [http://www.nib.int/about\\_nib](http://www.nib.int/about_nib)

<sup>26</sup> Until now, cooperation took place with the countries of Latin America, Africa and Middle East, Asia and Europe regions.

when the most important tasks were economic development and financing of the infrastructural projects, today the role is more based on fulfilling the Millennium Development objectives, reduction of poverty, and sustainable development<sup>27</sup>. As a part of implementation of Paris declaration on aid effectiveness, and a series of reforms of regional banks had been launched. Regional financial institutions aim at supplementing activities of the World Bank, promotion of regional economic integration, and strengthening the weaker members' economies.

## CONCLUSION

Global financial institutions had been created in response to growing complexity of relations and higher interdependence among economies and people around the world. The problems over time having piled up and having become more complex, the criticisms of their current structure and operation is to a certain degree quite justified. Certainly, economists will not come to agreement over many issues, both practical and theoretical, but what these institutions should do is to give countries opportunity to consider alternatives, to make their own choices, that is, to provide necessary resources to the countries, while the countries are to inform themselves and choose their option, fully aware of possible consequences and risks that each of the selected options involves. On the other hand, as assessed by a large number of experts, the eurozone is in a crisis to the extent that many are no longer certain that the „europroject will work“. Even the IMF does not have an answer to long-term solution to debt crisis. Undoubtedly, the crisis must be followed by the reorganization of financial system and the system of monitoring and supervision in the world. It is necessary to harmonize regulations and national policies as well as to determine common rules for recapitalization of the banks, the national approaches being irrational and wasteful. It is necessary to reorganize the role of IMF, toward timely and flexible providing multilateral temporary liquidity. For small countries, such as Serbia, cooperation with the IMF is nearly unconditional (due to the budget deficit to be covered, but also due to the possibility of regular servicing of public debt) or otherwise the financial collapse would ensue, since one of the IMF's main objectives is to maintain its member states' financial discipline. On the other hand, numerous prominent economists do not trust the IMF, considering drastic austerity measures imposed by IMF on its clients to be “a wrong solution“ (especially in case of over-indebted eurozone countries), not functioning positively in the crisis conditions and therefore pushing the countries into a more profound crisis. Thus, besides numerous positive sides and good results they have shown, international financial institutions have also been strongly criticized. So, in some opinions these institutions are the real representatives of western-type capitalism and are imposing free-market model on the developing countries, that are still not prepared for such a big step. Often, as a bad side is emphasized the misuse of the position of powerful countries in these institutions (mainly USA and EU member states), which use their leading role in order to achieve their foreign policy goals. In the period of political and ideological disagreement it is of utmost importance to maintain political priorities outside international institutions and to secure its

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<sup>27</sup> Federal Ministry of Economic Cooperation and Development, Combating Poverty – Our Objectives in the Regional Development Banks, March 2007. [www.bmz.de/en/.../type.../strategie148.pdf](http://www.bmz.de/en/.../type.../strategie148.pdf)

independent action. If every request for a loan were evaluated pursuant to political aspects and interests, the international system would become wholly paralyzed. Because of that, it is important that international institutions maintain its apolitical character. Furthermore, critiques are directed to specific IMF and World Bank projects. In opinion of its critics, the IMF does not provide resources for the countries facing economic problems, its fields of activity are defined too broadly, it reflects the power of multinational companies and highly developed countries, suffers from managerial problems, lack responsibility and transparency. In case of the World Bank Group, the critics object ineffective projects, bureaucratic institutions, clandestine conclusion of contracts, that the Bank management does not respond to any parliament or political institution, corruption, too big influence of industrially developed countries. In the contemporary situation of a world struck by a great economic crisis, all eyes are fixed on international financial institutions. They themselves have to direct more energy on solving current economic situation, and leave aside political pressure from developed countries and multinational companies. The most important matter for their future work is to return to apolitical activity.

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